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Insights
Strategy
Analysis

OUTLOOK ASIA PACIFIC 2025

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ASIA PACIFIC

Potential structural and cyclical changes colliding

The current cycle in Asia Pacific is not a simple repetition of a typical cycle. While Asia Pacific economies have not been immune to supply chain disruptions and elevated inflation, interest rates and construction costs, real estate capital market liquidity in the region (ex-China and Hong Kong) has fared much better than in other parts of the world.

We see signs of structural changes and a distinctly different cycle from historical norms in the macroeconomy, as well as in several real estate markets and sectors. As a case in point, China could easily be mistaken for Japan 10-20 years ago, struggling with deflationary pressures and an erosion in land prices.

Certain factors, such as climate change or the acceleration of artificial intelligence (AI), are not unique to the region. Some, such as adjustments in monetary policy, could have a relatively immediate impact on economies and real estate fundamentals. Others, such as labor market reforms (e.g., in Japan) or supply chain restructuring, could take years or even decades to manifest. Signs of structural change and a markedly different cycle point to the potential for a significant deviation from historical norms and a lack of mean reversion to historical trends. These factors could have a combination of positive and negative implications for investors, some of which may only become apparent years later.

Our *ISA Outlook 2025* Global chapter focuses on four themes for the year ahead. Look for these icons throughout this chapter whenever we tie back our observations for Asia Pacific to these global themes.

THE MORNING SKY	THE CAPITAL STACK HANGOVER	THE BREAKFAST MENU	THE EARLY BIRD
Falling rates but risks on the horizon	Clear-headed investors have an advantage	Making sense of complex investment options	The best market entry points tend to be early in the cycle

Project Platinum
Tokyo, Japan

Stark contrast between China and Japan

The most pronounced signs of structural change or a distinctly different cycle can be observed in China and Japan. These two major economies in the region demonstrate the starkest contrast to global trends in the region, and stand in sharp contrast to one another (see exhibit AP-a). In China, the plummeting housing market and a multi-decade low in consumer confidence are exerting deflationary pressure on the economy. The People's Bank of China (PBOC) has pushed interest rates to record lows. In contrast, Japan in 2024 appeared to be exiting its roughly 30 year-long deflationary environment. In March 2024, the Bank of Japan (BOJ) made a historic shift from its unorthodox monetary policy and began to raise policy interest rates.

IN HINDSIGHT

Looking back on key calls from last year's *ISA Outlook* Asia Pacific chapter.

Right / Mostly right | Remains to be seen | Not right / Not quite right

Japan: *"Most likely, even in an environment where inflation can sustainably exceed the 2% target, interest rates in Japan are likely to be substantially lower than those in the rest of the world."* (*ISA Outlook 2024*, p. AP-60)

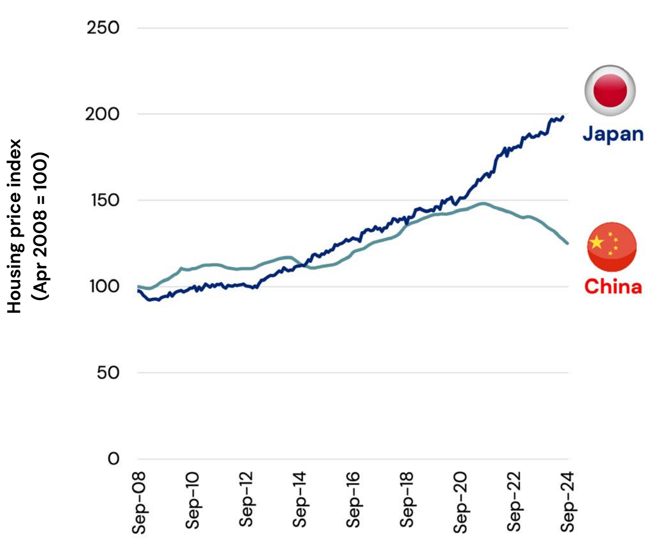
We stand by this call. The BOJ raised interest rates in 2024. Interest rate hikes in Japan are likely to continue in the next 12 months. However, the magnitude of interest increase is likely to be moderate due to the narrowing interest rate differential between it and the US following the Fed rate cut. Moreover, the BOJ is also expected to exercise caution in the near term, given the potential for some political uncertainties before the 2025 Upper House election.

From September to mid-November of 2024, **China** launched the largest economic stimulus campaign since the pandemic, including a substantial package of fiscal measures, policy changes and historically low interest rates. While the latest stimulus measures represent a step in the right direction, they are far from sufficient to address the current economic problems, namely a depressed housing market, lack of consumer and business confidence, indebted local governments, and a shrinking and aging population. Given heightened geopolitical tensions between the US and China, and the absence of impactful structural reforms or larger-scale stimulus packages, the Chinese economy is likely to remain depressed for an extended period. These circumstances should contribute to a challenging environment for China's residential and commercial real estate markets over the next few years.

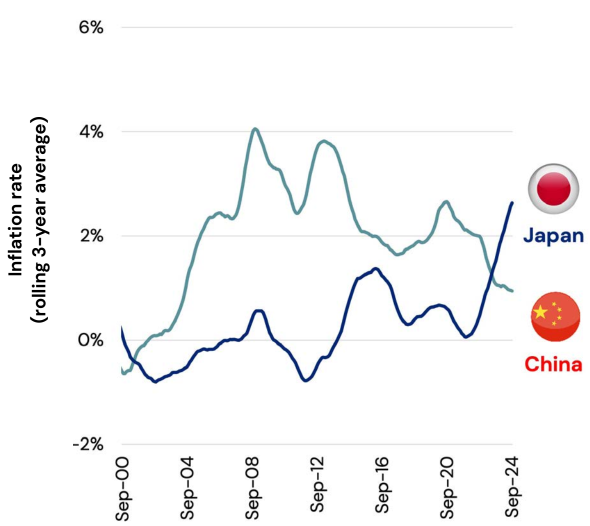
With a bias toward raising rates and reflation, **Japan** is in a considerably different position. That said, the BOJ is emphasizing flexibility and predictability after the Japanese stock market experienced historic volatility following the July rate hike. The snap election on October 27, 2024 resulted in a surprise defeat for the Liberal Democratic Party (LDP), which lost its outright majority in the Lower House for the first time in 15 years. A degree of political uncertainty is likely until the Upper House election, likely to be in July 2025. Japan could muddle through this period, if wage growth continues beyond 2025 and the government deploys more ammunition to boost household spending to cope with the high cost of living. The BOJ might have to be mindful of raising interest rates too quickly or too sharply in the interim, which could be welcome news for real estate investors.

AP-a | Diverging trends in China and Japan

Housing price index



Headline inflation

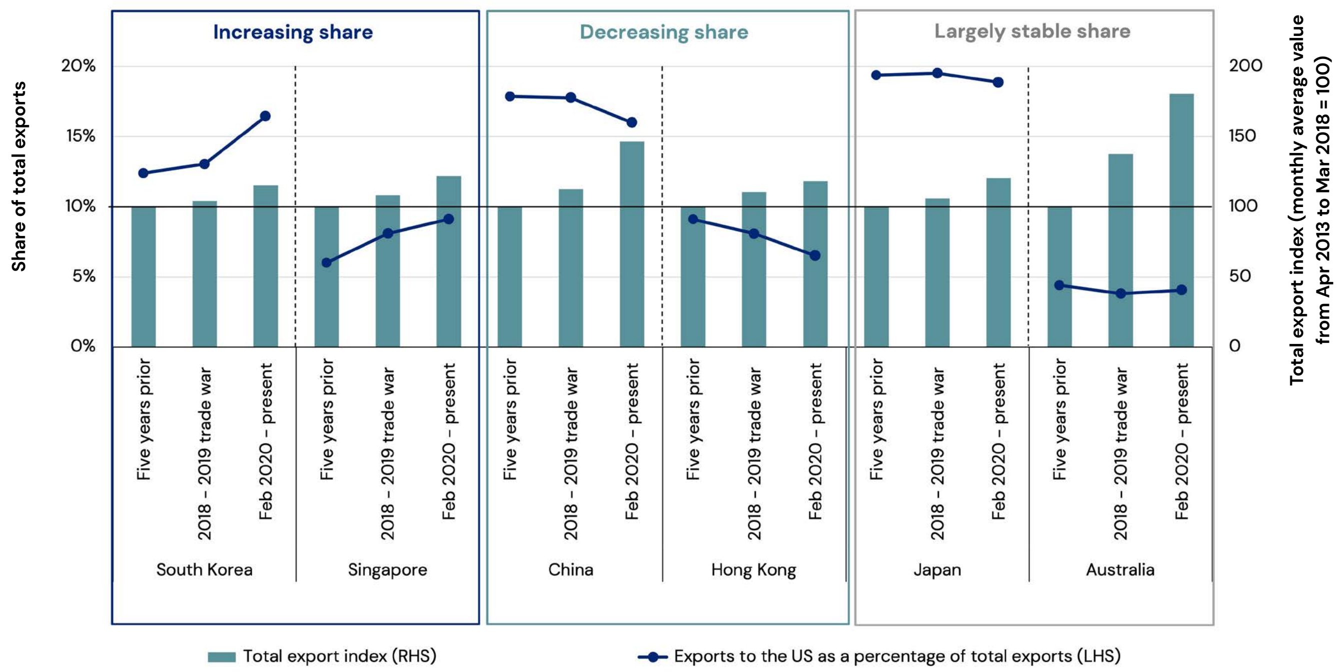


Note: The housing price index is based on existing home sales prices in 70 major cities in China and on new and existing condominium prices in Japan.

Source: WIND (China housing price), CEIC (Headline inflation and Japan housing price), as of September 2024.

AP-b | Total exports increased during the 2018-2019 Trade War

Total exports and share of exports to the US



Note: The total export index and the share of exports to the US are based on monthly export data for each market. The 2018-2019 trade war was from April 2018 to January 2020, five years prior to the 2018-2019 trade war was from April 2013 to March 2018 and present is as of September 2024 for Australia, Hong Kong, Japan and Singapore and as of October 2024 for China and South Korea.

Exports are based on local currency except for China and South Korea which are in USD.

Source: The Australian Bureau of Statistics, the Census and Statistics Department of Hong Kong, the Ministry of Finance of Japan and Enterprise Singapore, as of September 2024; the General Administration of Customs of China and Korea Customs Service, as of October 2024.

Trade and Trump 2.0

Adding to the complexity, US President-elect Donald Trump's victory is likely to usher in a period of heightened economic uncertainty and capital market volatility for most Asia Pacific economies.[1] Trump 2.0 may come to be characterized by aggressive trade policies, pockets of strained geopolitical relationships and a need for strategic adaptation among the region's governments, businesses and investors. China is particularly vulnerable and, to a lesser extent, Hong Kong. Other Asia Pacific nations will need to balance their relationships with both the US and China. Potential supply chain disruptions in countries such as Australia, Japan, South Korea and Southeast Asian countries linked to China also cannot be ignored, as China remains their largest trading partner. All countries in the region will have to consider whether trade barriers require a domestic policy response, such as stimulus measures.

That said, it is too early to tell whether the US will end up imposing tariffs that are as broad or as high as what was pledged on the campaign trail, or if the Trump Administration will take the opportunity to negotiate bilateral trade agreements with key trading partners in the region. The 2018-2019 trade war demonstrated that the imposed tariffs can be lower than those proposed if China imports more US goods to narrow the US trade deficit. While the share of exports going to the US varied, total exports of major Asia Pacific economies in value terms generally increased (see exhibit AP-b). Looking ahead, the Trump 2.0 era could lead to periodic episodes of capital market volatility. Investors may therefore consider focusing on Asia Pacific real estate markets/sectors that are anchored by domestic demand (e.g., Japan multi-family, Australia industrial) and domestic capital (e.g., Japanese real estate, Seoul office).

1. While we covered the global and US implications of the US election result in our *ISA Briefing, "The Red Sweep and real estate,"* the implications specific to the Asia-Pacific region deserve special treatment.

SOUTH KOREA

Two engines with uneven thrust

South Korea's economic performance in 2024 resembles a dual-engine plane flying with one engine noticeably underperforming. Exports (particularly of semiconductors) are the powerful primary engine, propelling the country's economy on the global stage. However, domestic consumption, the second engine, is running at a reduced capacity, limiting the plane's ability to reach its full potential. This imbalance makes the economy more susceptible to unexpected headwinds. The risk of a potential US-China trade war 2.0 clouds the outlook for South Korea's exports, particularly the semiconductor exports. While the global AI boom presents a mitigating factor, it may take time for South Korean firms to secure market share in this evolving landscape. The recent developments in domestic politics further complicate the outlook, potentially hindering the effectiveness of fiscal policy support. Nonetheless, the Bank of Korea is taking a proactive monetary policy approach to mitigate some potential external shocks and stimulate domestic demand. While we recognize the difficulty of predicting precise economic outcomes, economic growth in South Korea is expected to decelerate in 2025, suggesting no or limited growth potential even in resilient real estate sectors (e.g., office).

AUSTRALIA

Slowing tailwinds

The tailwinds to Australia's economic growth momentum are weakening. The government's objective to reduce net migration by 2025 could reduce immigration's contribution to GDP growth from the peak level seen over the past two years. Government spending is projected to reach a record high by the end of 2025[2] but could slow thereafter as tax revenue declines. The good news is that more jobs are being created, especially in healthcare, keeping the unemployment rate comfortably below the historical average.[3] However, the tight job market contributes to elevated inflation which remains broad-based and stubbornly above the Reserve Bank of Australia's (RBA) 2-3% target. Due to elevated inflation and the low unemployment rate, financial conditions in Australia are expected to remain tight in the near term. Furthermore, even after the July 2024 tax cuts, consumer spending is expected to remain tepid by historical standards, as households prioritize savings and debt reduction over discretionary purchases. In 2025, economic growth is expected to remain below its historical trend for a third consecutive year, though a recession is unlikely. Amid the decelerating economic growth outlook, the recovery in unfavored real estate sectors (e.g., office) is likely to be constrained in the near term, while continued strong growth in favored sectors (e.g., industrial and living) should be limited.

2. Source: Westpac Banking Corporation, as of October 16, 2024.
3. The historical average unemployment rate was 5.2% from 2004 to 2023. Source: The Australian Bureau of Statistics, as of 2023.

IN HINDSIGHT

South Korea: *likely to be first-in-first-out, "The BoK [Bank of Korea] is likely to be the first to end its rate hike cycle."* (ISA Outlook 2024, p. AP-62).

We rightly pointed out that the BoK was likely to be the first to end its rate hike cycle in Asia Pacific. In light of the US Federal Reserve's initial rate cut in September 2024 and the stabilization of inflation and household debt levels in South Korea, the BoK proceeded to cut interest rates by 25 bps on October 11, 2024. This was done with the objective of rebalancing the export-reliant economy by stimulating domestic demand and investment.

IN HINDSIGHT

Australia: *"The Reserve Bank of Australia (RBA) is one of the few central banks with an explicitly defined triple mandate to maintain price stability, promote full employment and ensure financial stability. The RBA intends to pause rate hikes to balance the three objectives."* (Outlook 2024, p. AP-61).

We were mostly right. Over the past 12 months, the RBA has maintained interest rates at their current levels, largely due to concerns over inflation and the near-historically low unemployment rate. In the near term, uncertainty over inflation and government spending is likely to keep interest rates high-for-longer.

Project Genesis
Seoul, South Korea

SINGAPORE

Growth momentum peaking

Singapore's economy demonstrated resilience for most of 2024, buoyed by an unexpected increase in global demand, particularly within trade-related sectors. Nevertheless, should the US impose heavy tariffs on Singapore or its key trade partners, there could be a potential slowdown in the recent trade momentum. Conversely, should the US-China geopolitical tensions intensify, Singapore could continue to attract investment inflows diverting from China and Hong Kong, particularly in the wealth management industry. During the first eight months of 2024, there was an 18% increase in the number of family offices.[4] While wage growth is coming off its cyclical peak, the labor market remains healthy. Singapore's economy is expected to grow by 1-3% in the next two years,[5] slightly below the historical average. As the growth momentum of several real estate demand drivers decelerates, the potential for rental growth in real estate sectors with near-term supply is limited.

IN HINDSIGHT

China: *"We expect domestic investors, especially insurance companies, state-owned enterprises, RMB funds and REIT managers, to continue to dominate the capital market and some could even speed up the pace of investments in the next 12 to 18 months."* (ISA Outlook 2024, p. AP-64).

Although we correctly predicted that domestic capital sources would continue to dominate the capital market in China, we did not anticipate a significant deceleration in the pace of capital deployment. Due to deteriorated occupier fundamentals and the weak economic outlook, domestic investors have become highly selective, with the majority of transactions conducted on a non-arm's length basis.

HONG KONG

Weighed down by China

Hong Kong's economic growth has slowed, mainly driven by declining retail sales due to cost-conscious mainland Chinese tourists, a strong Hong Kong dollar and Hong Kong residents diverting spending to across the mainland border. These trends are expected to continue in the near to medium term. The territory's close link to US monetary policy through the US dollar currency peg could provide some relief to capital market liquidity, if the US Fed continues to ease interest rates. However, we maintain a high degree of caution about the outlook for Hong Kong's economy and capital market liquidity, due to its close ties to mainland China.

4. Source: The Straits Times "Single family offices in Singapore balloon to 1,650 amid thriving wealth management sector," as of September 7, 2024.
5. Source: Bloomberg, as of November 8, 2024.

Regional opportunities and risks

The diverse and complex Asia Pacific macroeconomic environment addressed on the preceding pages presents a variety of opportunities for real estate investors with a range of risk-return profiles.

MULTI-FAMILY

At a nascent stage, except Japan

The living sectors across Asia Pacific are undergoing significant transformation driven by demographic shifts and policy support. For example, as household sizes shrink in most major Asia Pacific markets due to delayed marriages and low fertility rates (see exhibit AP-c), there is a growing preference for renting over owning. In the near term, we maintain a positive rental growth outlook for most multi-family rental markets in Asia Pacific, recognizing their ability to pass through inflation due to typically short lease terms.

Japan multi-family leads as a well-established market characterized by stable net operating income (NOI), deep institutional ownership and healthy liquidity, keeping it attractive to core investors. Despite high entry prices, recent wage growth momentum creates opportunities for investors to pursue value-add strategies, such as retrofitting of older buildings and improving amenities.

Markets in the rest of the region are still in their infancy in terms of professionally managed multi-family rental units, implying potential for institutionalization. The Australian government plans to reduce net migration by 2025 while maintaining migration pathways for the long run. Going forward, it may be difficult to achieve high returns in Australia due to normalizing rental demand and high interest rates, but the living sectors remain attractive to investors with long or flexible investment horizons.

Similar to Australia, young adults in South Korea opt to rent due to lifestyle preferences and high housing prices. In addition, tenants are shifting from Jeonse[6] to monthly rent contracts, and this trend is expected to continue. Investment opportunities could emerge in areas where a young population concentrates. Since the multi-family rental sector is still in its infancy, exit liquidity is not yet proven. It would therefore take time to fully unlock value in this emerging sector.

In China, despite favorable policy toward the sector, the near-term outlook remains uncertain. For example, in Shanghai, the government's commitment to social security housing[7] and tax reductions for landlords and operators have spurred investments, but have also led to oversupply in selected submarkets. Non-core districts are more vulnerable to supply risk than core districts. Additionally, ongoing concerns over job security and income reductions could continue to weigh on tenant affordability.

OFFICE

Navigate cycle changes versus potential for structural shifts

The office landscape in Asia Pacific is more complex than ever. Office markets in Seoul, Singapore and Japan are undergoing somewhat of a typical cycle, while Greater China and Australia are demonstrating signs of potential structural changes (see exhibit AP-d). Office market performance across the Asia Pacific region is likely to vary significantly by market, location, tenant profile, building specification and sustainability credentials. In addition, the timing of entry and exit and risk mitigation plans are becoming increasingly important.

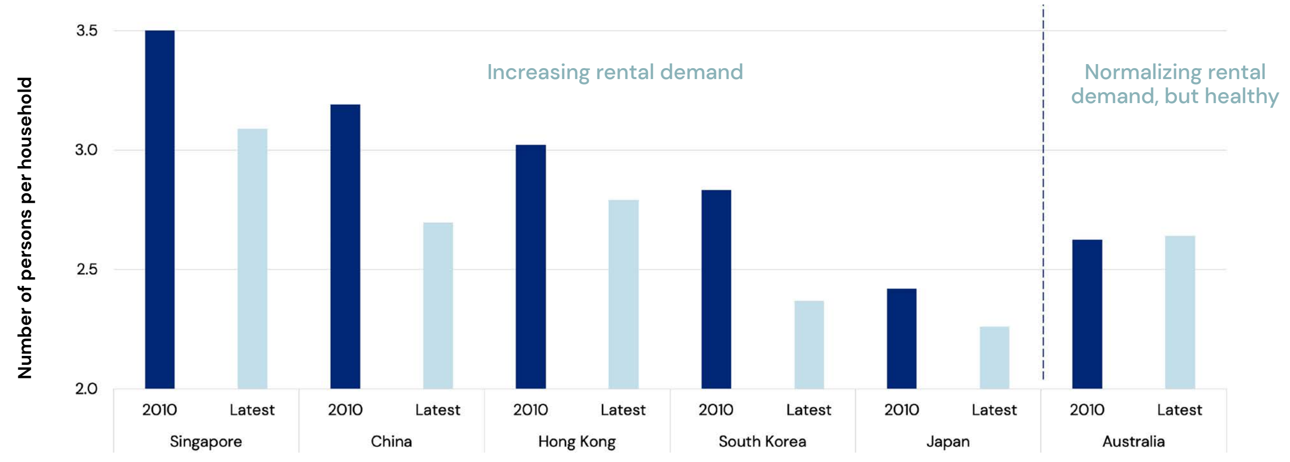
Seoul stands out as the healthiest office market in the region, with low single-digit vacancy rates. Strong demand is mainly driven by domestic conglomerates supported by technology and export-oriented industries. Looking ahead, the potential economic deceleration due to uncertainty in exports, particularly semiconductor exports, suggests no or limited rental growth potential in the Seoul office sector in 2025. For higher-return strategies, asset-level leasing plans and disciplined investment horizons are critical, as net effective rent has grown over 50% since 2019,[8] and more pipeline projects will be coming to the market after 2028.

6. Jeonse is a unique residential rental system in South Korea. In lieu of regular monthly rental payments to the landlord, a one-time lump sum payment (up to 50-80% of the property's value) is made for the duration of the contract. Monthly rental contracts have overtaken Jeonse contracts since 2023.
7. Social security housing is a type of multi-family in which rents are set at 10% below market rates and annual rent growth is capped at 5%. The interiors and indoor facilities of social security housing are similar to those of market-rated multi-family.

8. Source: JLL REIS, Q3 2024

AP-c | Asia Pacific Multi-family: A supportive demographic trend

Average household size: 2010 versus latest

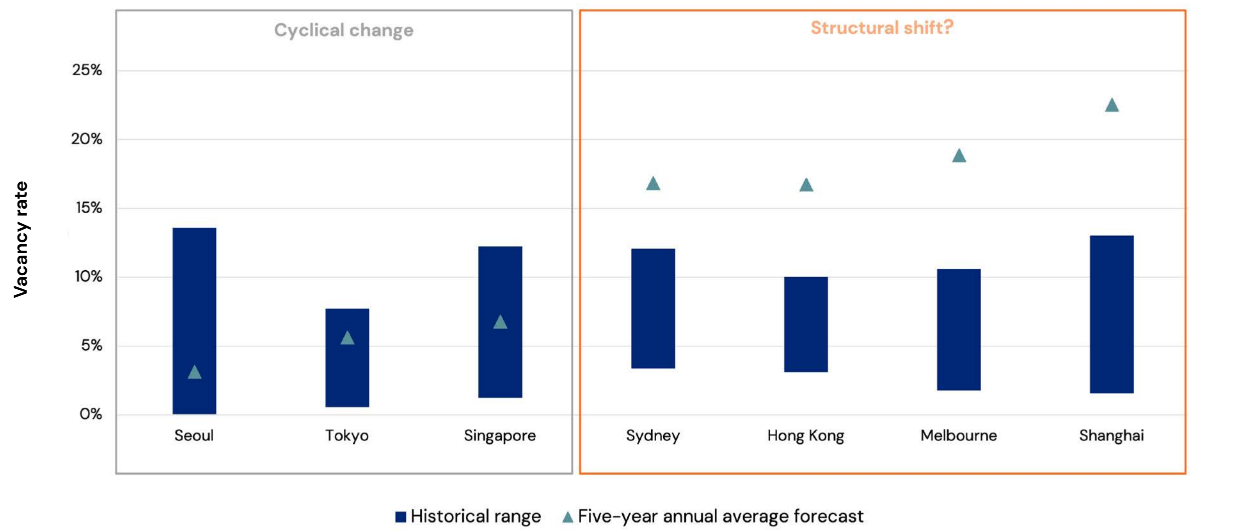


Note: Due to data availability, the latest data for Australia is as of 2016, for Japan and China are as of 2020, for Singapore is as of 2022, for Hong Kong and South Korea are as of 2023.

Source: Oxford Economics, as of 2023.

AP-d | Asia Pacific Office: Navigate cycle changes versus potential for structural shifts

Office vacancy rate: Long-term historical range versus five-year forecast



Note: The long-term historical vacancy rate time series for most markets are from 2000 to 2019, except for Shanghai (from 2007 to 2019).

The five-year annual average vacancy rate forecast is from 2025 to 2029.

Vacancy rates are based on all-grade offices for Melbourne CBD and Sydney CBD, grade-A offices in Tokyo 5-ku and investment-grade offices in Shanghai CBD, Hong Kong (including Hong Kong Island, Tsimshatsui and Kowloon East), Singapore CBD and Seoul (including CBD, Gangnam and Yeouido).

Source: JLL REIS, LaSalle Investment Management, as of October 14, 2024.

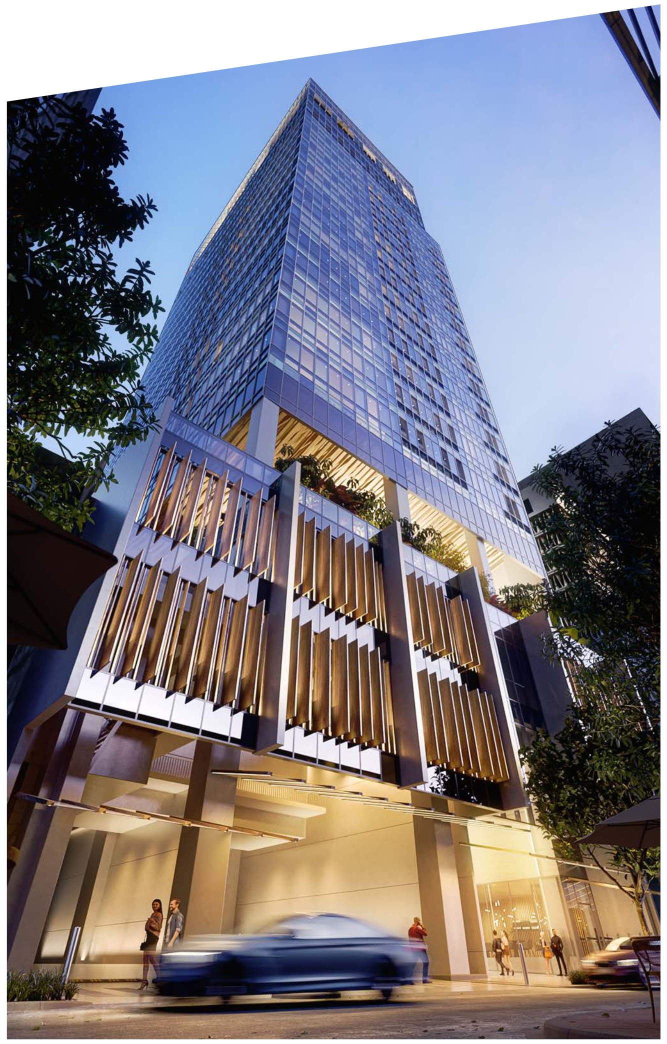
“In Singapore, both occupier fundamentals and capital values are peaking.”

Office market fundamentals in Japan remain relatively sanguine by global standards, but there are potential risks associated with rising interest rates and high supply pipelines in select locations. Most Japanese companies are encountering challenges in attracting talent. In response, the government has introduced a series of labor market reforms to enhance worker mobility and re-skilling. Additionally, the outlook for corporate profitability varies by company size and industry, influencing tenant preferences. Large conglomerates and companies in growth industries like technology are in a favorable position to afford high-quality offices, while tenants with constrained corporate budgets should continue to prioritize affordable rents in locations with convenient commutes to attract talent. Additionally, leasing strategies that target specific tenant profiles and preferences are crucial to drive NOI growth and mitigate risks going forward.

In Singapore, both occupier fundamentals and capital values are peaking. In the next 12-18 months, the market is likely to experience limited expansionary demand and higher new supply. However, for investors with flexible investment horizons or seeking to preserve wealth over the long term, freehold offices in prime locations, which are scarce, remain an attractive proposition despite cooling fundamentals.

In China, Hong Kong and Australia, which are showing signs of potential structural change, a near-term return of market fundamentals to their historical norm would not likely be in the offing. Weak business conditions and the downsizing of foreign companies in China and Hong Kong have significantly reduced office demand, casting uncertainty over whether demand will return to pre-pandemic levels. Despite easing financial conditions, low liquidity and weak fundamentals should continue to impact capital values.

It is too early to enter these office markets despite discounted prices. In Australia, the potential increase in return-to-office mandates in 2025 may improve office utilization, but it is unlikely to materially improve the supply-demand imbalance over the next three to five years. Moreover, starting in July 2025, government tenants will have a higher minimum NABERS energy rating requirement for new office leases.[9] This is likely to further concentrate demand for prime-grade offices, at the expense of secondary-grade offices. The weak office fundamental outlook and a high-for-longer interest rate environment suggest that office capital values in Australia are likely to remain under downward pressure in the next few years. Therefore, it is likely too early to enter the Australian office market unless prices are adjusted to reflect these risks.



Project Solitaire
Singapore

9. NABERS refers to the National Australian Built Environment Rating System. It provides sustainability measurement across property sectors.

LOGISTICS

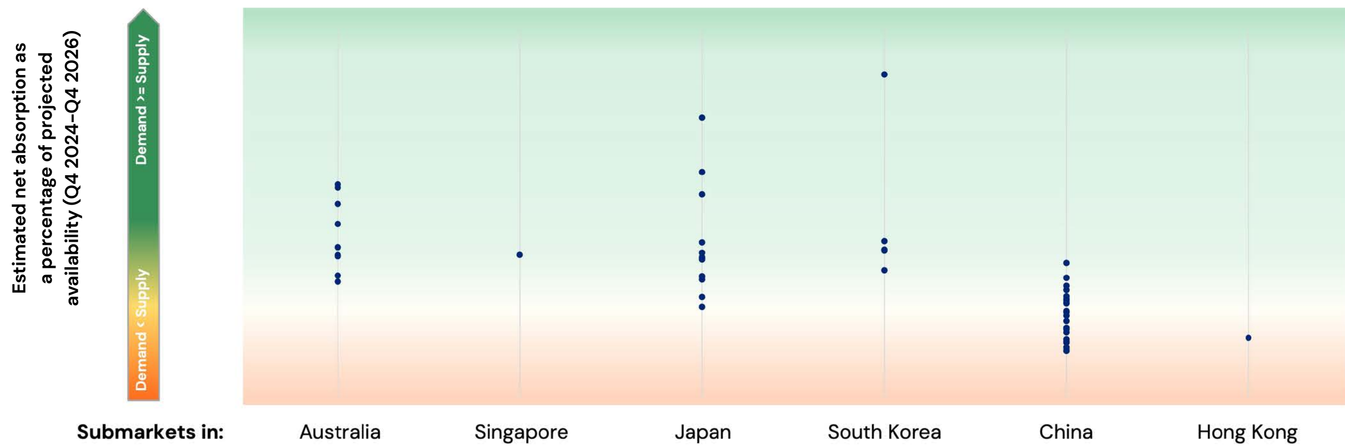
Not a clear outperforming sector

The dispersion of performance across logistics markets in Asia Pacific has widened. Australia, Singapore and several markets in Japan, such as Greater Fukuoka, are maintaining relatively balanced supply-demand dynamics. While investment opportunities remain in these markets, logistics prices are high despite a slowing outlook for rental growth, pushing down return expectations. In China and Hong Kong, high supply and/or plummeting demand have led to a substantial supply-demand imbalance and a sharp decline in rents, which is expected to continue for an extended period. Despite the correction in asset prices, investors might want to consider avoiding these markets in the short to medium term, unless they have a high risk appetite or long or flexible investment horizons.

The supply-demand dynamics also differ drastically across logistics sub-sectors and submarkets (see exhibit AP-e). For instance, in Greater Seoul, the oversupply of cold storage facilities has led to their underperformance relative to dry warehouses. With improving borrowing costs in South Korea and a conservative underwriting approach, discounted entry prices have created select opportunities for leased or pre-leased dry warehouses. On the contrary, in Greater Tokyo, dry warehouses in selected submarkets are facing increasing supply in the near term. But there remains a shortage of modern cold storage facilities, creating opportunities in locations close to suppliers, consumers, expressways, existing aging stock (to capture demand for upgrades) and, most importantly, near port areas (to capture demand for imported food). These nuances suggest that market, submarket and sub-sector selection remain important but may be insufficient to generate the returns that investors were accustomed to a few years ago.

AP-e | Asia Pacific Logistics: Australia the healthiest, China and Hong Kong the weakest

Logistics: Supply versus demand at the submarket level



Note: The projected availability is based on the sum of existing vacancies and projected supply pipelines from Q4 2024 to the end of 2026. The estimated net absorption is based on historical demand over the last three years and adjusted with forward-looking demand drivers over the same period as the projected availability.

The latest data is as of Q3 2024 except for Japan, which is as of July 2024.

Source: Ichigo Real Estate Services (Japan), as of July 2024; JLL REIS (all markets except Japan), as of Q3 2024; LaSalle Investment Management, as of October 14, 2024.

Logiport Tama Mizuho
Tokyo, Japan

Kishiwada CanCan Bayside Mall
Osaka, Japan

For logistics value-add and development strategies in the region, in-house leasing and execution capabilities are key to outperformance under the current market environment of elevated land and construction costs. Furthermore, for development strategies in Japan, labor shortages pose another challenge, so the ability to secure general contractors is essential.

RETAIL

Distinctive consumption patterns

Asia Pacific's retail sector is dynamic and heterogeneous, encompassing a wide range of sub-sectors and markets with distinct consumption characteristics. As such, it is not fair to say with a broad brush, as we have in other markets, that it has "rebalanced." Only well-managed retail assets that have adapted their tenant mixes and market positioning in response to changing consumption habits will outperform, adding to operational intensity. Some assets are transforming into vibrant social hubs that offer a diverse range of experiences (e.g., live performances, libraries), cater to local tastes (e.g., seasonal festivals) and adopt omnichannel strategies. A granular, asset-level approach to investment is crucial, given the performance variations across markets and subsectors.

China's recent trends reveal a marked consumption downgrade, as evidenced by a reduction in luxury spending, a preference for discount retailers, delayed big-ticket purchases (e.g., automobiles) and increased household savings. This retrenchment is expected to continue and weigh down occupier demand and asset valuations. In the near term, real consumer spending in Singapore is expected to be relatively flat, while in the Australian and Hong Kong markets, it is expected to decline. However, a widespread, pronounced consumption downgrade analogous to China's is not foreseen in these markets. Although some retail asset valuations have been adjusted downwards, it is premature to consider investments in these markets unless there is a rationale for deal-specific strategies.

The retail sector in Japan is characterized by distinctive dynamics, notably a strong preference for in-store shopping compared to other Asia Pacific markets and tourist consumption supported by a relatively weak yen. Consumer spending has recovered to pre-pandemic levels in value terms. However, consumers are cost conscious due to inflationary pressures, and are expected to continue to prioritize non-discretionary and service-oriented spending in the near term. There could be selective core or value-added opportunities in Japanese retail, particularly for non-discretionary and service-oriented asset types, or to a lesser extent, tourism-driven properties.

HOTEL

Momentum mostly priced in, except Japan

Outside Japan, Asia Pacific's hotel sector offers only a limited set of investment opportunities that are attractive on a risk-adjusted basis. Hotel markets such as Australia, Singapore and South Korea are trending towards normalization in demand (see exhibit AP-f on the next page), given the outlook of slowing domestic consumption and the lack of inbound Chinese tourists. Furthermore, hotel transaction prices in these markets indicate that the post-pandemic recovery has been reflected in current prices. Therefore, there are limited opportunities for high-return strategies in these markets over the near term.

The hotel sector outlooks for China and Japan, the two largest hotel markets in the region, present contrasting dynamics. China's hotel sector, predominantly reliant on domestic demand, is expected to continue to face headwinds from excessive existing hotel stock and declining tourism spending per person. A decrease in transaction prices is not sufficient to compensate for these risks.

IN HINDSIGHT

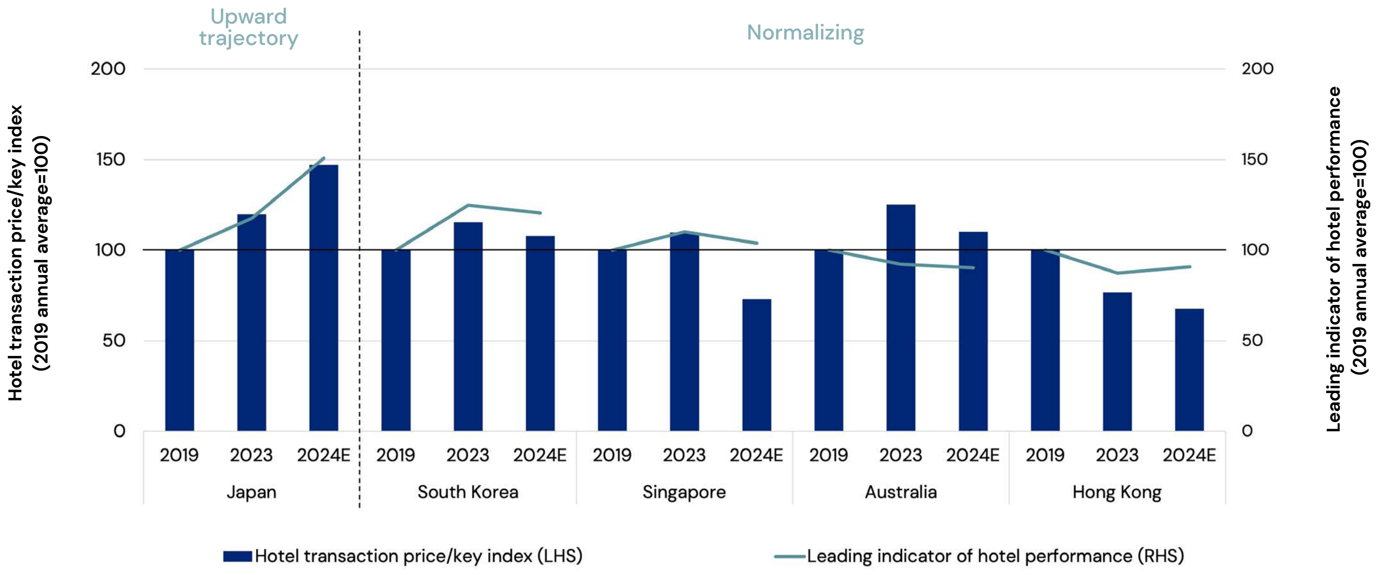
Hotel: *"Countries with relatively weak currencies (e.g., Japan and South Korea) are seeing higher hotel demand from inbound travelers, while keeping domestic travelers onshore."* (*ISA Outlook 2024, p. AP-66*)

We are mostly right. The relatively weak yen has encouraged Japanese residents to vacation within the country and attracted an increasing number of inbound tourists. Most economists expect that the yen will strengthen but remain relatively weak by historical comparison over the next two to three years, which is likely to support both domestic and inbound tourism in the near term.

Project Tifety
Okinawa, Japan

AP-f | Asia Pacific hotel: Momentum mostly priced in, except Japan

Leading indicator of hotel performance versus hotel transaction price trend



Note: The index on median hotel transaction price per key is derived from median prices in local currency. The estimated 2024 hotel transaction price per key is as of Q3 2024. Due to limited data availability for South Korea, RevPAR is utilized as a proxy for hotel performance in 2019 and 2023.

The Skift hotel health score measures the performance of the hotel sector based on searches for future hotel stays, reservations made for upcoming stays, and key performance indicators, including hotel occupancy and average daily rate (ADR) based on the average scores for the first nine months of 2024.

Source: MSCI/ RCA (median hotel transaction price per key), as of Q3 2024; Skift Research (hotel performance leading indicators for all markets except South Korea), as of September 2024; The Korea Hotel Association (historical RevPAR for South Korea), as of 2023; Yanolja (2024E leading indicator of hotel performance for South Korea), as of Q3 2024.

In contrast, the Japanese hotel market is set to continue its growth trajectory, driven primarily by domestic demand and, to a lesser extent, inbound tourists. These factors propelled hotel transaction prices in Japan to a record high in 2024. However, performance is expected to vary across segments, influenced by operational challenges such as labor shortages and rising labor costs. Survey results indicate that 85% of Japanese hotel operators anticipate ongoing capacity restrictions.[10] Consequently, maximizing occupancies may prove difficult, especially for small hotel operators. There could be opportunities to acquire non-luxury hotels from owners who lack the capital to upgrade existing rooms and facilities through strategic repositioning and operational improvements. Moreover, hotel operators with access to labor and greater staffing flexibility are in an advantageous position to improve revenue per available room (RevPAR) in Japan.

Capital market conundrums

Commercial real estate liquidity in Asia Pacific has demonstrated resilience compared to other global regions but is still constrained to varying degrees, except for Japan. Capital raising for Asia Pacific real estate was the lowest in over a decade in early 2024,[11] underscoring investor caution. Of the major markets in the region, China is the least liquid and has seen significant reductions in prices. To a lesser extent, Australia has also been experiencing price declines, particularly for office assets. By contrast, despite varying degrees of liquidity, CRE prices in Japan, Singapore and South Korea have been relatively resilient (see exhibit AP-g on the next page).

10. Source: A survey conducted by the Japan Federation of Service and Tourism Industries Workers' Unions in May 2024 showed that 85% of travel and hospitality operators were forced to restrict their operations either by reducing the number of operation days or by reducing the number of rooms for sale due to labor shortages.
11. Source: "The trends shaping the APAC real estate market," PERE, as of September 9, 2024.

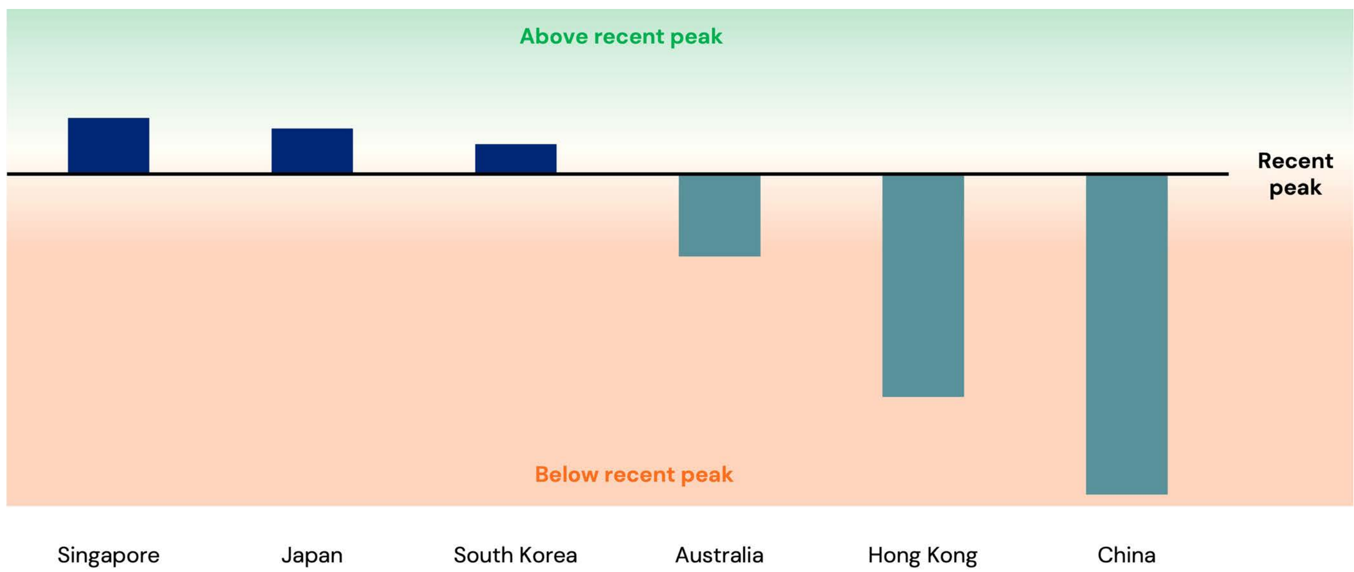
The resilience of CRE prices in these markets has presented challenges for some investors, particularly in markets and sectors where there is uncertainty over NOI growth. The gap between buyer and seller expectations is weighing on liquidity. In Japan, the long-awaited return of inflation, if sustained, could provide opportunities for cash flow growth, but could also impact cap rates. Nevertheless, interest rates in Japan are likely to remain the most accommodating in the region, despite the likelihood of further increases in the near term. Historically, domestic investors have accounted for 76-81% of the total CRE transaction volume in Japan.[12] Should the substantial domestic investor base in Japan continue to anchor the capital market, the potential downside risk to cap rates or capital values is likely to be limited.

Conservative lending practices also mark a common thread. Banks and other traditional lenders continue to finance CRE in most markets. However, lenders are highly selective, focusing on prime assets in good locations while remaining cautious on lower-quality assets and development projects in secondary locations. In particular, stringent lending standards in Australia and the reluctance to lend in China have led to a bifurcation in debt availability and costs across asset qualities and borrower profiles.

12. Source: MSCI/RCA, as of Q3 2024

AP-g | Diverging commercial real estate pricing

Change in commercial property price from recent peak



Note: The commercial property price index for Singapore, Japan, South Korea and Australia is based on MSCI/RCA transaction data for office, industrial and retail. For China and Hong Kong, the commercial property price index is based on the stock-weighted capital value data which is calculated using JLL's stock and capital value data for office, industrial and retail. The recent peak of the commercial property price index for Singapore, Japan, South Korea and Australia was in Q2 2022, and for China and Hong Kong in Q1 2022.

Source: MSCI/RCA commercial property price index for all markets except China and Hong Kong, JLL REIS (stock-weighted capital value index for China and Hong Kong) as of Q2 2024.

> "Savvy investors understand that the best cyclical returns sometimes come from vintages in the wake of cycle turning points or when signs of structural change emerge."

The implementation of monetary easing policies in Hong Kong, Singapore and South Korea could provide some relief to capital market liquidity, but it is likely to be accompanied by some downside risk on NOI. The expectation of high-for-longer interest rates in Australia will likely force some property owners to address the funding gaps.

Some investors are adopting a wait-and-see approach due to challenges in existing portfolios, denominator effects and home-country bias. Some of these hurdles prevent investors from investing in what could turn out to be the best investments in a few years. Savvy investors understand that the best cyclical returns sometimes come from vintages in the wake of cycle turning points or when signs of structural change emerge.

LOOKING AHEAD

- Investors in Asia Pacific real estate must navigate new investments and existing portfolios in a complex environment with signs of structural change and a distinctly different cycle compared to historical norms. Investment strategies focusing on operational intensity (e.g., transaction execution, in-house leasing, etc.) are important for value creation and preservation.
- The current economic climate, coupled with the impending changes brought about by Trump 2.0, is set to present significant challenges for the Chinese economy and real estate markets in the coming years and, to a lesser extent, Hong Kong. Beyond China and Hong Kong, it is difficult to predict clear winners or losers from the election result, given the rest of the region's close trade relationship with China. However, select real estate markets or sectors could benefit from supply chain rebalancing, such as Fukuoka logistics. In the event of significant dislocation or capital market volatility resulting from Trump 2.0, there could be attractive entry points or creative, structured solutions to address capital stack issues for some troubled owners or developers.
- While Japan remains a liquid market in the region with inflationary growth prospects, investors should consider the potential impact of further interest rate hikes and capital market volatility. It is crucial to allow for flexibility and the potential for unanticipated outcomes when evaluating prospective investment opportunities.

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