Facing adversity

Major trends support core and core-plus strategies in Asia Pacific

by Suchad Chiaranussati and Jyoti Ramchandani

The spectacular economic growth in Asia Pacific over the past few decades has made the region the world's key growth engine. Data from the Economist Intelligence Unit shows Asia Pacific's share of world GDP has risen from slightly less than 20 percent in 1980 to more than 40 percent in 2019. With the continued rise of the middle class, strengthening domestic business growth and emergence as one of the most digitally advanced regions, the Asia Pacific's share of the world's economy is set to continue to grow.

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Asia Pacific's growth story and maturing market have brought immense opportunities and changes to the region's real estate landscape. Once seen as an opportunistic part of the world, key gateway cities in Asia Pacific have since become the darling of the core and core-plus investing space among global investors, with several major trends supporting such investment strategies in the region:

Growth driving new urban hubs across the region

Rapid urbanisation and an increase in the working population have led to new urban hubs being established within the main gateway cities. Density issues have become key for the continent, particularly in cities such as Hong Kong and Tokyo, where land is becoming increasingly scarce and prices are rising. To varying degrees, some of the region's cities have seen a trend in office decentralisation, whereby occupiers are seeking accommodation outside of traditional central business districts. This trend has been supported by government strategy and investment in infrastructure, occupancy cost pressures, availability of space, and employees' desire to work closer to where they live. In turn, this has led to the expansion of locations in the region that can be classified as institutional-grade in the core or core-plus space.

Think of Parramatta in Western Sydney, or Yokohama, which lies southwest of Tokyo. Both are enjoying a boom in government and private investment, have excellent transport infrastructure and numerous amenities, and are experiencing population and employment growth. Parramatta, for example, is Sydney's second-largest employment destination, located in proximity to the city's geographic centre in Western Sydney, which is expected to house more than 50 percent of Sydney's population in the next 20 years. Yokohama's lower cost of living, supplemented by major city amenities and immediate access to Tokyo, has been key to attracting both new residents and office utilisation, such as R&D and satellite offices. What is more, one can see immediate value in both cities' real estate markets, which enjoy low grade A vacancy rates and rents that are significantly below those in Sydney and central Tokyo, respectively.

These key features of "growth corridors", which refer to urban areas outside of traditional established locations that themselves are becoming established, provide depth, strong fundamentals and great potential for long-term growth.

A significant rise in education at all levels

Asian parents place strong emphasis on their children's academic achievement, as they see education as a way to success and are amongst the top spenders on education globally.

Singaporean families, for instance, spent S$1.4 billion (US$1.0 billion) in 2018 on private education services, up from S$650 million (US$479 million) in 2003, according to a government survey on household expenditure. In South Korea, data from the Ministry of Education and Statistics also showed that spending on private education spiked to a 10-year high in 2019 to US$17.6 billion. In addition, with increasing workforce participation and the jobs of the future requiring a much more sophisticated skill set, young adults are also looking to upskill themselves and gain foreign experience by enrolling in courses abroad. These have created increased tenant demand for education-related real estate, namely student accommodation and commercial properties, particularly in Asian markets with strong education sectors.

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One of the top global destinations for international students, Australia's education sector is propelled by a number of important growth drivers, including seven local universities in the top 100 of the QS World University Rankings, the affordability of tuition, English being the official language, cultural diversity in the country, Australia's relative political and economic stability, as well as employment and migration opportunities. Asset classes such as student accommodation now fall into the remit of core and core-plus buyers in the Asia Pacific region, reflecting the strong drivers and income stability in the sector. While the current pandemic may have created some uncertainty, long-term master leases, which are common in this industry, can provide downside protection.

The increased focus on education is not restricted to higher education. It is not uncommon for Asian parents to escort their young children from one tuition class to another on the weekend. Catering to this demand, tuition centres for young children have proliferated, particularly in Hong Kong, Japan, Singapore and South Korea. Commercial assets housing these sought-after centres can provide a defensive real estate opportunity for investors, especially for those located in strong residential catchments or education clusters.

Universities, vocation, education and training providers, and language centres, are also increasing their office accommodation footprint to cater to increased demand and ability to service CBD and key metro locations.

Technology driving new demand

Technology and increased digitalisation are key global megatrends, and Asia is embracing them with remarkable speed. Asia accounts for half of the world's internet users, and the sector is booming. Rising ecommerce penetration has been fuelling the logistics sector. More recently, this includes cold-storage facilities, reflecting consumers' changing lifestyles and preferences, with increasing demand for quick delivery of fresh produce. Solid growth in data usage, increased demand for digital services and growth in edge computing are spurring demand for data centres from both operators and investors. Although a relatively new asset class, current demand is high from core and core-plus investors, driven by strong and sustainable growth in the sector. Data centres provide investors with surety of income because of the defensive nature of the asset class and current supply and demand characteristics. Often, data centres are secured by long-term leases to account for the significant capital investment in the facilities.

Transparency and ESG take on importance

Alongside these trends is a move towards greater transparency in Asia Pacific's real estate investing market, which is a crucial key to unlocking further capital flows into the region. Efforts by industry associations, such as the Asian Association for Investors in Non-listed Real Estate Vehicles to collate and analyse data from managers on fund performance, fees, assets under management, leverage and capital raising help industry players to benchmark and form a better understanding of regional trends. This helps tighten up investment criteria, and gives investors and fund managers alike the confidence to explore emerging opportunities in the core and core-plus space.

Finally, environmental, social and corporate governance (ESG) is a major focal point for real estate investors in the region and has become a key driver of performance. As the quality and standards of a building are crucial considerations of core investors in particular, assets, tenants and locations with strong ESG credentials are most likely to attract such investors. After decades of breakneck economic growth and the

Parramatta, Western Sydney

Yokohama, Japan

environmental degradation that came with it, Asia Pacific is becoming more acutely aware of the need to protect the environment. Developers, real estate operators and owners alike are keen to burnish their environmental credentials, with places in the Dow Jones Sustainability Indices and the Global Real Estate Sustainability Benchmark, for example, being highly sought after.

Growth trends accelerated by COVID-19

The outbreak of COVID-19 has demonstrated the resilience of core and core-plus real estate in the region and accelerated some of the trends that have driven its success. There is a clear flight to quality, as core and core-plus investors seek cash-flow certainty and resilient, high-quality assets in established markets and high-performance sectors in Asia Pacific.

Decentralisation, an established trend supported by population growth and public and private investment, has been in the spotlight as a result of COVID-19. Occupiers are rethinking their operating models or expediting plans to establish satellite offices closer to residential hubs, to save on costs in a challenging business environment and to respond to employees' desire to work closer to home. The region's key growth corridors could be significant beneficiaries of enhanced demand for satellite offices as space requirements and potentially quality of occupiers are enhanced, which will further drive demand from core and core-plus investors.

Technology-related demand is going from strength to strength as people have adapted to living, working and learning from home during COVID-19. Core and core-plus investors will continue to target technology-backed assets as a result of increased demand for ecommerce, technological services and the increasing importance of online presence.

The COVID-19 situation has also accelerated localisation trends amid global trade tensions, driven by political, national and security concerns. Compared with the years of "globalisation", local and intraregional trade are looking more robust than ever — and getting even stronger. Supply chains are becoming shorter as speed to market also becomes critical. Local manufacturing may go through something of a renaissance. Space requirements are likely to increase in a sector that already has limited vacancy for modern and well-located assets. Robust demand in this sector will no doubt warrant the attention of core and core-plus investors attracted by the prospect of stable income and strong growth.

Real estate opportunities evolving in a growing market

Despite the disruption of COVID-19, investors should remain positive on the long-term growth drivers in Asia Pacific's real estate market as the region takes a greater slice of the world's growth. In many ways, the establishment of new core locations is the natural evolution of a region that is maturing after years of growth. In addition, the trends in the region are opening up increasing opportunities in alternative sectors, and it is likely more core and core-plus investors will jump on the alternatives bandwagon soon. The current global pandemic has shown the resilience of the key trends identified, which have taken on an even greater significance in the face of adversity, laying the groundwork for a broad range of new investment options for core and core-plus investors looking for stable income and yield. ❖

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