December 2019

Asia Real Estate Market Outlook

For Investment Professionals only

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested. Where past performance is shown, please note that this is not a guide to future performance.

Executive summary

- Real estate returns expected to remain resilient amid more accommodative macro policies and balanced supply and demand
- Yields for commercial real estate expected to remain low as relatively higher return profile for the sector continues to attract strong capital flows
- Logistics markets with more sizeable consumer bases should continue to deliver strong returns, providing buffer against decline in global trade and geopolitical rifts
- Resilience of office rental income supported by high occupancy rates, well managed supply pipeline and healthy demand from growth sectors
- Residential sector in Japan's most populous cities to provide defensive returns

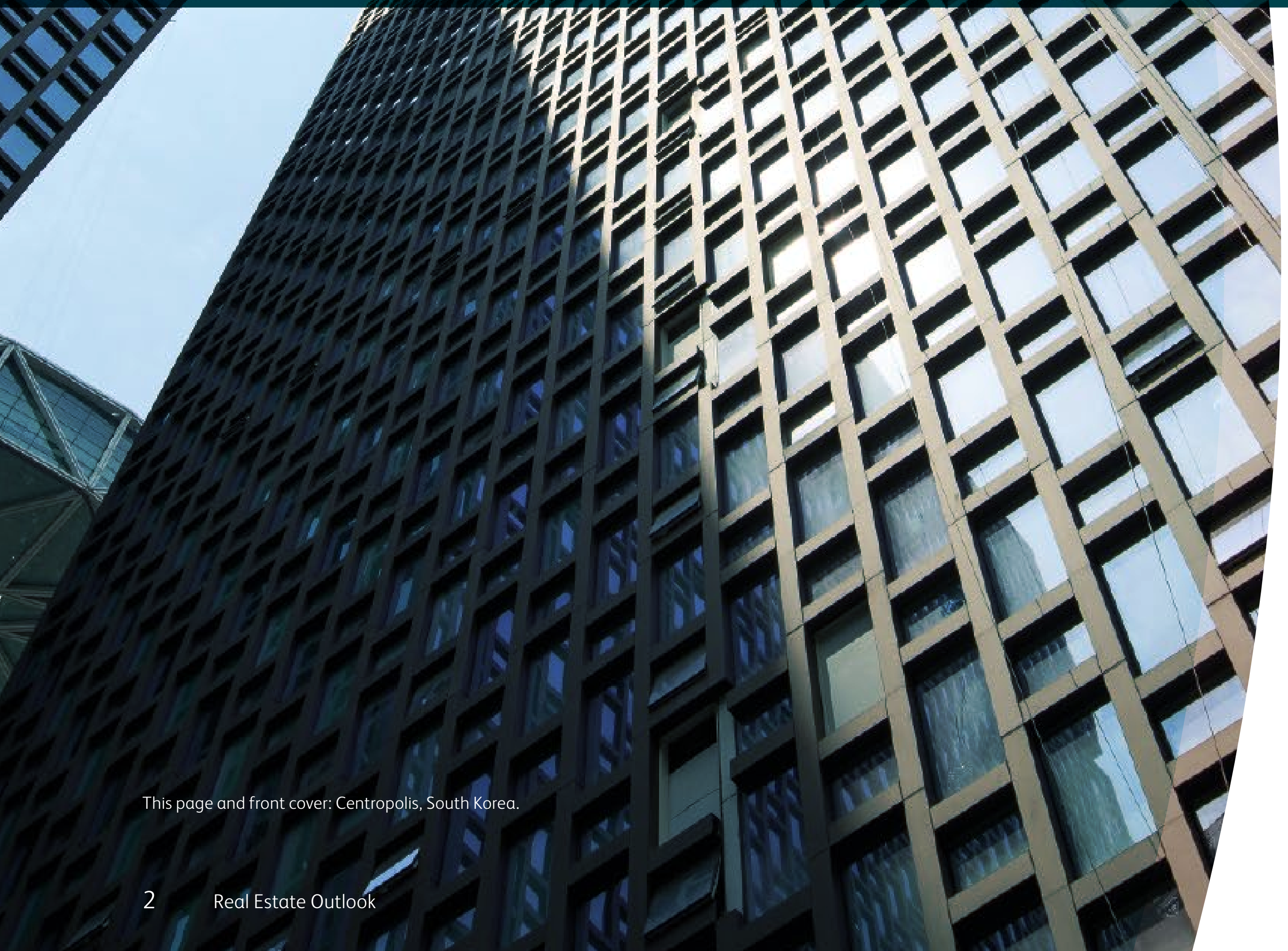
Key total return forecasts for 2020*

5.4%
for APAC

8.8%
for logistics

6.7%
for offices

*All total return forecasts are on an unlevered basis.



This page and front cover: Centropolis, South Korea.

Key sector trends for the next 12 months

Logistics

- Key cities in Australia, Japan and Greater Seoul: growing and/or sizeable populations provide relatively strong consumer markets to offset decline in global trade

Office

- Regional cities in Australia and Japan: flight-to-quality in the former is driving incentives down while record low vacancy in the latter is supporting rental growth

Residential

- Tokyo and key regional cities: newer and better located assets should register strong demand from younger generation and the rise of dual-income families

Retail

- Australia and Japan: rents in regional shopping centres are likely to remain challenged by structural changes in consumer behaviour; more active asset management required to sustain values

Figure 1: Logistics continues to deliver highest unlevered total returns for APAC

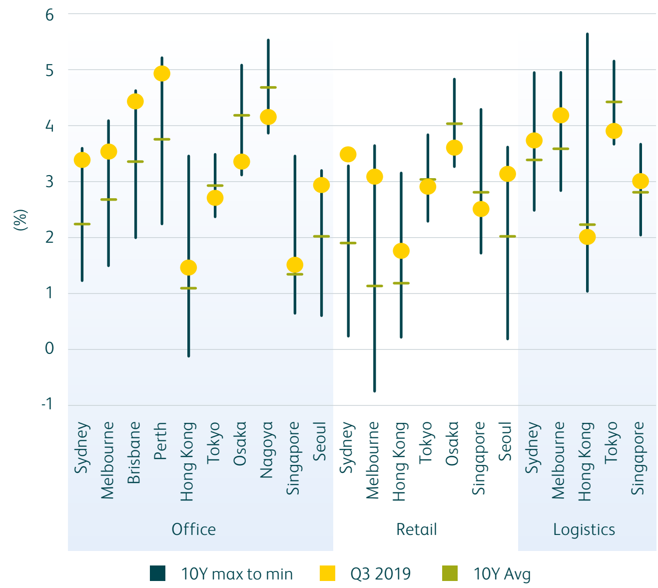
Source: M&G Real Estate estimates, as of November 2019.

Accommodative macro policies to sustain core real estate returns

Central banks across Asia Pacific have acted quickly to counter potential downside risks to economic growth, given slower trade activity arising from protectionism, increased geopolitical tension, as well as lower global manufacturing demand. Australia, South Korea, Hong Kong and Japan are expected to maintain low interest rates in the near term, easing upward pressure on real estate yields and sustaining the average 320 bps yield spread between real estate and 10-year government bond (GB) yields across the core market sectors.

Additionally, governments in core markets are expected to raise fiscal spending to encourage consumer sentiment and bolster growth. The South Korean government, for example, has drafted a KRW 513.5 trillion (USD 424 billion) fiscal budget for 2020: an 8% increase on 2019 and the biggest spending planned since the Global Financial Crisis. Part of the proposed set of fiscal policies seeks to create more jobs and increase research and development expenditure to enhance South Korea's future growth industries such as 5G networks and artificial intelligence. The implementation of similar fiscal initiatives in other APAC markets should support demand for the major real estate sectors, such as offices; further strengthened by the potential multiplier impact on private investments and consumption over the medium term.

Figure 2: Expansionary monetary policies widen real estate yield spreads over 10YGBs



Source: M&G Real Estate based on data by PMA, Oxford Economics, as of November 2019.

Positive domestic fundamentals to support higher returns in logistics

Logistics markets with relatively larger domestic consumer bases and stronger e-commerce growth are likely to continue to register healthy demand. Benefiting from global uncertainty, third-party logistics growth is expected to remain fuelled by the outsourcing of logistics operations by both e-commerce retailers and manufacturers, as many retailers hold back from expanding their own operations. Among the core markets, the logistics markets in Sydney, Melbourne, Tokyo, Osaka and Greater Seoul should see the strongest space demand due to their sizeable populations and positive demographic fundamentals. Logistics rents for these markets are forecast to grow by an average 1.8% annually over the next three years. Well located prime assets should record greater rental growth on the back of limited space availability, particularly for modern stock with a higher specification.

Coupled with higher yields versus the office sector and increasingly more resilient income streams, logistics assets should continue to attract strong investor interest. With more investment appetite weighing on yields, further yield compression for logistics in Australia, Japan and South Korea is expected, supporting forecasted returns of 8.8% in 2020 and 6.5% pa over the next three years. Given the short construction lead time, the key downside risk to expected returns would be oversupply.

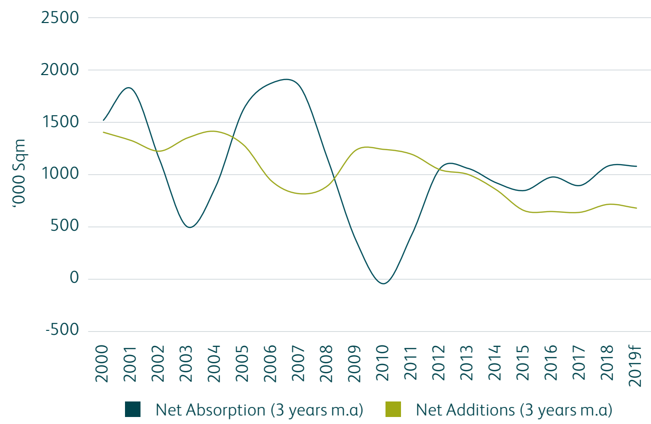
Limited space availability to buoy the office sector

Office demand in the core APAC markets has exceeded net supply in the last few years, consequently driving down vacancy rates in markets such as Melbourne, Tokyo and Osaka to below long-term averages. With limited space available for expansion or relocation, corporates have also turned to upcoming completions in the next 12-24 months. As such, key upcoming developments have registered high pre-commitment rates in the range of 70-80%. Empty back-fill (or shadow) space has also seen active interest from occupiers. Given low vacancies and a more controlled supply pipeline, APAC core office markets are expected to remain resilient, should demand for space slow down on the back of increased headwinds in the global economy.

In addition, the digitalisation of the developed APAC economies should continue to drive the creation of service-based jobs and lend strength to the prime office sector, particularly from growing innovation industries such as information-communications, 5G networks and financial technology. This would also provide diversification beyond the manufacturing-based sectors.

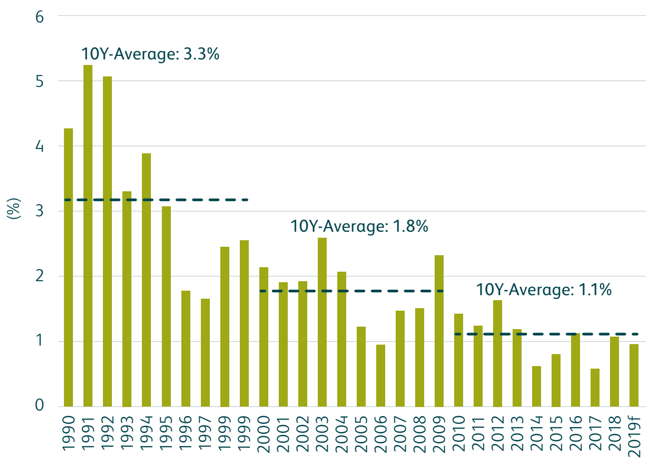
Overall, the office sector is expected to deliver close to 7% in total returns in 2020 – the second best performing sector within the core markets – as prime offices in most cities should continue to register positive net effective rental growth. Osaka prime offices, in particular, are expected to outperform with annual rental growth of around 8% in 2020 and 5.6% over the next three years. The Hong Kong office market is expected to perform worst within the region as persistent civil unrest is likely to further depress the already sluggish space demand from occupiers, particularly from Mainland Chinese corporates.

Figure 3: Net absorption outpacing net supply in the core APAC office market



Source: M&G Real Estate based on data by PMA, as of October 2019.

Figure 4: Net supply as a percentage of total office stock declines in core APAC



Source: M&G Real Estate based on data from PMA, as of October 2019.

Strong demand for inner-city living in Japan to provide defensive returns

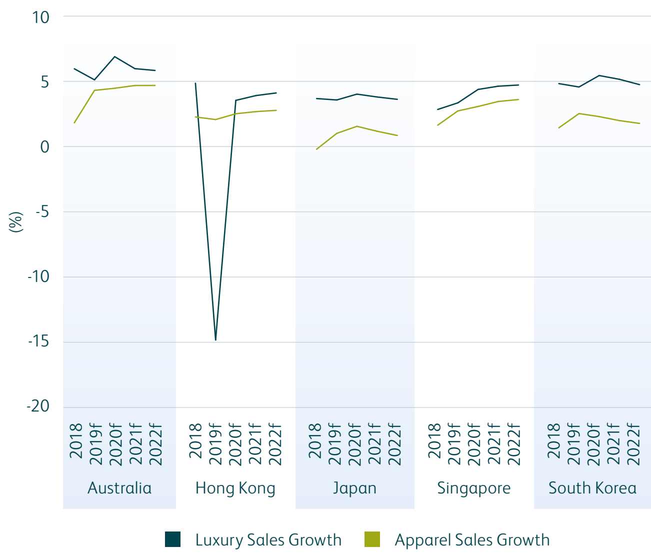
Tokyo and regional cities in Japan, such as Osaka and Nagoya, should continue to attract both locals from more provincial areas and foreigners as the job-to-applicant ratio remains relatively high in these cities. The consolidation of population into key regional cities supports demand for multi-family residential, particularly among the younger population and dual-income households that display stronger preference for inner-city convenience, transport connectivity and amenities. For investors, stock selection is crucial to cushion against a down-cycle; newer assets that are situated within close proximity to key train stations have recorded more stable occupancy rates. Such assets are therefore likely to prove a better store of value and income in the event of a market downturn. Multi-family residential in Tokyo and Osaka are forecast to deliver a 4.7% total return in 2020, backed by stable rental growth.

Scarcity of well located prime retail likely to support capital values

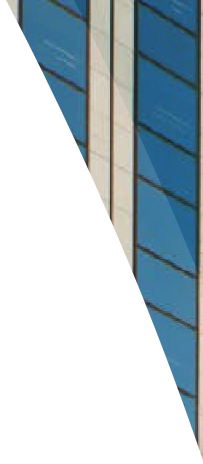
Amid a more challenging macro environment, retailers are expected to place even more emphasis on seeking prime retail space, as better located and managed assets provide a more resilient operating platform for business. This should drive further bifurcation in the retail markets as prime high street and well located shopping centres outperform those in weaker trade areas. As such, prime high street retail in cities such as Tokyo, Osaka, Sydney and Melbourne are forecast to register stronger rental growth, backed by sustained demand from luxury and higher-end international retailers seeking distinct showrooms to increase their exposure to locals and tourists alike.

From an investment point of view, high street assets are also relatively less intensive to manage when compared to shopping centres, thereby demanding lower operating costs. Given the scarcity of such assets, for instance in Ginza, Tokyo or Myeongdong, Seoul, yields for high street retail should continue to hold firm in the near term. Total returns for this segment in Australia, Japan and South Korea are forecast to reach around 6% in 2020. Prime retail in Hong Kong, however, is likely to see negative returns of around 15-20% due to the current civil unrest that has affected tourist arrivals, consumer sentiment, as well as retailers' daily operation.

Figure 5: Luxury retail sales growth to outpace apparel sales



Source: M&G Real Estate based on data from Euromonitor, as of November 2019.



Long-term strategy recommendations

Office

- Take advantage of increased office demand linked to the advancement of digital and knowledge-based economies
- Focus on location, design and service quality, with employee wellbeing increasingly important among corporates
- Identify growing decentralised sub-markets, backed by government initiatives, in markets such as Sydney, Hong Kong and Singapore, for diversification

Retail

- Target prime retail locations in gateway cities to serve as branding and marketing touchpoints as omni-channel retailing becomes more prevalent
- Effective asset management required, with potential for footfall and marketing success to displace sales turnover as key performance tracker
- Develop strategies to cope with potential structural changes; rising social consciousness among consumers, particularly Generation Z (or post-millennials), may reshape peoples' consumption behaviour

Logistics

- Tap into growth relating to e-commerce, healthcare and higher-value manufacturing
- Zone in on strategic locations that provide quick and easy access to transport networks, ports and labour with infrastructure developments likely to unlock new sub-markets
- Focus on higher specification assets as logistics providers seek to optimise supply chain

Residential

- Benefit from population growth in gateway cities such as Tokyo, Singapore and Sydney, as well as the rise of dual-income families, by targeting multi-family units
- Satisfy preference for inner-city living and convenient access to public transport and amenities among millennials

Centropolis, South Korea.

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