Busan, South Korea

We See Attractive Cyclical Entry Points

With greater uncertainty from the backdrop of rising rates through 2022 and 2023, real estate transaction volumes across Asia (MSCI, as of Q1 2024) have fallen around 50% from their peak in Q4 2021, though we do observe the rate of decline slowing.

In this environment of lower transaction volume, real estate markets are repricing, but unevenly. This is in part due to the strength of rent growth, which is supporting prices even as cap rates rise. With price changes uneven across markets and sectors, it is essential to be selective in identifying relative value.

We use our proprietary Composite Capital Market Score (CCMS[1]) to identify markets and sectors where prices show the most potential for attractive returns. By our metrics, a low CCMS score is a clear signal that assets are transacting below fair value (a buy signal). But acquiring investments at a compelling entry cost is only part of the recipe – value can also be created through asset management initiatives including leasing, refurbishment, repositioning, and redevelopment for eventual sale. The CCMS helps identify markets where capital market conditions have the highest probability of being stronger at the time of planned asset dispositions.

[1] This proprietary Hines metric is intended to measure the current value of a given market compared to its own history. It is calculated as a percentile using the long-term averages of five indicators (price to trend, capitalization rate spread, growth-adjusted spread, trailing annual total return and trailing annual price return).

Finding Relative Value from Data

By using our proprietary fundamental and pricing analysis, we can identify meaningful differences in value across asset classes and markets. The strength of capital demand for residential assets, underpinned by attractive fundamentals (and risk-aversion among investors), is currently supporting prices. However, while there is compelling support for the living sector in the Asia region, entry pricing is higher relative to other sectors.

Warehouse markets remain fundamentally healthy (despite the rise in supply) with above-trend rental growth delivered over the last 12 months, led by the east coast of Australia. Rental growth has maintained warehouse values even as capitalization rates have softened. In our view, medium-term sector supply and demand conditions are positive, and we are focused on identifying warehouse assets in markets where repricing has been sharpest and/or there is a structural mismatch between supply and demand.

The regional office sector shows the widest dispersion in regional performance, with some pockets of positive rental growth (most notably in Seoul), but downward pressure generally prevailing. As of Q4 2023, office rents in Japan had fallen for 15 consecutive quarters from Q1 2020 for a total decline of 19.7%, according to data from Jones Lang LaSalle, though we see the cycle starting to turn. Working patterns vary substantially across Asia’s office markets, and we see this creating attractive opportunities to acquire and upgrade underperforming office assets in core locations of Asia’s leading cities.

Key Takeaway:

By our calculations, Developed Asian real estate prices have fallen about 10% overall from their peak as of Q2 2022. Although not consistent across the region, this adjustment is starting to result in quality assets being offered at or below fair value. With future returns most likely to be driven by rental growth, we are focused on sector and submarket combinations where we have identified mismatches between supply and demand that will likely better support future rent growth and appreciation.