Why Asia Now: The Case for Asia Real Estate

May 2024

Tokyo, Japan

Hines


T3 Collingwood | Melbourne, Australia

Introduction

Very simply, we believe a compelling case can be made for having an Asian real estate allocation in global investor portfolios. This case is based on four fundamental pillars:

- **Positive Regional Growth Outlook**
  The region has become wealthier, stronger economically, and more self-reliant. Asia has been, and is expected to remain, the major regional contributor to global growth. These trends are underpinning healthy real estate demand fundamentals.

- **Increasing Benefits from Diversification**
  Correlations between Asia and the United States/Europe, as well as between the region's major economies and real estate markets, have fallen as trade and economic growth patterns shift. Intra-regional diversification supports a more stable return profile (lower downside volatility) and attractive risk-adjusted returns, including currency impacts.

- **Depth of Opportunity**
  The broad scope of value-add opportunities fostered by secular growth trends both in traditional and alternative asset classes is supplemented by resilient, low-volatility sectors with strong rental growth. Asia offers differing risk/return profiles from other global regions with meaningful differences within region by sector, and with supply constraints helping to support positive rental growth.

- **Attractive Entry Points**
  Investors can tactically deploy capital by focusing on pockets of emerging value in different countries at different cyclical positions driven by rates and pricing. Since 2022, Australia and New Zealand have demonstrated more substantial moves in rates than North Asia with consequential impacts on liquidity and market pricing.

Yes, at the time this is written, investors are still facing some significant headwinds in this space with global real estate markets nearly two years into a generational transition. Most central banks have long abandoned the accommodative “no-rate” policies of the recent past, so real estate values have been forced to adjust to dramatically higher long-term debt costs.

In addition to these capital market challenges, we at Hines[1] continue to observe and measure substantial structural changes in supply/demand fundamentals across different real estate sectors and asset classes. These changes were (in many cases) accelerated by the upheaval in work/live/play patterns resulting from the global pandemic. At the same time, the growth of China’s maturing economy has slowed while geopolitical shifts have resulted in a widespread reconfiguration of global supply chains.

Yet amidst this turbulent global landscape, the dynamics in Asia do look somewhat different from the rest of the world. This makes real estate in Asia, in particular, a valuable component of a global investment mix.

In our view, a diversified, well-constructed, pan-Asian portfolio can capture attractive market beta via exposure to markets and sectors with the strongest growth prospects. In addition, our highly skilled local sourcing and execution teams seek to generate alpha by uncovering attractively priced and placed assets and through effective strategy execution.

[1] All references to “we” or “our” will refer to Hines Research.

Seoul, South Korea

Asia Projected to Outperform Other Global Regions

Historically, Asia's economies have substantially outperformed their North American and European peers (over 5-, 10-, and 20-year time horizons). Annual real gross domestic product (GDP) growth from 2012 to 2022 was 4.3% in Asia, versus 2.3% in the U.S. and 1.7% in Europe. This growth came during a time of substantial expansion in China's economy, which more than doubled in size during the decade from $8.5 trillion to $17.9 trillion – an average annual nominal GDP growth rate of 7.7% (real 6.2%)[2].

As Exhibit 1 illustrates, China contributed to around two-thirds of regional real GDP growth from 2010 to 2019. This enormous and sustained expansion has had significant and positive effects on growth across the entire region. For example, exporters of raw materials (such as Australia and Indonesia) and key manufacturing trade partners (like Japan and South Korea) have all grown and benefited by investing into this once-in-a-generation growth story.

Strong Regional Economic Growth Is Expected to Evolve

The Asia region is projected to maintain its outperformance of global aggregates. In fact, published Oxford Economics data forecasts that Asia's economic growth rate could be more than double that of the U.S. and Europe annually through 2028. As such, Asia will likely continue to drive global growth, with Oxford Economics projecting Asia will contribute more than 50% to global growth from 2024 to 2030.

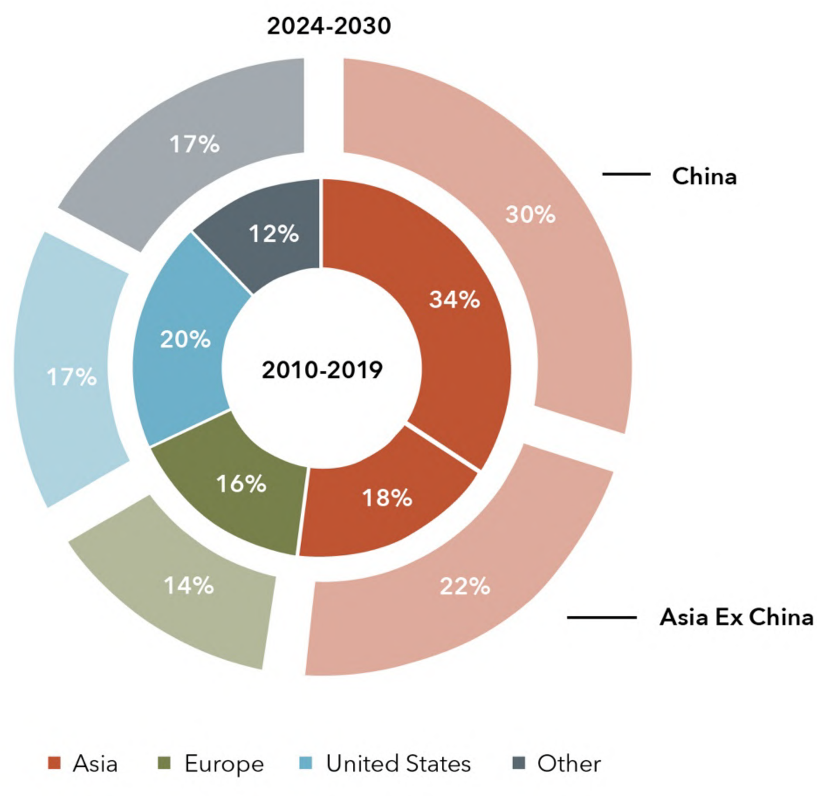
[2] Oxford Economics. As of March 27, 2024.

However, the fundamental forces driving this growth have changed. No longer is Asia's economic activity centred on manufacturing for and exporting to the Developed World. Rather, Asia's economy is increasingly intra-regionally driven. As it becomes richer, consumption will, in our view, be a stronger driver of growth.

Furthermore, while China will likely still be an important contributor to regional growth, its relative share is projected to fall as other parts of Asia grow more rapidly. As illustrated in Exhibit 1, Asia ex-China's share of global growth is projected to rise from 18% in the period from 2010 to 2019, to 22% from 2024 to 2030 — a meaningfully larger contribution to global growth than from either the U.S. or Europe.

Exhibit 1

Regional Contribution to Global Real GDP Growth, 2010-19 vs 2024-30(F)



Source: Oxford Economics, Hines Research. As of Q1 2024.

Regional Trade Patterns Realigning

Geopolitical tensions certainly can have disruptive tendencies, particularly as these pertain to trade. It's no secret that there are major reconfigurations underway in global trade patterns. These shifts are described by different terms – "decoupling", "derisking", "friendshoring", "reshoring", "nearshoring" – but in essence reflect that trade between countries has shifted as some relationships diversify or realign towards geopolitical partners.

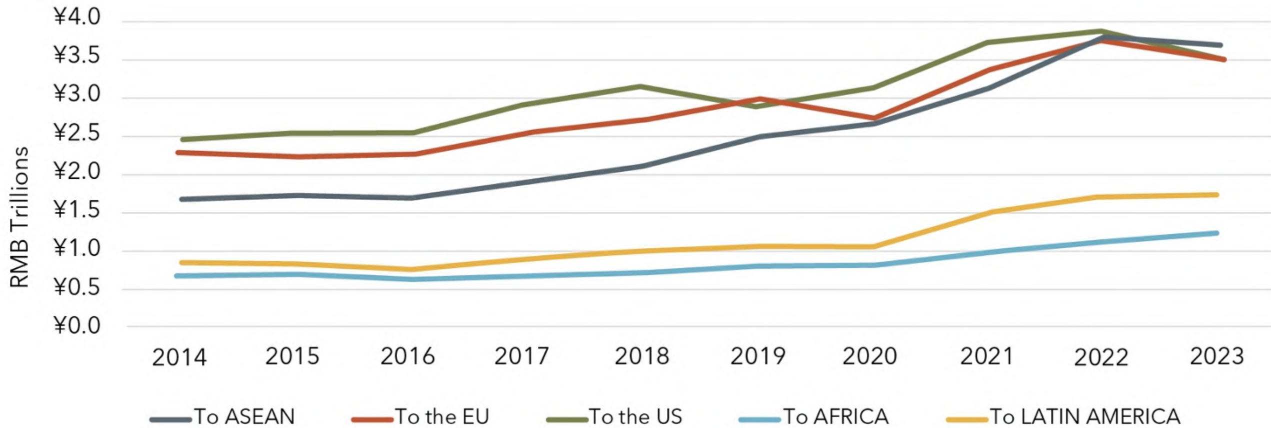
The Asia region has long had integration in regional manufacturing value chains that crisscross national borders. Even with increased geopolitical tensions, regional trade corridors remain strong and, in some cases, bolstered by free trade agreements. Interestingly, it is the U.S. that may appear to be more of an outlier[3] in its shifts to geographically aligned partners and more diversified supply chains.

As the US increasingly engages with the regional trading bloc represented by the Association of Southeast Asian Nations (ASEAN[4]), supply chains grow longer and more complex, but not necessarily less ultimately reliant on China. At the same time, Europe's trade with China remains relatively robust, with China exports to the EU as of Q1 2024 tracking around 18% above the 10-year average in RMB terms (Exhibit 2). China continues to grow its trading relationships with developing economies around the world as illustrated in Exhibit 2.

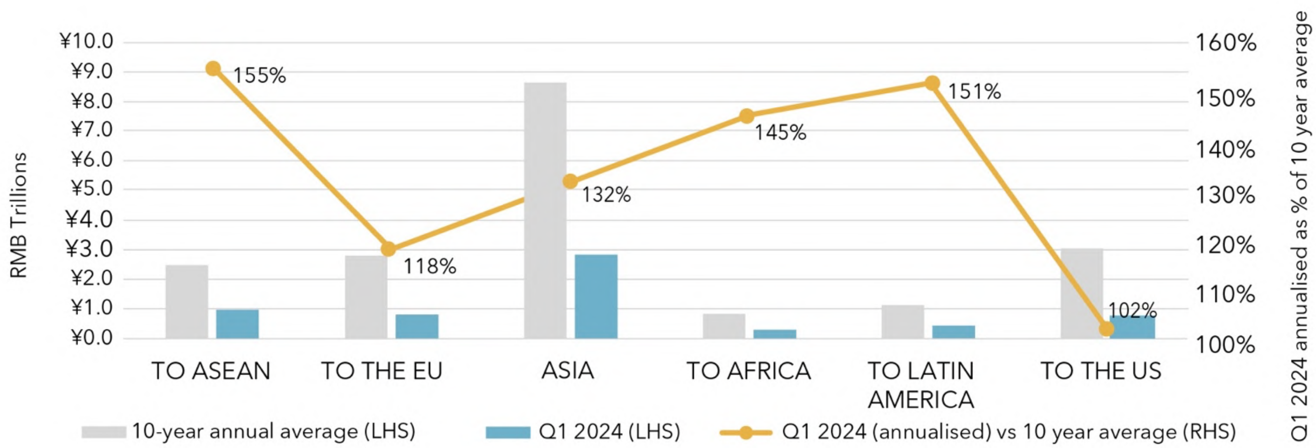
[3] McKinsey Global Institute, Geopolitics and the Geometry of Global Trade. By Jeongmin Seong, Olivia White, Michael Birshan, Lola Woetzel, Camillo Lamanna, Jeffrey Condon, and Tiago Devesa. January 17, 2024.
[4] The Association of Southeast Asian Nations (ASEAN) is a trading bloc that includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

Exhibit 2

More Chinese Exports Remaining in the Region



China's Trade with All Regions Ex-US Running Significantly Above 10-year Average



Source: CEIC, Hines Research. As of April 2024.

For the past 20 years through 2022, Chinese exports to the EU, U.S., and the rest of Asia had followed a steadily rising but slowly converging path. However, last year for the first time, the $524 billion of Chinese exports to the 10-nation ASEAN regional trading bloc exceeded[5] that of the U.S. and of Europe (Exhibit 2). With "nearshoring," Asia is less reliant on global trade and more insulated from global trade disruptions (like in the Red Sea). Given the current state of affairs, one could argue that the level of economic disruption potentially dragging on the Chinese and Asian economies is overstated.

[5] Bloomberg, Shifts in Chinese Exports Show Ties with US Economy Fraying, Bloomberg News. January 15, 2024.

Chinese exports to Mexico in 2023 (through November 2023) were up more than 5%, with some companies likely shipping there for import into the U.S. to avoid tariffs[5]. And with the Chinese economy maturing, there is likely to be more exports to the region (for example, Thailand and Vietnam) to save money during final assembly. Clearly, this is all a reflection of the state of current global relationships, as well as the slowing Chinese economy. While calibrating the economic impacts of these shifts in depth is beyond the scope of this short paper, we believe these forces are positive for Asia's maturing and future growth.

Other Growth Vectors

It is undeniable that (as of Q4 2023) China's growth has slowed, which is to be expected from a maturing economy that continues to move up the economic value chain. As China's economy has developed, it is consuming more of what it produces. In 2022, China's total goods trade was equivalent to 35% of GDP, down from its peak[6] in 2006 of 64%. Given the relative size of China's economy (more than 50% of total Asia GDP), it will likely continue to be a notable contributor to regional economic growth, supported by positive secular urbanization trends and further growth in the service sector. However, there is much beyond the China story.

China's move away from lower value-add manufacturing, combined with an evolution in global supply chains due to geopolitical trends and the global pandemic, has bolstered and accelerated shifts in market sentiment and growth across the region. We see this particularly in Japan, which after years of economic sluggishness and price deflation has become more cost-competitive and a legitimate manufacturing alternative to China.

With Japan's strong ties to the U.S., it also has a leg up on supplying those products (currently exported to the U.S. by China) directly (this is also true for South Korea). The equity market seems to agree, with the Nikkei recently climbing to over 40,000[7], breaking a record that had stood since December 1989.

Additionally, Australia's economy is supported by strong population growth, tight labor markets, and healthy consumer spending. According to data released by the Australia Bureau of Statistics in December 2023, population growth in the year to June 2023 was 624,100 (2.4%), the strongest growth rate on record. Net migration accounted for more than 80% of this growth at 518,000.

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[6] McKinsey Global Institute, Geopolitics and the Geometry of Global Trade, By Jeongmin Seong, Olivia White, Michael Birshan, Lola Woetzel, Camillo Lamanna, Jeffrey Condon, and Tiago Devesa. January 17, 2024.
[7] CNBC, This Analyst Predicted the Nikkei Would Cross 40,000. Lim Hui Jie. March 4, 2024.

Singapore is also a clear beneficiary of ASEAN shifts as companies set up regional headquarters and high-tech manufacturing facilities, while South Korea's economic growth prospects are trending up too, driven by the pick-up in global trade (particularly in higher-end goods). Semiconductor exports and auto exports were up 56.2% and 24.8% y/y respectively as of January 2024[8]. The turnaround in the global semiconductor cycle and surging interest in artificial intelligence (AI) chips will likely bode well for continued strengthening of South Korea's exports.

Outside of Developed Asia, Vietnam has emerged as a beneficiary of the "China Plus-1" strategy, whereby manufacturers are diversifying their production facilities more broadly across the region. India's economy has exhibited a relatively low correlation to China, given its economy is more domestically driven and its positive demographics offer a differing growth profile. Projected annual economic growth of 6.5% - 7.0% over the next 5 years is underpinned by improving employment and robust private consumption[9].

Key Takeaway:

Strong economic growth in the region is supporting healthy real estate fundamentals. In a global real estate portfolio context, one could view Asia as the growth stock given the correlation between GDP per capita and the value of real estate. Based on our proprietary projections, the total value of investible real estate in Asia is expected to grow from the smallest share relative to the US and Europe (at 30% of the global market, as of end-2023) to the largest share (at 36%) by 2032[10].

[8] Source: Oxford Economics – South Korea Country Economic Forecast. As of Jan 2024.
[9] Source: Oxford Economics – India Country Economic Forecast. As of Mar 2024.
[10] Sources: Real Capital Analytics, Oxford Economics, Hines Research, using annual data from 2022 to 2032. The property value are estimates by Hines Research for the four major property types (Apartments, Office, Retail and Warehouse).


Sydney, Australia

A Dynamic and Diverse Region

Asia is a highly heterogeneous region comprising both developed and developing economies. Our primary focus is on Asia's developed economies, which are supported by meaningfully different economic structures and growth drivers, demographics, levels of urbanization, monetary policies, and currency regimes. Due to this diversity, it is rare that all economies across the Asia region exhibit similar economic conditions at any one point in time. Across the largest four markets in Developed Asia – Australia, Japan, Singapore, and South Korea – there are key differences as of Q4 2023.

Japan's economy has been bolstered by a dovish monetary policy and a weakening currency. Interest rates have peaked or are likely close to peaking in Australia and South Korea, but it is more likely that rates will modestly rise in Japan from 2024 through 2026 as inflation continues to exceed the 2% Bank of Japan target. The Australian economy has been slowed by rapidly rising interest rates but has begun to stabilize with the support of positive demographics and a strong labor market. As such, policy rates in Australia are expected to remain around current levels. South Korea has experienced relatively weak growth due to tight credit conditions, but in our view, policy is likely to loosen over the next 12 months.

Exhibit 3 provides a snapshot of this, illustrating where major regional economies' 10-year bond yields stand relative to each other and relative to each economy's 15-year history. In China, policy is at the loosest level in a generation, while the reverse is true for Hong Kong and Singapore. In Australia and New Zealand, policy remains tight but notably beneath peaks while policy in South Korea and India is broadly in line with long-term averages. Bank of Japan's policy remains the loosest in the region but on a tightening trajectory.

Exhibit 3

Diversity in Regional Monetary Policy Persists – 10-year Bond Yields, Q1 2009 – Q1 2024

Source: CEIC, Hines Research. As of March 2024.

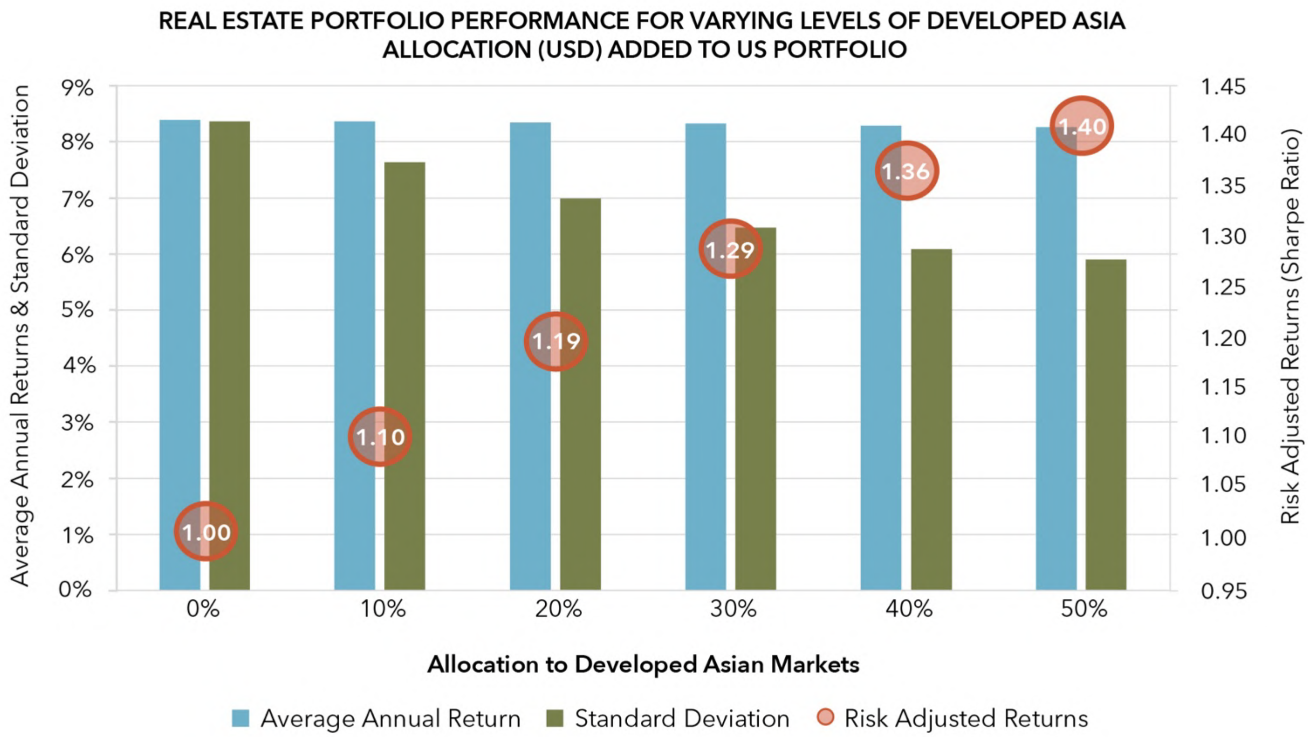
This leads to two important takeaways:

First, this diversity in underlying economic conditions has meaningful impacts on individual real estate markets (discussed in more detail in the "A Deep and Compelling Opportunity Set" and "We See Attractive Cyclical Entry Points" chapters of our report). These differences mean that individual markets are not highly correlated, allowing investors to benefit from diversification across the region. Part of the explanation of lower correlations is due to currencies and the next section "A Deep and Compelling Opportunity Set" covers regional currency dynamics in more detail. Our analysis of MSCI global return data (unleveraged) shows that historically an Asia allocation adds return and reduces volatility (increases risk-adjusted returns) of a global portfolio.

In addition, based on our analysis of MSCI data, Asia portfolios have the lowest downside volatility, as shown in Exhibits 4 and 5 below. This is intuitive because different underlying markets have varying cycles, meaning it is rare that all markets move up or down together. This is best evidenced by the more limited real estate price corrections observed in the aggregated Asia regional data versus North America and Europe, even as individual Asia markets have shown similar quantum of correction to the US and Europe[11].

Exhibit 4

Adding a Developed Asia Allocation Increases Risk-Adjusted Returns for U.S. Investors

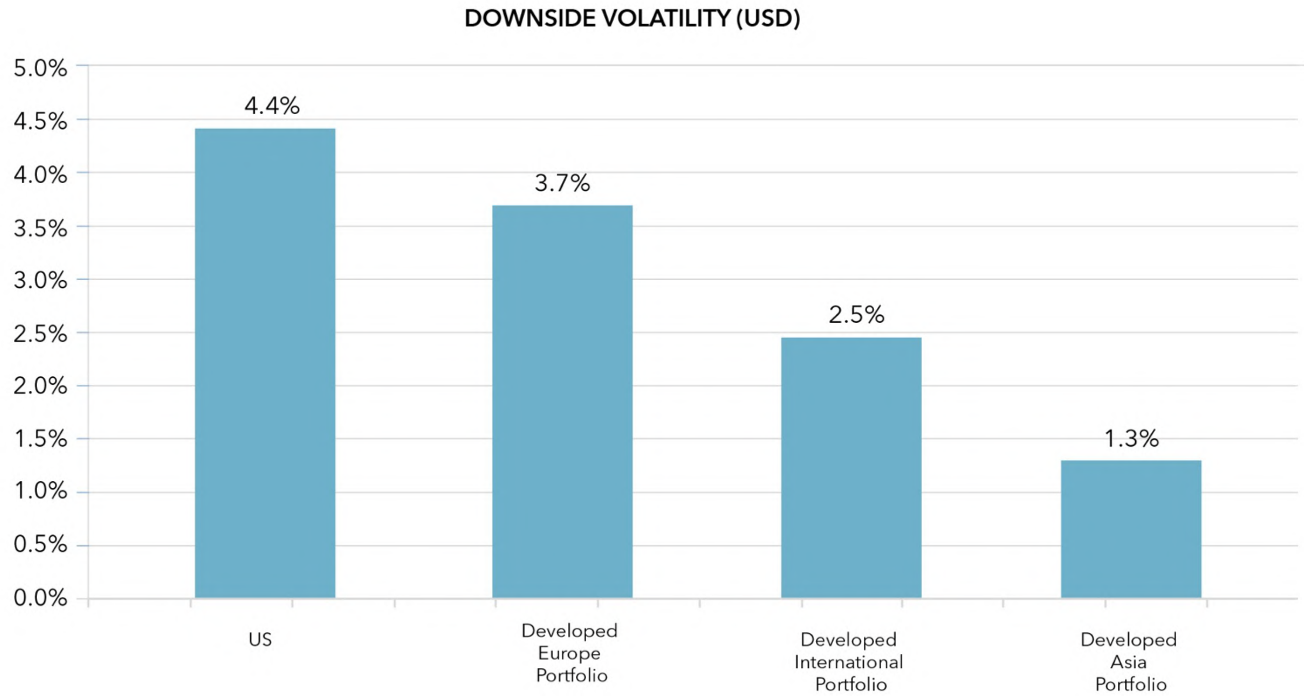


Source: MSCI, Hines Research. As of June 2023.

[11] Sources: MSCI, Hines Research. As of Q2023. Sources: MSCI, Oxford Economics, Real Capital Analytics, Hines Research. As of 4Q2022 as data is annual and 2022 is the most recent available datapoint. Covers period from 2001 to 2022 inclusive. The Developed Asia Portfolio includes Australia, Hong Kong, Japan, Korea, New Zealand, Singapore, and Taiwan. The Developed European Portfolio includes Denmark, France, Germany, Ireland, Netherlands, Norway, Spain, Sweden, and United Kingdom. The Developed International Portfolio is a combination of the two. All countries are combined using a weighting that is determined by the respective country market's share of total property market value (among the constituents of a global and ex-US portfolio), as estimated by Hines Research. Downside volatility is calculated using a methodology that looks at standard deviation only for negative returns, so is related to the measure of downside capture (how much a market moves down when it suffers declines.

Exhibit 5

A Developed Asia Portfolio Demonstrates Lower Downside Volatility Compared With That of Other Regions



Source: MSCI, Hines Research. As of December 2022 (latest data available).

Second, our analysis of MSCI data suggests the importance of diversification has grown, and it is growing in two dimensions: between regions (U.S. vs. Europe vs. Asia) and within the Asia region. This makes intuitive sense given the shifting global and intra-regional trade patterns highlighted earlier.

Key Takeaway:

Hines Research analysis suggests the diversification benefits of adding an Asia real estate allocation to other global real estate exposure are strong and growing. This allocation should provide investors exposure to assets with differing – and in some cases – less correlated, underlying demand drivers which could help boost risk-adjusted returns.

A Deep and Compelling Opportunity Set

The supportive growth profile and diversification outlined in the previous sections underpin a deep and compelling opportunity set. The broad scope of value-add opportunities fostered by secular growth trends both in traditional and alternative asset classes have been supplemented by resilient, low-volatility sectors with strong rental growth. We observe differing risk/return profiles from other global regions (and within Asia) with meaningful differences by sector (most notably office).

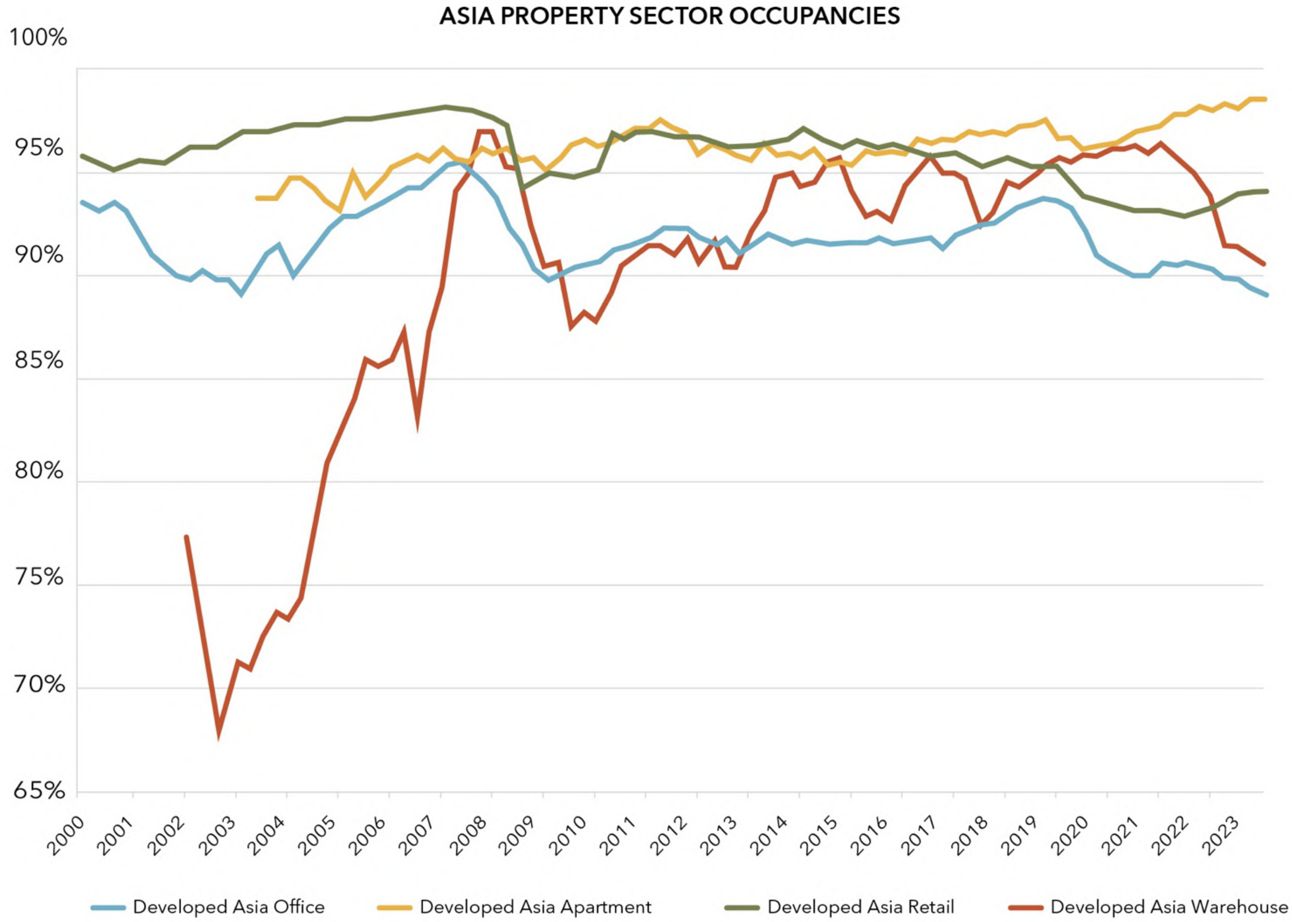
In aggregate, real estate fundamentals across Developed Asia have been positive. With healthy labor markets and unemployment at or close to record lows, real estate demand has been strong. As an example, Developed Asia office markets continue to exhibit positive momentum with trailing 12-month absorption (as of Q1 2024) improving for four successive quarters and reaching the highest level since Q2 2019, surpassing the long-term average[12]. New supply in the region has been broadly contained, with only a few market/sector combinations facing challenges presented by new development.

As an illustration, Exhibit 6 showcases the historical occupancy trends across Developed Asia's key property sectors: apartments, offices, retail, and warehouses.

[12] Source: JLL / Hines Research. As of Q1 2024.

Exhibit 6

Fundamentals in Developed Asia Have Been Strong



Past performance cannot guarantee future results.

Sources: JLL, CoreLogic, ARES, Hines Research. As of Q4 2023. Developed Asia includes Australia, Hong Kong, Japan, New Zealand, Singapore, and Korea. All of Asia includes China and India.

The retail sector is on an improving trajectory, aided by phenomena like post-pandemic revenge spending and a boost in tourism. The warehouse segment, however, even amidst high demand, has seen the sharpest rise in vacancies due to increased supply. As an example, the South Korean warehouse sector saw demand growth of almost 25% over the last year, but this was outpaced by a 40% increase in supply. Within this context, local expertise with the capability to identify sub and micro markets with the best underlying fundamentals is critical to delivering outperformance.

Rent Growth

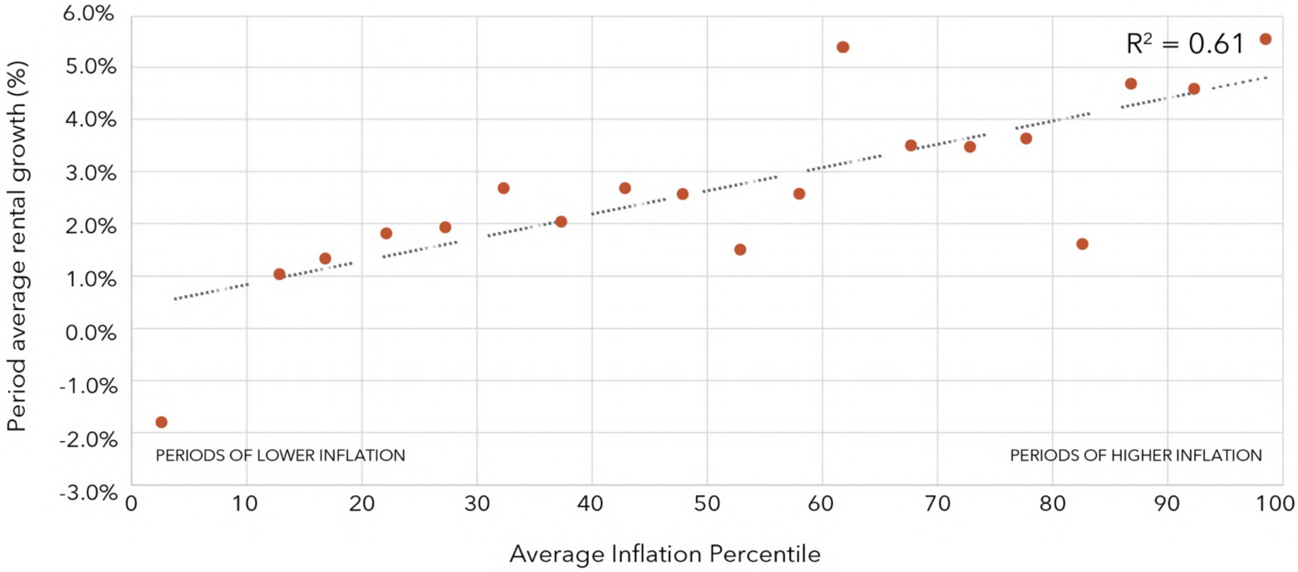
Regional rental growth remains robust. Our proprietary 5-year forward rent forecasts (based on long-term rent trends and fundamental demand and supply analysis) remain positive. Specifically, our rent growth projections for Developed Asia are double that of both the U.S. and Europe[13]. We have done considerable analysis on the evolving policies of global central banks in response to inflation. Based on the data, in our view it is likely that inflation will remain higher for longer than expected, allowing central banks to inflate their way out of current debt loads.

This will likely benefit Asian real estate due to rental growth acceleration. There is a very strong historical correlation (R^2= 0.77)[14] between trailing annual rent growth and inflation in Developed Asia. While this pattern is observable across the globe, as shown in Exhibit 7, the correlation in Asia is higher than the global aggregate. In other words, the relationship between inflation and rents is stronger in Developed Asia than for Europe or the U.S. At the same time, higher costs for developers (materials, insurance, labor, and financing) have significantly slowed the pipeline of new supply. Given this backdrop, there is some likelihood that our current growth forecasts will likely be further revised upward via further reductions in supply.

[13] As of Q3 2023.
[14] The R^2 is defined as the coefficient of determination (ranging as a value between 0 o and 1) that reflects the percentage of the variation of the model. The higher the number, the more correlation, with a value of 1 representing a complete correlation.

Exhibit 7

Global Real Estate Rents Have Historically Risen in Line with Inflation[15]



Source: Oxford Economics, JLL, CBRE, PMA, NCREIF, CoStar, Hines Research. As of Q3 2023.

Currency Impacts

Combined with the likelihood of long-term Asian currency appreciation against the U.S. dollar, we see positive tailwinds for real estate in Asia. As of year-end 2023, many Asian currencies were trading at significant discounts[16] to the dollar. Examples include Japan, China, India, Malaysia, the Philippines, Hong Kong, and Australia. While a strong U.S. dollar generally increases buying power in countries with the weaker currencies, this opportunity can be fleeting.

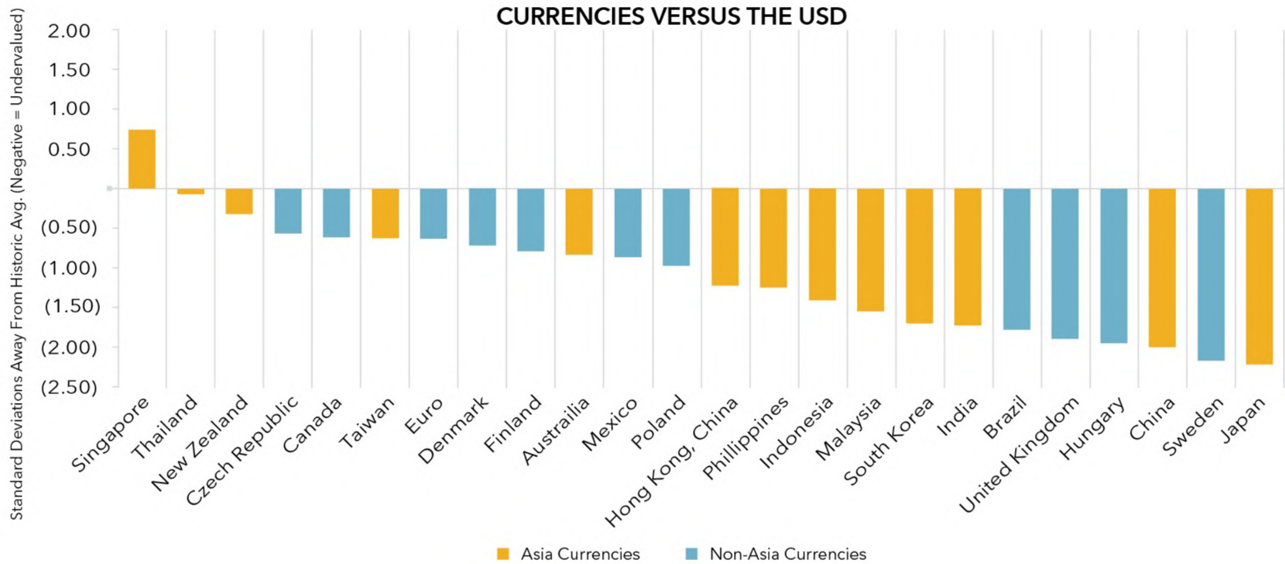
Historically, these discounts are mean-reverting and are likely to shrink and/or reverse to premiums. As shown in Exhibit 8, Hines Research calculated a basket of Developed Asia currencies versus the long-term trend. This currency basket, as of Q1 2024, was trading 20% beneath the long-term trend (Exhibit 9). As such, we believe investing on the back of a strong U.S. dollar may help make the case for Asia all the more compelling.

[15] Hines Research took country-level trailing annual inflation and scored each quarter's (normal distribution) against the country's own history. This was applied to all markets under coverage in Europe, Asia, and North America. All datapoints were bucketed into bands of 5 points (i.e., 0-5, 5-10, etc.). Then the trailing annual rent growth associated with each datapoint (each quarter for the market in question) was averaged for each band. The results are charted here or quoted in the table as shown by each blue dot. The period covered is from 1981 to present, though data availability differs by market. * R2 is a measure that indicates the proportion of the variance in the dependent variable that can be explained by the independent variables in a regression model. It provides an assessment of how well the regression line fits the observed data points. R2 values range from 0 to 1, where a higher value indicates a better fit of the model to the data. An R2 value of 1 indicates that all the variability in the dependent variable can be explained by the independent variables, while a value of 0 suggests that the independent variables have no explanatory power.

[16] Oxford Economics, Hines Research. As of Q1 2024.

Exhibit 8

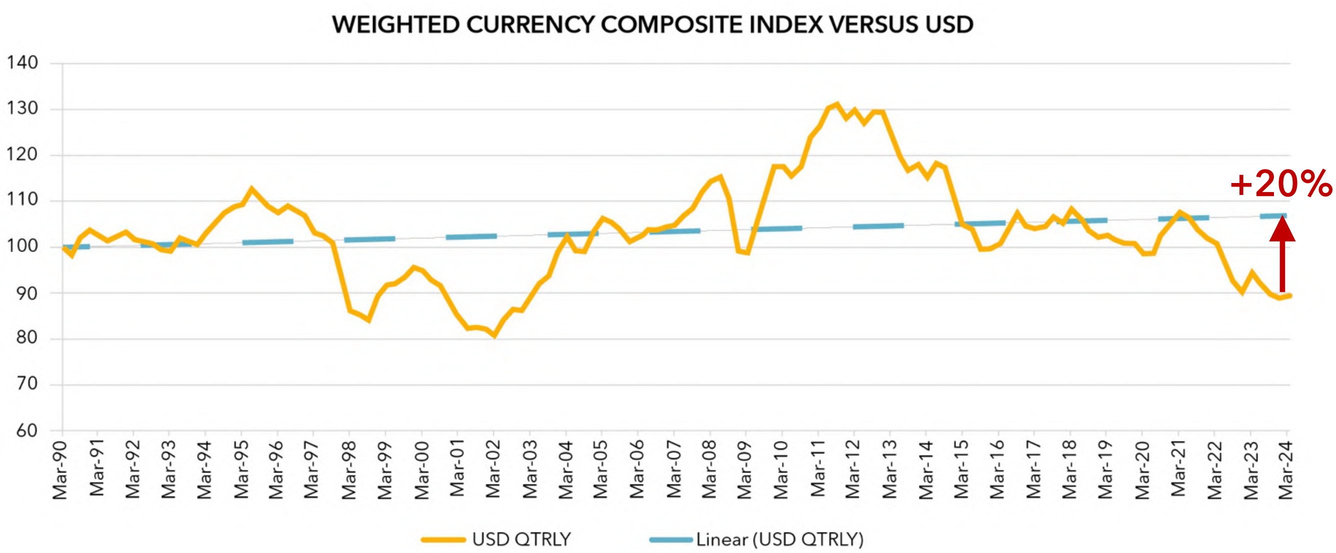
Asia's Currencies Are Trading at Discounts to Their Long-Term Average Exchange Rate with the USD



Source: Oxford Economics, Hines Research. As of Q4 2023.

Exhibit 9

Potential Upside over the Medium-Term as Currencies Revert to the Mean[17]



Source: Oxford Economics, Hines Research. As of Q1 2024.

[17] Based on Asia currency basket with weightings of: Australia 39.5%, Japan 26.6%, South Korea 18.6%, Hong Kong 15.3%.

A Closer Look at the Region's Major Sectors

OFFICE: WORK FROM HOME (WFH) DISTORTIONS HAVE ABATED

While some countries have experienced these distortions more than others, the COVID-related work from home revolution never really caught on in Asia. By the end of 2023, the level of employees returning to the office full-time[18] had surpassed 80%, significantly higher than Europe and about 30 percentage points above the U.S. Office absorption rates reflect this trend. These have been positive for three consecutive years[19], and in our view, available space will likely remain in demand.

APARTMENTS

Compared to (for example) the U.S., the Asian apartment market is fairly small. Nonetheless, average occupancy has equalled or exceeded 95% since the global recession over 15 years ago, with some areas (such as Japan and Australia) doing even better[20]. Build-to-rent is now a focus in Australia, with considerable development needed (and underway) based on demand.

INDUSTRIAL AND LOGISTICS

The industrial sector in Asia remains healthy by our measures, and based on supply chain reorientation and e-commerce trends, more growth is likely. Based on an in-depth analysis, we have discovered that once e-commerce penetration rates reach 10%, warehouse rents accelerate as more facilities are sought for packaging, shipping, and return processing. The U.S. reached this point back in 2013, with Europe and Asia breaking through this level around 2018 and 2019, respectively. Rents subsequently accelerated in all three regions, but with Asia last to reach 10%, we believe its rent growth has longer to run. Our estimates suggest that if Asia matches the e-commerce trajectory in the U.S. and Europe, rents could rise by 21%[21] over the next few years.

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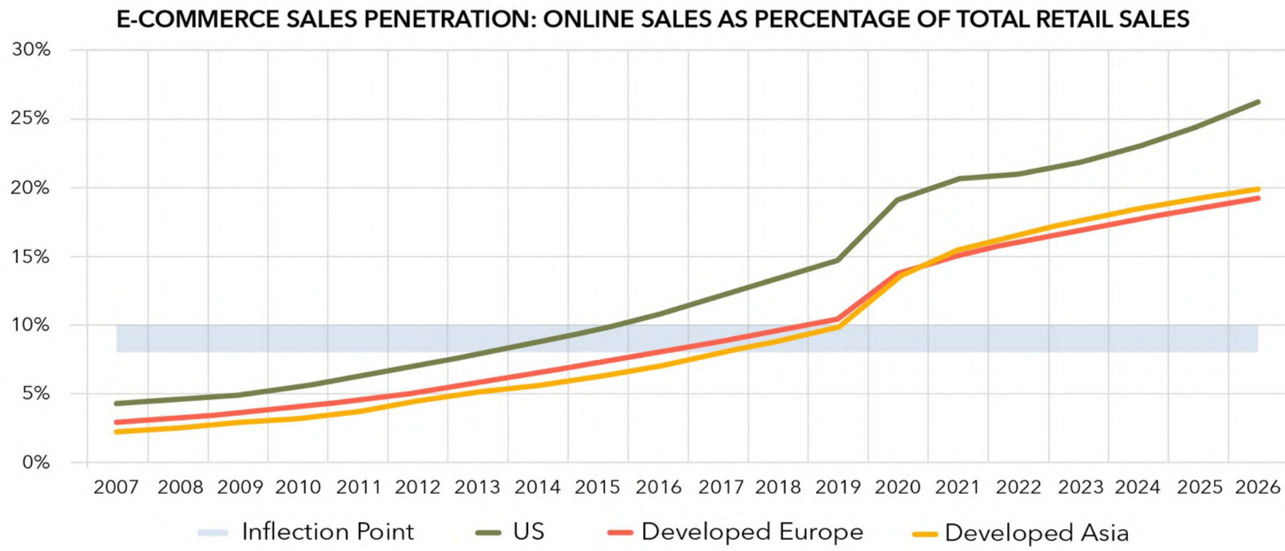
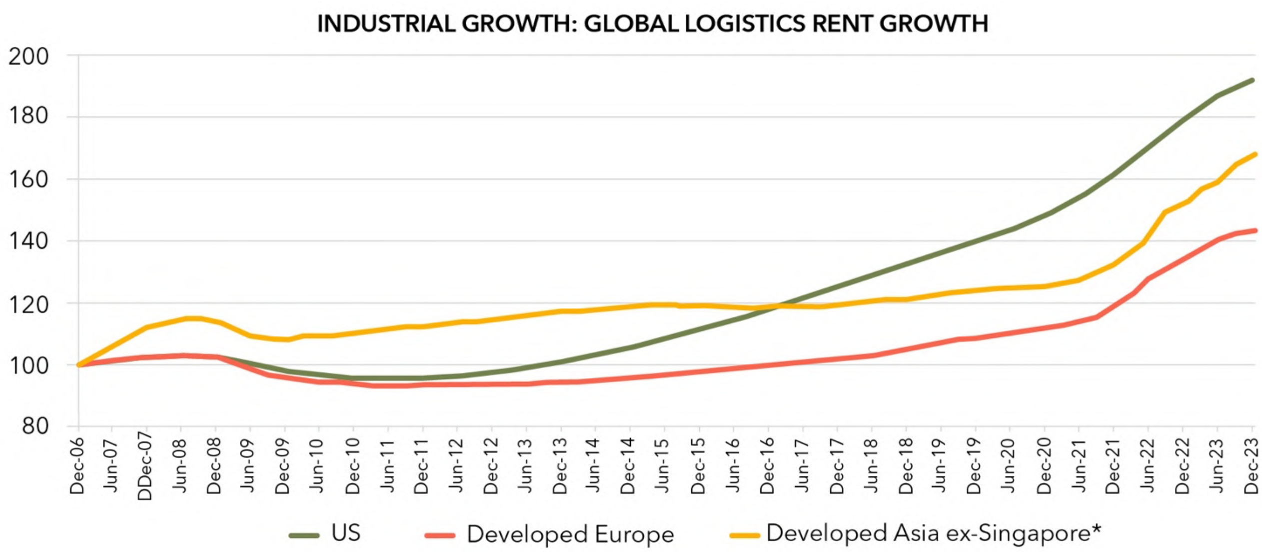
[18] JLL Research, Hines Research. As of Q4 2023. These are based on survey results led by JLL Research.
[19] JLL, CBRE, Hines Research. As of 3Q2023. Asia markets include only the developed economies of Australia, Hong Kong, Japan, Singapore, and South Korea.
[20] Sources: JLL, CoreLogic, ARES, Hines Research. As of Q4 2023. Developed Asia includes Australia, Hong Kong, Japan, New Zealand, Singapore, and Korea. All of Asia includes China and India.
[21] Euromonitor International, JLL, CBRE, PMA, CoStar, NCREIF, Hines Research. As of Q3 2023.

Exhibit 10

E-commerce as a Driver of Warehouse Rent Growth





Sources: Euromonitor International, JLL, CBRE, PMA, CoStar, NCREIF, Hines Research. As of Q4 2023 but using annual data for online sales penetration which starts in 2006 for the chart above. The period of 2023 and onwards are forecasts per Euromonitor.
*Singapore is excluded as its rent growth had a uniquely sharp increase in 2007 that skews the Asian line upwards inappropriately.

RETAIL

In Asia, retail has followed the global trend of improving fundamentals. Based on our proprietary data, after bottoming in mid-2021, Asian retail seems to be on the path to recovery. In fact, based on our proprietary scores which measure the health of leasing markets, Asian retail has been on a sharp upward trend since mid-2021. This is consistent with data showing that despite recent weakness, more than half of developed global retail markets are predicting positive rent forecasts.

Key Takeaway:

We see a broad array of opportunities in all sectors, with robust rent growth forecasts in the Asia region supported by strong fundamentals and limited new supply. Our work on the strength of the historic relationship between rent growth and inflation in Asia suggests the potential for upgrades in our rent forecasts, should supply be further constrained due to persistent construction cost inflation.

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[22]) 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.

[22] 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

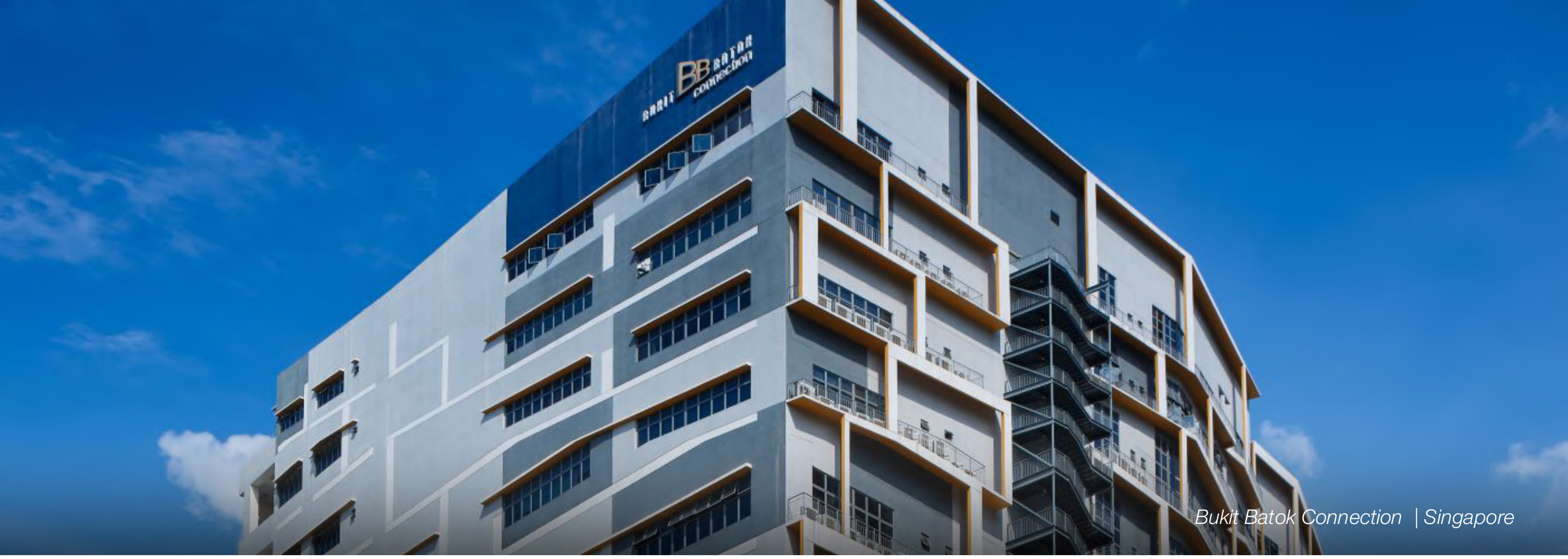
By using our proprietary fundamental and pricing analysis, we can identify meaningful differences in value across asset classes and markets. The strength of capital demand for residential assets, underpinned by attractive fundamentals (and risk-aversion among investors), is currently supporting prices. 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.


Bukit Batok Connection | Singapore

Summary

The Case for an Asia Real Estate Allocation

When considering real estate investments in 2024 and beyond, it is important to remember that there are hundreds (if not thousands) of markets worldwide. Hype and headlines may impact sentiment in each, but in our opinion fundamentals ultimately drive long-term pricing.

With that in mind, we believe that fundamentals are pointing in a positive direction in Asia. Estimates of future economic growth in both Developing and Developed Asia are double that of the rest of the world, and the possibility of more stubborn inflation could provide a further boost to rent growth.

The region has become wealthier, more resilient, and increasingly likely to look inward when conducting business. These developments have reduced the market correlation between Asia and the U.S./Europe, increasing its value as a diversification play.

And perhaps most importantly for investors, the confluence of these trends is occurring in a market that has experienced price adjustments, particularly in USD terms, at a time when factors like financing availability and general risk aversion may be reducing competition in the region. We believe this environment is creating opportunities across the region as this cyclical reset concludes.

At Hines, we believe we have the knowledge and resources to take advantage of these market conditions and acquire quality projects that can help deliver long-term value for investors. In addition, our deep local presence enables us to be nimble, identify the right assets, capitalize on market dislocations to access attractive deals, and to seek to optimize value through active management.

About Hines' Proprietary Research Team

JOSHUA SCOVILLE
Head of Global Research,
Hines

TIM JOWETT
Managing Director, Asia Research
Hines

Joshua Scoville and his team, including Tim Jowett, Managing Director, the lead author on this paper, are responsible for constructing the Hines macroeconomic view and outlook for commercial real estate market fundamentals and pricing. Hines Research is also responsible for assisting with the development of investment strategies for the firm's investment programs; working closely with the local and fund management teams, clients and partners; and supporting U.S. regional and international country heads in identifying market/submarket opportunities and risks. The views of the local and fund management teams on the latest market developments are exchanged regularly via biweekly conference calls and quarterly market updates and are essential for reviewing investment strategies and fund portfolio allocations.

Additional members of Hines' Proprietary Research team include Michael C. Hudgins, Ryan McCullough, James Purvis, Erik Thomas, Michael Spellane, and Anthony Witkowski.

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