A demographic future

How ongoing structural shifts fuel value-added opportunities across the Asia Pacific region

by Skip Schwartz

For investors seeking value-added exposure in their real estate portfolios, the Asia Pacific region offers an attractive array of investible structural trends. The region — for this article, Asia Pacific typically includes the markets of Japan, South Korea, Hong Kong, Singapore, Australia, New Zealand and China — is in the midst of an era of unprecedented demographic change and technological disruption. China's emergence as the world's largest consumer society, the rise of Asia Pacific millennials and their still-underserved preferences, and steadily increasing market transparency are all examples of secular trends that should persist, even through a downturn.

Given secular trends, we have identified five value-creation strategies that may shape real estate markets in Asia Pacific over the coming decade.

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We have identified five of the region's most impactful transformations, the potential effects on local real estate, and how value-added investors might capitalise on these long-term, structural shifts.

- Generational shift: In 2020, millennials will comprise 35 percent of Asia Pacific's working population and become the world's largest consumer group by income. Millennial preferences are disrupting every real estate sector in these markets. Their parents' generation is likewise ageing into a new stage of life, requiring institutional services only now emerging in the region.
- Wealth expansion: GDP per capita in Asia Pacific gateway cities already ranks high on a global basis. Growth is still forecast to outpace most of the United States and European Union, spurring demand for higher-quality offices, housing, recreational space and shopping areas.
- Urbanisation: Oxford Economics forecasts the urban population in the Asia Pacific region will increase by another 200 million residents over the next decade — a pace of 20 million per year, mainly through migration, effectively generating an entire urban megalopolis each year. These new city dwellers will need places to live, work and play. New infrastructure projects are transforming neighbourhoods and expanding capacity.
- Online consumption: China and South Korea have already surpassed the United States and EU in online retail sales and mobile-payment penetration. Other Asia Pacific countries are fast catching up. E-commerce will continue to grow as companies seek to offer better and faster services. This will require investment in state-of-the-art distribution centres, and the reconceptualisation of traditional retail as part of a larger omnichannel ecosystem.
- Transparency and liquidity: Asia Pacific has steadily climbed the ranks of JLL's Global Real Estate Transparency Index and has grown to represent a full 30 percent of the global investible universe, according to MSCI's *Real Estate Market Size 2018* report. This improvement precipitates a virtuous cycle as data quality and regulation improve, resulting in more investments.

Given the above secular trends, we have identified five value-creation strategies that may shape real estate markets in Asia Pacific over the coming decade.

1. Office: creative urban centres

The Asia Pacific office landscape is undergoing secular changes in both geography and function. In terms of geography, Asia Pacific occupiers are increasingly willing to lease space outside of traditional CBDs in pursuit of high-quality amenities at lower rents. CBRE's *Asia Pacific Occupier Survey 2018* found take-up in Asia Pacific CBDs fell to only 20 percent of all take-up over the year, as absorption shifted to near-CBD zones and emerging centres. Value-added investors could benefit from investment in new, accessible urban centres outside of traditional CBDs and by upgrading amenity packages to align with the changing preferences of occupiers.

Though part of this geographical disruption is cyclical — expensive CBDs are a factor — it is also secular. Traditional office space per capita is shrinking. Work environments are becoming less formal, and amenity-rich, culturally vibrant atmospheres are in demand. New office-leasing demand is now substantially driven by creative tech, media and flexible-space providers. Tech and media companies will likely continue to out-absorb traditional occupiers as consumer technology plays an ever-increasing role in daily life and millennials achieve their peak spending potential.

2. The living sectors: moving up, moving out

Though institutional markets for these sectors are still shallow in much of Asia Pacific, we believe demographic trends will render living-sector growth inevitable over the coming years. Investment in build-to-rent multifamily, co-living, senior housing, and student housing could drive value-added returns, especially as the sector matures and attracts the attention of larger capital sources.

The living sectors' lack of institutional stock, as well as low implied apartment yields, indicate a build-to-rent strategy or heavy conversion is currently the primary way to access most Asia Pacific markets and meet value-added returns. The demographic drivers behind multifamily, student housing, aged care, and co-living are too stark to ignore, however.

3. Logistics: anything, anywhere, anytime

Logistics is hot across the world, and Asia Pacific is no exception. The structural drivers supporting the sector in the region will likely persist over the long term. Refurbishment of older logistics facilities near major transport corridors and population centres could provide one avenue to access the sector. Given the lack of existing stock, however, development or turnkey acquisitions may be necessary.

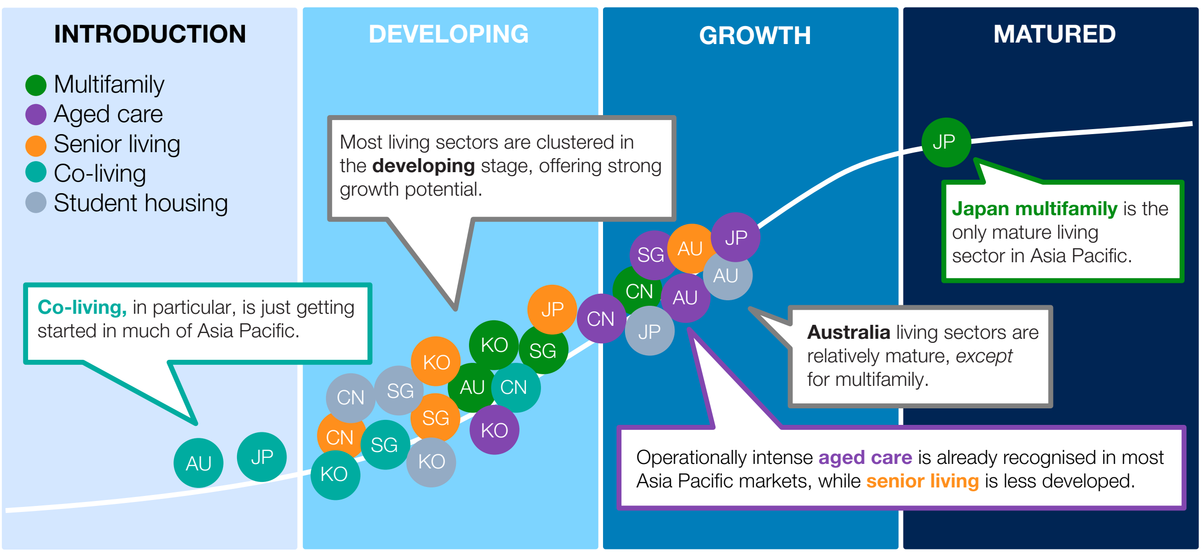
In many ways, the Asia Pacific region is already a leader in e-commerce. As previously mentioned, China and South Korea boast online retail sales penetration above that of the United States and the United Kingdom. Third-party logistics companies are still expanding, even as some large retailers also enter the leasing market to take better control of their supply chains.

The region lags other developed areas of the world, however, in terms of stock. Developers are now racing to meet the sector's considerable demand. In Tokyo and Seoul, 2019–2020 logistics development is expected to amount to almost 30 percent of 2018 stock, with new projects announced regularly. On Australia's Eastern Seaboard, total quarterly supply routinely surpasses 10-year averages. Despite these impressive supply figures, new stock is largely pre-leased when delivered. In all markets, cutting-edge fit-outs, large floor plates, capacity for automation, and last-mile solutions are in high demand.

4. Self-storage: Wrap it, pack it, sell it

Self-storage market fundamentals, such as rising incomes and population density, as well as insufficient stock per capita, support market growth in Asia Pacific. Given ample investor interest in the sector, its gradual maturation in Asia Pacific, demonstrated success in the United States and Australia, and supportive macroeconomic fundamentals, self-storage in Asia Pacific presents an opportunity for investors to capture structural growth.

Asia Pacific living sectors market maturities by country, 2019



Note: Hong Kong is not shown but is generally in line with China. "Senior living" refers to retirement communities, while "aged care" facilities have a more-active nursing component.

Sources: JLL's 2019 The Living Sectors, *Heitman Research*

The sector is trending toward institutionalisation. Australia and Singapore already have significant institutional presences. The Singaporean market saw a landmark deal in early 2019, when Warburg Pincus acquired CapitaLand's StorHub platform and its 12-facility, 800,000-square-foot (74,322-square-metre) portfolio for S$180 million (US$131 million) and an estimated cap rate of approximately 6.00 percent to 6.75 percent. In Japan, local listed operators launched modest investment funds of less than US$50 million in 2018, with others planning to follow suit. In Hong Kong, South Korea and China, global private equity firms are seeding investments in local platforms. In all markets, operational expertise and alignment are key drivers of success.

Similar to the maturation of the sector in the United States and Europe, value-added investors could reap the benefits from aggregating or creating local portfolios of self-storage assets, stabilising them, and marketing them to institutional buyers. A self-storage allocation serves three important functions in a value-added portfolio: yields exceeding those of traditional assets by up to 100 basis points, which can help shore up portfolio returns in a low-yield environment; defensive operational characteristics, which can support income even during a market downturn; and portfolio diversification, helping to reduce volatility and overconcentration.

5. Retail: clicks, bricks and the omnichannel ecosystem

There is no question the traditional retail market is facing headwinds. In the United States, Green Street Advisors estimates about 1,000 regional malls currently operate across the country. Only half are expected to survive the decade. The remainder will be shuttered or repurposed. Retail properties in some Asia Pacific markets are now feeling similar stress.

A creative value-added investor could benefit from repositioning both suburban retail centres and urban high-street shops. Suburban retail will likely require heavy repositioning and at least partial change of use. Valuations have already started to fall in Australia, and other markets could follow. This could present acquisition opportunities, especially for assets in good catchments that could benefit from a change of use. Urban retail, for instance, could present value-added opportunities in the back streets of growing shopping districts. This is especially true for areas benefitting from Asia Pacific's burgeoning tourism industry. Refurbishment opportunities should be present, especially given trendy urban retail will continue to play an important role in an e-commerce ecosystem, offering event spaces, Instagrammable experiences, and pop-up shops.

In summary, Asia Pacific's story of unmatched growth, urbanisation and demographic change renders the region fertile ground for strategic value-added execution. For risk-conscious investors in particular, a value-added strategy offers an opportunity to participate in the region's secular transformation, while still enjoying the stability granted by a foundation of income. ❖

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