Private Markets

September 2024

APAC Real Estate:
Growth without added risk

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Asia Pacific Value Add Real Estate

BlackRock Real Estate Research and Strategy – September 2024

Key Takeaways

1. Growth without added risk

- Access the region's prosperity and global influence, without taking emerging market risk.
- Allocate to the most transparent and liquid markets such as Australia, Japan, Singapore and New Zealand.

2. Diversification benefits

- APAC markets have low return correlations with other global markets.
- Global portfolio construction must include an allocation to APAC markets.

3. Cyclical and structural opportunity

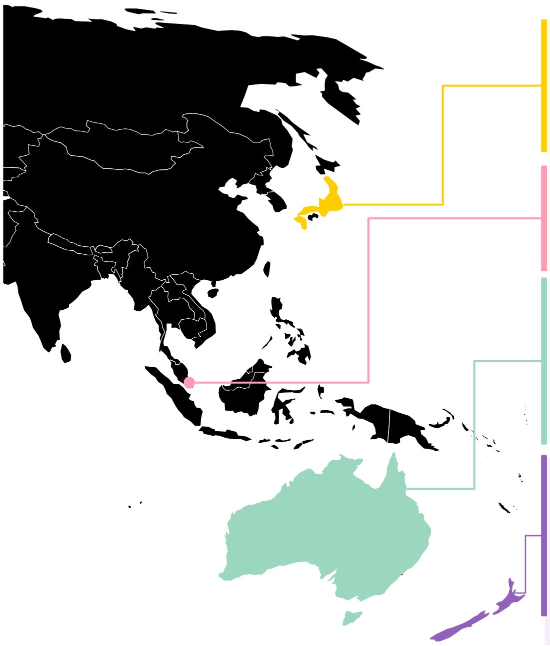
- Repricing creates a compelling cyclical opportunity.
- Changing needs from the built environment drive the structural opportunity for investors.

4. Capturing the APAC lag

- Winning strategies in the US and Western Europe are nascent in the APAC.
- To implement this strategy, local knowledge allied with a global footprint is critical.

Why Asia Pacific? Large and Investable

Figure 1: APAC Market



Tokyo

- Greater Tokyo population is largest in the world, sitting at 37M
- Ranked 2 globally for city innovation

Singapore

- Largest trading port in the World
- Third wealthiest country per capita globally

Australia

- Highest forecast population growth in OECD till 2030, with population growing at an average of 1.5%pa.
- Expanding trade surplus fueled by strong growth in commodity exports

New Zealand

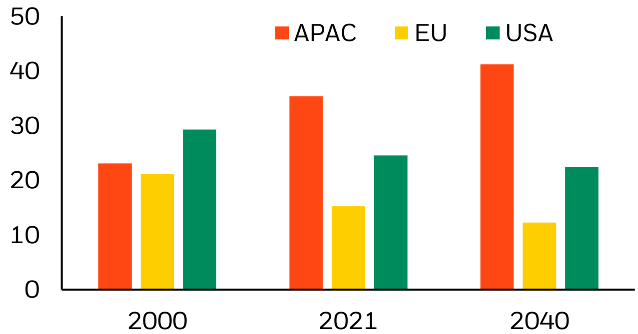
- Ranked 8th in the world as an attractive place to do business
- Aukland contributes 38% of GDP and one third of population

Source: Eurostat, Datareportal, Tataki Auckland Unlimited, Oxford Economics, September 2024.

The Asia Pacific (APAC) region today offers investors a compelling opportunity to benefit from its strong economic momentum, increasing global influence, demographic advantages and idiosyncratic country level characteristics. There has been a rebalancing of the global economy over recent decades, whereby the APAC region plays a critical role in the global growth story, accounting for over 52% of global GDP growth in the decade to 2023. As shown in Figure 2, APAC GDP currently accounts for 36% of world GDP and is projected to increase to 41% by 2040[1].

[1]S&P – The Ascent of APAC in the Global Economy as at September 2024

Figure 2: % Share of World GDP



Source: Oxford Economics Forecasting, 6 August 2024. **Forecasts may not come to pass.**

Investing in APAC does not equate to increasing risk-taking. By focusing on the most transparent and liquid countries, strong risk adjusted performance can be delivered. Australia, Japan, Singapore and New Zealand are countries where these opportunities can be accessed. Without investing directly into the large (and riskier) engines of growth that are India and China, real estate investors can allocate into the less-volatile markets which benefit from 'being on the doorstep' of these economies. Given the pro-cyclicity of real estate, investing in regions predicted to show robust growth contributes to long-term resilience.

Figure 3: Transparency Rank

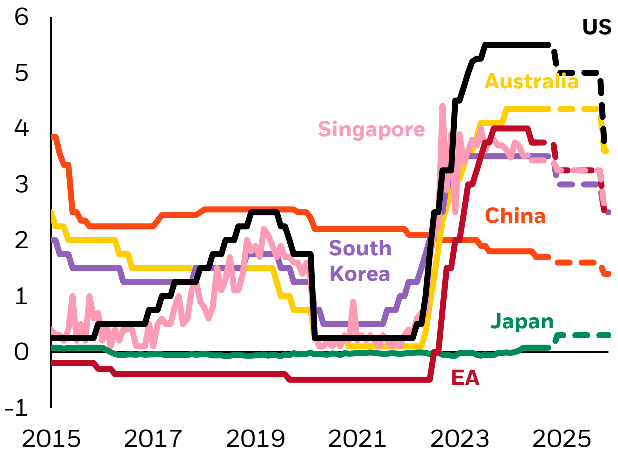
Level	Global Rank 2024	Market
High	4	Australia
	7	New Zealand
	11	Japan
	13	Singapore
Transparent	15	Hong Kong SAR
	27	South Korea
	30	China
	31	India
Semi	49	Vietnam

Source: JLL, China and India refer to Tier 1 I c Sept 2024

Investing into transparency. A misconception may exist that APAC is a higher-risk investment destination, but analysis shows that this is misleading. Figure 3 shows the 2024 JLL Transparency index, which provides an extensive analysis of real estate market transparency and liquidity. APAC continues to advance in terms of liquidity, transparency and governance recording the strongest average transparency improvements since 2022[2] .

For example, Australia, Japan, Singapore and New Zealand are ranked as 'highly transparent'. JLL notes that this top set of 13 'highly transparent' countries has attracted over US$1.2trillion in direct commercial investment over the last two years, over 80% of the global total. These countries are positioned to lead the cyclical recovery in liquidity as capital market activity increases.

Figure 4: Policy Interest Rates (%)



Source: National Statistical Agencies, Capital Economics, 16 September 2024

Benefitting from diversity. The APAC region is more heterogenous than markets in the US or Europe. Investors can diversify away single drivers of risk by exposing to a range of macroeconomic environments and demographic profiles. For instance, despite the recent rate increase, Japan maintains its relatively accommodative monetary stance whilst in Australia and New Zealand, sharp interest rate hikes over the past 18 months have created a cyclical repricing opportunity like that observed in Europe and the US (Figure 4).

Global investors can further diversify specific market risk by including an allocation to APAC in their portfolio construction. As highlighted in Figure 5, we observe low correlations in returns with other major economies.

Figure 5: APAC 15 year total return correlations

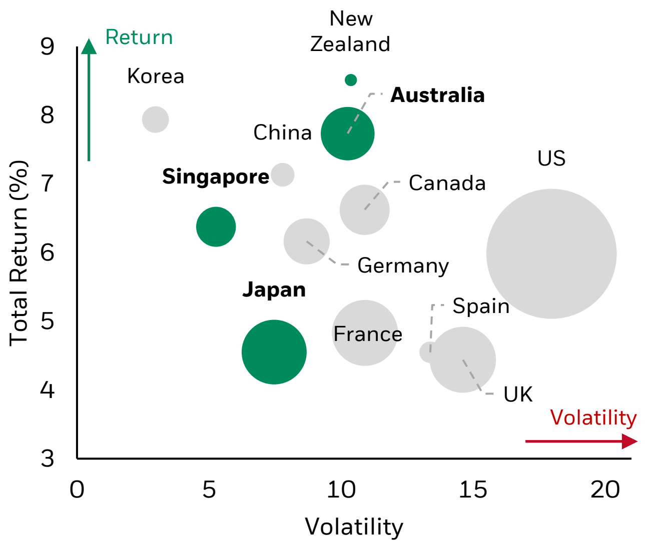
	UK	US	Canada	Europe	Japan	Australia	Singapore
UK	1.00	0.73	0.66	0.87	0.26	0.60	0.29
US	0.73	1.00	0.85	0.78	0.55	0.80	0.71
Canada	0.66	0.85	1.00	0.74	0.38	0.87	0.63
Europe	0.87	0.78	0.74	1.00	0.50	0.52	0.25
Japan	0.26	0.55	0.38	0.50	1.00	0.21	0.40
Australia	0.60	0.80	0.87	0.52	0.21	1.00	0.74
Singapore	0.29	0.71	0.63	0.25	0.40	0.74	1.00

Source: MSCI Annual Property Indexes (Unfrozen; Weighting: Market Size) published Annually (Standing Investments), 31 December 2023. NCREIF, 31 December 2023. Main city returns used as a proxy for country.

[2] JLL Transparency Index 2024, as at September 2024

Figure 6 shows that APAC portfolios typically exhibit stronger risk adjusted returns due to lower cyclical volatility.

Figure 6: Total Return vs Volatility



Source: MSCI Annual Property Indexes (Unfrozen; Weighting: Market Size) published Annually (Standing Investments), Standard Deviation as a proxy for volatility, 15-year returns, 31 December 2023.

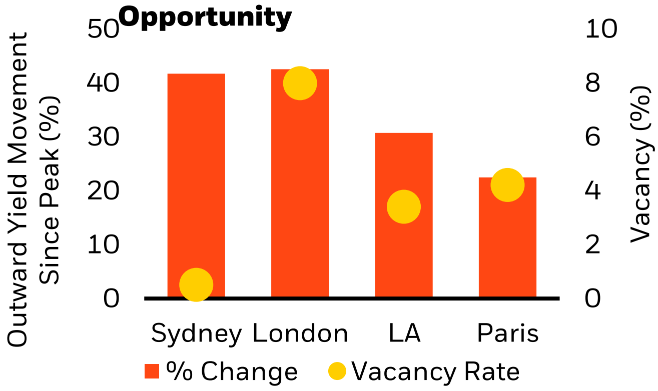
Unlocking Value Add

In APAC, investor preference has shifted towards value-add strategies. Recent surveys show it is now the preferred investment style for 63% of investors in 2024, up from just 33% last year[3]. Value add is a compelling strategy at this stage in the cycle given the ability to deliver both income and capital gains within an acceptable level of risk. Investors have the opportunity today to benefit from the cyclical upside whilst aligning their strategy to structural trends that will drive strong future performance.

The repricing we have observed today has created one of the most attractive buying opportunities since the GFC. The post-COVID era and the subsequent inflation spike is characterized by uncertainty in the wake of elevated debt costs, limited price transparency and illiquidity across the globe. Repricing creates a compelling entry point for the skilled investor as refinancing pressures increase distress driven opportunities with fewer competitors in the current market. Repricing is not consistent across the region with some sectors/markets experiencing much more significant value declines. For example, markets such as Japan are not expected to reprice significantly, however cyclical markets namely Australia and New Zealand are repricing just as much or more than other global markets.

As shown in Figure 7, the repricing in Sydney logistics has been as significant as that observed In London and more significant than markets such as LA and Paris. A clear difference however is how robust and attractive fundamentals remain, as highlighted by record low vacancy rates.

Figure 7: Logistics Repricing Opportunity



Source: Yield Movement Sep 22 to Jun 24, Sydney Vacancy and NIY, JLL, London MSCI, Paris MSCI and CBRE, LA Cap Rates MSCI, as at 4 Sep 2024.

Unlike other cyclical downturns, fundamentals in APAC have remained robust. Real estate returns in APAC sat at 4% last year whereas returns remained negative in both Europe (-3.1%) and the US (-7.3%)[5]. This can be attributed to the strong fundamentals and the different cycles playing out across the region. For example, Japan's accommodative monetary environment creates a distinctly different environment for real estate investors today. A value correction combined with a healthy occupier market supports our view that today marks an attractive cyclical opportunity for market entry, particularly in Australia and New Zealand.

For example, the Sydney last mile logistics market exhibits very attractive fundamentals. Vacancy rates are currently at 0.5%, which is the tightest vacancy reported in any city across the globe[6]. Rental growth has been robust and is forecast to increase further given that there is low supply, and no more expected to enter the market in the near term. This is due to continued upward pressure on construction costs alongside potential higher and better uses for the land, namely as residential or data centres.

Another example is the Japanese residential market, where condominium values are high, and this lack of affordability is driving increased demand for rental housing. Migration into select major cities continues to trend upwards. These factors are driving low availability in the key cities, with vacancy moving in circa 200bps to around 1.5% since the pandemic[7]

[3] CBRE Investor Intentions as at September 2024
[4] MSCI as at September 2024
[5] MSCI Asia, Europe, US Annual Property Index. As at September 2024
[6] CBRE as at September 2024
[7] CBRE Key cities: Tokyo 23 Wards, Nagoya, Osaka. 2020-2023

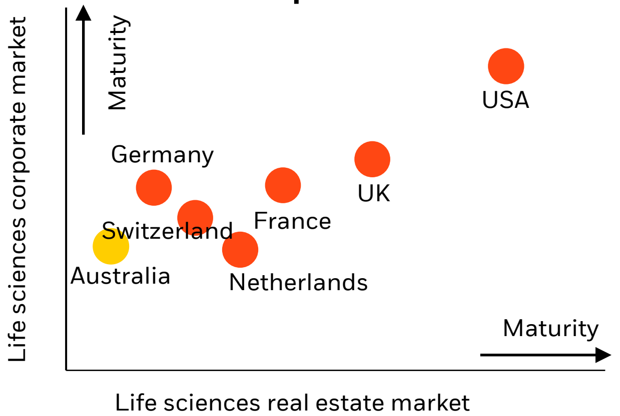
Benefiting from the APAC lag. Emerging sectors in western markets that have evolved into mature investment sectors over the past cycle, are yet to fully play out in APAC. Informed investors can build strategic conviction around such sectors, benefiting from early-mover advantage.

For example, investor allocations to life sciences have grown significantly in both the UK and US in recent years. European Investor intention surveys showing that one third of investors are pursuing alternatives are focused on life sciences[8]. As the sector has matured life science rents have settled at circa 40% premium to A-Grade office. These levels are justified by the supply demand imbalance[9].

Australia is recognized as a global leader in medical technologies and pharmaceuticals, with considerable public and private finance targeting the sector. Yet the life sciences real estate sector remains in relatively early stages with limited supply of vacant space to purchase often cited as a barrier to entry for private capital. This is not the case and there is an established presence of laboratory assets in life sciences clusters around Australia.

We believe that we will see the sector follow a similar growth trend to that we have observed in the UK and US. This would enable investors to capitalize on early mover advantage in a low-risk manner by purchasing existing high-quality assets and take advantage of the "APAC lag" as the market matures into an institutional sector.

Figure 8: Life Sciences Corporate & Real Estate Market Development



Source: JLL, August 2024

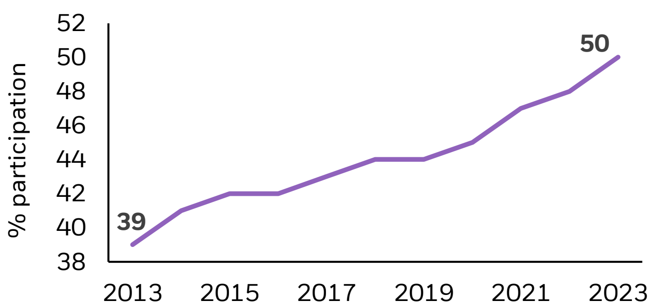
Capitalizing on structural shifts. We believe this cycle will be different. Investors need to have an acute understanding of the big structural trends which will drive value and income security in the next cycle. The APAC market is well positioned to benefit from these shifts.

One of the key mega-forces is demographics. In western economies, population dynamics are often a headwind to growth with an ageing demographic.

In contrast, the growing, younger population in Australia and New Zealand, combined with healthy net inward migration will bolster demand for all types of real estate. Benefitting residential property and adjacencies such as self-storage in the key cities.

Australia's younger and growing population, allied with more women re-entering the workforce, has created a high conviction for the childcare sector. As highlighted in Figure 9, the childcare participation rate continues to grow, widening the supply/demand gap. Institutional investors are being attracted to the sector's similar characteristics to social infrastructure, securing long, inflation linked leases with government subsidized income. A valid value add strategy would be to partner with developers to build a large diversified portfolio of these assets for future institutional ownership.

Figure 9: Australian Childcare Participation Rate (%)



Source: Federal Australian Government Data with broker reports, CBRE & JLL findings as at September 2024

The implications of the energy transition are becoming increasingly important across all sectors. Regulation is evolving across the region, which will increase demand for compliant space, of which there is currently a shortfall. According to JLL estimates, 40% of APAC office space is currently in need of refurbishment, representing some US$400 bn in value-add potential.

Similar to Europe, we expect to see a green premium emerge in not only the office sector, but also in logistics and residential, as regulation becomes more stringent, and occupiers become more environmentally aware. Studies from various markets point to higher rents for green buildings, with rental premiums of 10-20% often cited[10] for offices and exit yield premia as core investors increase their science-based target commitments.

[8] CBRE Europe Investor Intentions as at September 2024
[9] CBRE , Savills, MSCI 2023
[10] PMA June 2022 as at September 2024

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