Executive Summary

With the year drawing to a close, we turn our attention to the outlook and identify the major occupier and investment trends that we expect to influence market conditions and investment performance in 2020 and beyond.

In the Asia Pacific region, we identify three region-specific trends that reflect opportunities to benefit from diversification by strategy and geography.

1. Occupier Demand to Moderate: Weaker economic growth points toward softer real estate demand in 2020, although net absorption of office and logistics space should remain positive.

2. CBD Affordability Becoming Stretched: Affordability is being stretched in the central business districts (CBD) of major cities, pushing occupiers toward cheaper submarkets and driving non-CBD rental growth.

3. Logistics Demand Supported by Online Growth: Logistics has become more closely aligned with the consumer cycle, while rising online spending points to significant growth in space requirements.

These region-specific trends, alongside our four key global trends, are set to have a significant aggregate impact:

1. More Employment Growth to Come: The current cycle continues to be driven by employment rather than productivity, while the stable outlook for global GDP growth points to another year of steady real estate returns.

2. Low Supply Environment Persists: The ongoing low supply environment continues to support prospects for rental growth, enhanced by a strong link with employment growth in the current cycle.

3. Further Scope for Yield Compression: Past interest rate increases have been weighing on real estate pricing, but the shift toward looser monetary policy paves the way for further yield compression in 2020.

4. Cross-Border Flows Weakening: Cross-border investment flows are weakening in the Americas and Europe, reflecting a wider slowdown in trade liberalization. Asia Pacific is bucking the trend.

In this excerpt we review the Asia Pacific trends in detail.
Among the major regions, Asia Pacific is in the midst of the most substantial slowdown in demand, although pricing, as in other regions, continues to be supported by low interest rates. Asia Pacific is set to attract further capital flows in 2020, notably as cross-border investment activity is holding up.

But while overall rates of economic growth look attractive in a global context, concerns about the outlook for trade, manufacturing and exports are feeding into a sense of uncertainty.

Employment continues to grow but density is rising and space absorption is slowing. CBD affordability is looking stretched and cost-conscious occupiers are increasingly turning to less expensive submarkets to meet requirements.

However, there are still pockets of growth potential across the region. Notably, logistics demand is growing at pace, despite slowing demand from the manufacturing sector, owing to the ongoing expansion of online retail requirements.

**Asia Pacific Trend 1: Occupier Demand to Moderate**

Weaker economic growth points toward softer real estate demand in 2020, although net absorption of office and logistics space should remain positive.

Economic growth momentum is softening across the Asia Pacific region, linked to weaker export demand, ongoing global trade tensions, and a global industrial production slowdown.

In an uncertain environment, firms are cutting back investment and delaying expansion decisions, actions that have a direct impact on real estate demand. The OECD’s leading indicator of economic activity, which has demonstrated a strong correlation with commercial real estate absorption through the current cycle, has fallen back over the past year and is pointing toward softer demand in 2020 (see exhibit AP1).

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**Exhibit AP1: Real Estate Absorption and Leading Indicator**

<table>
<thead>
<tr>
<th>Asia Pacific Commercial Real Estate Absorption and Leading Indicator</th>
<th>Net Absorption by Office Market and Sector (% Stock)</th>
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<tbody>
<tr>
<td><img src="image" alt="Normalized Commerical Real Estate Absorption" /></td>
<td><img src="image" alt="Leading Indicator (RHS)" /></td>
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<tr>
<td><img src="image" alt="Leading Indicators have eased, pointing towards a slower pace of net absorption in 2020" /></td>
<td><img src="image" alt="Most major markets recording weaker office demand in 2019…" /></td>
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<tr>
<td>Sources: JLL, OECD, PGIM Real Estate. As of December 2019.</td>
<td><img src="image" alt="…logistics markets holding up better than office and retail" /></td>
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**Exhibit AP1:**
- **Normalized Commerical Real Estate Absorption**
- **Leading Indicator (RHS)**

**Net Absorption by Office Market and Sector (% Stock)**

- **Office**
- **Retail**
- **Logistics**

**2018**

**2019**

- **Shanghai**
- **Beijing**
- **Melbourne**
- **Tokyo**
- **Singapore**
- **Hong Kong**
- **Sydney**
- **Seoul**
- **Most major markets recording weaker office demand in 2019…**
- **Logistics markets holding up better than office and retail**
However, Asia Pacific is a diverse region and the story varies by sector and geography. In the office sector, absorption is moderating as leasing activity in major markets is being driven largely by renewals rather than expansions. New development projects are also reporting slower pre-leasing activity.

Changing occupier preferences are having an impact too. Markets that have been relying on flexible office demand in recent years, such as Singapore, Hong Kong and Seoul, are facing a risk of a sharp fall in absorption as operators turn more defensive.

In the retail sector, tenants are facing near term headwinds from the pressure of rising online sales and slowing consumer spending growth. Absorption of retail space is set to remain weak, with only a handful of tourist-driven submarkets — in cities such as Tokyo and Seoul — and suburban markets in Singapore, benefiting from retailer expansion. Cautious sentiment toward retail investment is set to persist in 2020.

While leasing demand is likely to moderate overall, net absorption is set to remain positive in the office and logistics sectors in the coming year. Brisbane is at an early stage of demand recovery in its cycle, while markets such as Tokyo, Osaka, and Melbourne have higher exposure to domestic demand — meaning less dependence on exports — and should continue to record resilient take-up.

**Asia Pacific Trend 2: CBD Affordability Becoming Stretched**

Affordability is being stretched in the central business districts (CBD) of major cities, pushing occupiers toward cheaper submarkets and driving non-CBD rental growth.

Many office markets have recorded significant rental growth through the current cycle. Vacancy rates remain at or close to historic lows, and landlords are able to increase rents. However, there are concerns that rental affordability is becoming stretched.

Our simple Index of Affordability tracks the ratio of rents to economic output produced per unit of space over time (see exhibit AP2). If rents are rising more quickly than GDP per unit of space, then affordability diminishes, and vice versa if the ratio is falling.

The index shows that office markets across Asia Pacific have become steadily less affordable through the cycle and the reading is now above peaks recorded in 2007 prior to the global financial crisis. In several major cities, including Osaka, Seoul, Shanghai, and Tokyo, the index is at record levels compared to history.

Rising cost pressures mean that tenants are either increasing the density of their occupation or looking to alternative, more affordable, options. In many markets, there are steep discounts for occupiers to relocate to less desirable submarkets. Rising demand for decentralized office in Sydney and Singapore, and grade B space in Tokyo, for example, demonstrate a shift in preferences away from more expensive central locations.
Rents are starting to adjust. In contrast to the earlier part of the cycle, non-CBD rents across Asia Pacific have grown more quickly than their CBD counterparts since 2016.

While leasing demand is set to slow in 2020, occupiers continue to face affordability constraints in central areas. Submarkets or assets that can offer affordable leasing options are set to attract further demand from occupiers.

**Asia Pacific Trend 3: Logistics Demand Supported by Online Growth**

Logistics has become more closely aligned with the consumer cycle, while rising online spending points to significant growth in space requirements.

Benefiting from an ongoing structural rise in e-commerce penetration, the logistics sector continues to record rising occupier demand, largely driven by retailers that are looking to enhance their distribution networks, and third-party logistics operators.

As a result, logistics market performance is becoming less correlated with industrial production — its traditional driver of demand — and more closely aligned with the consumer cycle (see exhibit AP3). Given the expectation that headwinds impacting trade and manufacturing are set to persist in 2020, the shift toward consumer-driven performance bodes well for the sector.

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**The logistics sector continues to record rising occupier demand, largely driven by retailers that are looking to enhance their distribution networks, and third-party logistics operators.**
E-commerce growth is slowing, but it is still growing at an annual rate of about 20% across the region. Based on our analysis of global operators, our estimate is that for each $1 billion of additional online sales generated, an additional 100,000 square meters of logistics space will be required.

In 2020, online retail spending is set to increase by $440 billion, which implies significant growth in the demand for logistics space. While the logistics supply pipeline equates to about 15% of existing stock across major markets such as Shanghai, Tokyo, and Singapore, rising online demand is set to eat into a large share of space being delivered.

Although rental growth remains patchy, held back by factors such as declining operating margins and weaker trade growth, the relative resilience of the consumer sector and the prospect of further online spending growth point to ongoing opportunities in the sector.
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