

CBRE RESEARCH

REAL ESTATE MARKET OUTLOOK

Asia Pacific

CBRE



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Asia Pacific

OPPORTUNITIES IN THE NEW NORMAL

Low for Longer

Weak rental growth is expected across all sectors in most markets. Yields will remain low with limited room for further compression.



Stronger focus on portfolio optimisation

Occupiers craving higher efficiency will lease less space but in higher-quality properties.



More supply but limited choice

Occupiers will remain selective and demonstrate a strong preference for prime properties in core locations.



Placemaking in the experience economy

Landlords should differentiate their properties to enhance the end-user experience. This will create opportunities for asset conversions.



New locations, new sectors

Occupiers are expected to seek new locations for cost savings or growth potential. Investors are set to follow this trend and will also broaden their focus to niche sectors.



Source: CBRE Research, January 2017.

CBRE RESEARCH

This report was prepared by the CBRE Asia Pacific Research Team, which forms part of CBRE Research – a network of preminent researchers who collaborate to provide real estate market research and econometric forecasting to real estate investors and occupiers around the globe.

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EXECUTIVE SUMMARY

ECONOMY

Asia Pacific GDP growth stood at 4.3% in 2016 and is expected to ease slightly to 4.2% in 2017, well ahead of the 2.3% projected for the US and the 1.7% forecast for Europe, according to Oxford Economics.

The global outlook has become more difficult to predict following Donald Trump's victory in the 2016 U.S. presidential election and the Brexit. Asia Pacific has also seen its share of political turmoil, although authorities in major countries remain in a strong position.

The pace of interest rate hikes in the U.S. is a major unknown in 2017. However, most Asia Pacific markets are unlikely to increase interest rates in the short term as they need to consider their own economies before altering monetary policy. Currency devaluation is likely to continue.

Inflation in most Asia Pacific markets will accelerate this year but will remain below historical levels. Inflationary pressure in mature Asia remains mild as domestic demand remains weak.

OFFICE

Occupiers will remain cautious in 2017 and the focus on portfolio optimisation will drive an emphasis on space efficiency and higher quality offices. Net absorption is forecast to decline 5-10% in 2017, following a contraction of 16% in 2016.

Tech firms will lead office leasing demand, supported by

solid revenue and headcount growth. Leasing demand from the financial sector will continue to diverge between Western and domestic corporates.

Around 59 million sq. ft. NFA of new office space is forecast for completion in 2017, a marginally higher figure than in 2016. New projects will have to offer more flexible leasing terms and compromise on their ideal tenants. Rental growth will remain tepid and is forecast to slow further to around 1% in 2017. Sydney, Melbourne and Bangalore will lead rental growth.

Weaker demand and stronger competition from new supply will drive an emphasis on placemaking and prompt landlords to improve facilities to enhance end-user satisfaction.

RETAIL

The competitive retail landscape and fast-changing consumer preferences will ensure retailers retain a strong focus on agility across all aspects of their operations in 2017, including real estate. Store consolidation and pop-up space will become more prominent.

F&B and service-based retailers will continue to drive demand, supported by shopping centre landlords' strategy of increasing the retailtainment offering in their malls to offset the impact of e-commerce.

New retail supply is forecast to stand at 43.3 million sq. ft. in 2017, a decline on the 59.6 million sq. ft. of new stock completed in 2016. China alone will account for about half of the new supply.

Figure 1: 2017 Outlook – Leaders in Rental Growth and Investment Volume

Grade A Office rental growth



Sydney
Bangalore

Retail rental growth



Auckland
Sydney

Logistics rental growth



Shenzhen
Shanghai

Investment Volume



Australia
Japan

Source: CBRE Research, January 2017.

EXECUTIVE SUMMARY

The combined effects of cautious retailer expansion, the still considerable retail supply pipeline and the growth of online retail will ensure retail rents in most Asia Pacific markets remain flat this year.

The challenging retail environment will continue to drive shopping centre landlords to improve their facilities and add more retailtainment elements to ensure they stay competitive and provide consumers with a broad retail offering.

LOGISTICS

The Asia Pacific logistics market is expected to be stable in 2017 with the fundamentals of demand, supply and rents all pointing to steady but solid growth.

New supply is expected to become more balanced this year, helping to support overall rental growth.

Logistics rents are forecast to grow 1.4% y-o-y in 2017, roughly in line with the 2016 growth of 1.9%.

Selected niche sectors including data centres, cold storage and last mile facilities will enjoy rapid growth as they ride on structural alterations in the economy and favourable demographic changes.

INVESTMENT

Investors will retain a strong appetite for Asia Pacific real estate in 2017 amid continued low interest rates.

However, investment activity is expected to moderate due to tight pricing and the limited availability of investable stock.

The yield compression cycle will slow as the yield spread narrows. Some mild compression may still occur in the office and logistics sectors, but this will mostly be driven by liquidity and be confined to gateway markets in Hong Kong, China and Australia. Retail yields are expected to stay flat amid weaker investment demand.

Investors are expected to be more creative in formulating their investment strategies in order to achieve target returns. Potential strategies include adding value by asset reposition or asset enhancement.

Investors with a stronger appetite for risk will seek opportunities outside gateway cities in locations offering attractive pricing or prospects of a recovery.

The low yield environment will continue to encourage investors to seek opportunities outside conventional asset classes as they look for higher yields, guard against real estate cycles, and capture new demand resulting from changes in consumer behaviour.



The Asia Pacific real estate environment continues to acclimatise to the new normal of shifting demographics, evolving technology and solid market fundamentals.



Economic Outlook

SOFTER GROWTH AHEAD

**GROWTH EXPECTED TO EASE SLIGHTLY**

Asia Pacific GDP growth stood at 4.3% in 2016 and is expected to ease slightly to 4.2% in 2017, well ahead of the 2.3% projected for the U.S. and the 1.7% forecast for Europe¹, according to Oxford Economics.

Emerging giants China and India will continue to lead regional growth, accounting for three quarters of the total, while Southeast Asia is also expected to see robust growth, backed by positive demographic trends. Mature Asia, which includes Japan, South Korea, Taiwan, Singapore and Hong Kong, will grow at sub 2% in 2017, but is unlikely to slip into recession thanks to the stronger U.S. economy and slight slowdown in China. Growth in the Pacific will remain above the world average for mature countries, but the region's high exposure to slower growth in China is resulting in a softer outlook for 2017.

In **China** GDP growth is expected to decelerate to 6.5% or below in 2017 as the economy continues to shift from export-led to domestic demand driven growth. In 2017 the central government also plans to encourage innovation and company start-ups as new sources of growth. While

overall growth remains solid, the slowing trend is causing concern. However, recent signs of stabilisation in industrial production and fixed asset investment confirm that a hard landing remains unlikely. The performance of the housing sector will likely weaken from the rapid price and sale volume growth recorded in 2016 as cooling measures took effect. In order to meet growth targets, policymakers are expected to rely upon government-backed fixed asset investment and further monetary easing through Reserve Rate Ratio (RRR) cuts, rather than interest rate reductions.

The outlook for **India** is largely positive but several economists revised down their 2017 forecasts towards the end of 2016 from 7-7.5% to 6-6.5% due to the impact of banknote demonetisation, particularly on consumption and the services sector. Business process outsourcing (BPO) continues to drive the Indian economy, and the anti-outsourcing rhetoric voiced by the incoming administration in the U.S. is unlikely to take effect in 2017, particularly at a time when multinationals remain so cost sensitive.

¹ Sourced from Oxford Economics, January 2017. Same for other GDP figures if not stated.

ECONOMIC OUTLOOK

Growth in **Southeast Asia** remains largely on track. Indonesia and Malaysia registered GDP growth of above 4% in 2016. Both countries are expected to see GDP growth accelerate in 2017, thanks to robust domestic demand and stronger exports due to higher oil prices.

In **Japan**, growth is positive with the December 2016 forecast by the Japan Center for Economic Research expecting real GDP growth of 1.0% y-o-y in 2017. Oxford Economics is more cautious, forecasting growth of 0.6%. Should President-elect Donald Trump's inflationary policies be put into practice, it is highly probable that the Yen will continue to weaken, resulting in a positive outlook for 2017 corporate earnings. Despite the country's relatively low unemployment rate of 3%, wage growth has been minimal due to the high number of temporary part-time workers paid less than permanent full-time workers. However, should Prime Minister Shinzo Abe's promised labour market reforms, expected to be announced in H1 2017, succeed in lifting wages and raising workforce participation among women, domestic demand could improve and provide a more sustainable economic boost.

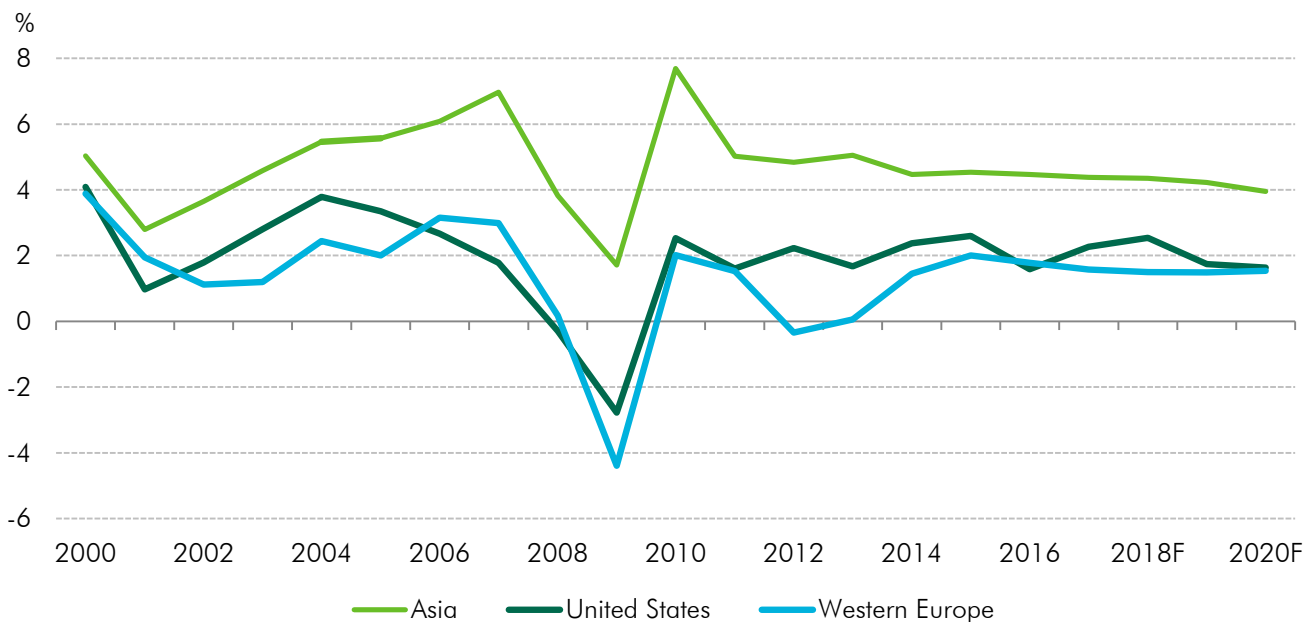
Australia saw GDP growth weaken in H2 2016 with slower

household consumption growth and a continued decline in mining investment. Economists expect a mild drop in growth in 2017.

New Zealand's economy is enjoying strong momentum, which is increasingly shifting from migration, housing and tourism to secondary drivers that will help sustain robust growth for some time. Secondary drivers include a strong labour market, which is boosting income growth and consumer spending. Increasing government revenue is also starting to find its way into greater fiscal stimulus.

While regional growth still looks impressive, it may not necessarily translate into the solid retail sales or employment growth that would be positive catalysts for stronger real estate demand. Projected growth for most other major Asian economies in 2017 remains positive but estimates are generally lower than the figures for 2016. The South Korean growth outlook is being dampened by the deepening political crisis and increased scrutiny of domestic conglomerates. These numbers could be further threatened if trade friction with the U.S. arises when President-elect Donald Trump takes office.

Figure 2: Real GDP Growth Rate



Source: Oxford Economics, CBRE Research, January 2017.

KEY RISKS



(1) TRUMP, BREXIT AND MORE CHANGE IN THE POLITICAL WORLD

Donald Trump's victory in the 2016 U.S. presidential election and the impact of the Brexit on the UK's business relationship with the rest of Europe have made predicting the global outlook a more challenging task.

Trump's win has brought with it expectations of higher U.S. growth, which will benefit export-driven economies such as South Korea, China and Taiwan. However, there is growing concern about potential restrictions on trade.

The process and timescale for the UK to leave the EU are still uncertain but there is a consensus that weaker economic growth will persist in both markets. This will have a negative impact on exports from Asia, although the effect will be diluted by stronger demand from the U.S. Multinationals from the EU are expected to adopt a more cautious stance towards business expansion in Asia

Pacific. The UK, particularly London, has been a top destination for outbound investment from Asia for some time, and this is not expected to change.

Political risk also increased in Asia Pacific over the course of 2016, prompting the downward revision of growth in some cases. In South Korea, political order is still being restored after the impeachment vote stripped President Park Geun-hye of executive powers. In India, the sudden implementation of banknote demonetisation shocked the market and negatively impacted retail sales in the short term. Taiwan and the Philippines continue to suffer from political disquiet, while Hong Kong is scheduled to see the appointment of a new chief executive in 2017. The Chinese Communist Party (CCP) will reshuffle a number of senior positions in 2017 as President Xi Jinping consolidates his leadership. The growing centralisation of power could allow Xi to further push his anti-corruption and political discipline campaigns.

(2) THE POSSIBILITY OF FASTER U.S. RATE HIKES

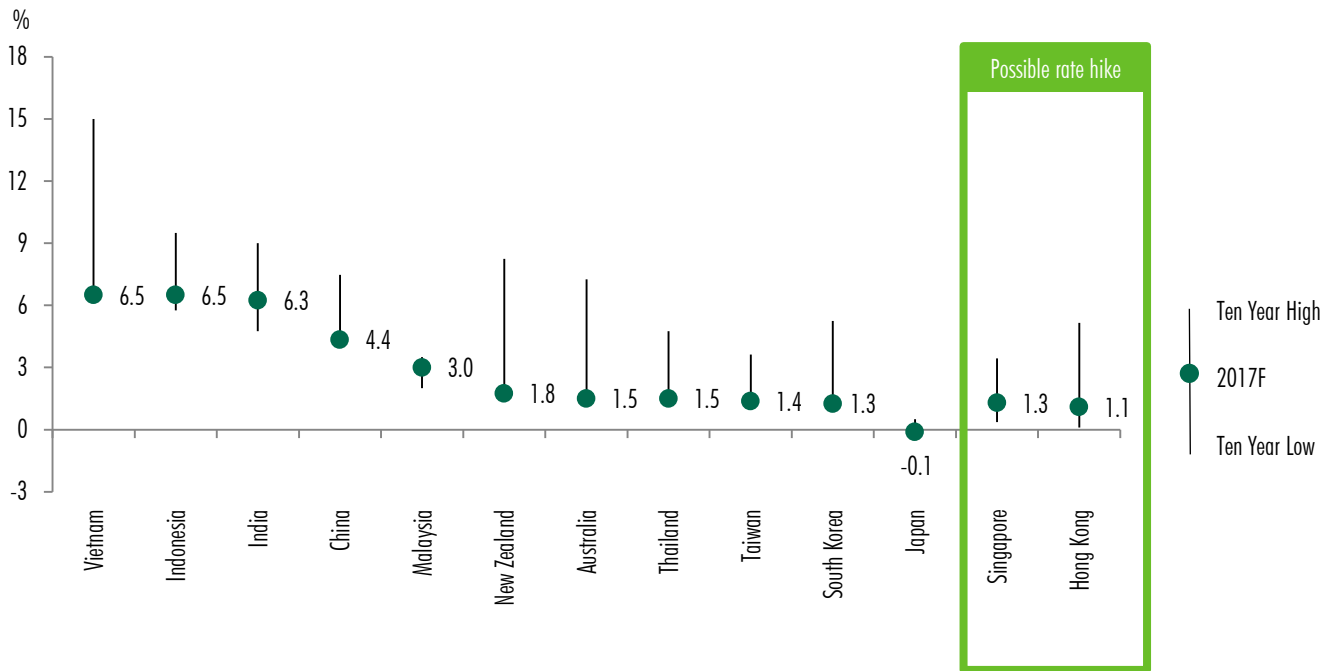
As widely expected, on 15 December 2016 the Federal Open Market Committee (FOMC) raised the Fed Fund rate by 25 bps to a range of 0.5-0.75%. The FOMC expects three interest rate increases in 2017, up from the two projected at its previous meeting in September 2016, as the outlook for the U.S. economy improves.

Most Asia Pacific markets are unlikely to put up interest rates in the short term as there is a considerable lag between policy settings in major economies in the region and those in the U.S. Asia’s two largest economies, China and Japan, are likely to keep rates flat, while increasing money supply in 2017. Although India kept interest rates unchanged in its December policy review, the country is expected to implement at least one rate cut in H1 2017 to accelerate growth which has been interrupted by demonetisation. In Australia, while most forecasters are predicting stable rates in 2017, a rate cut is possible if

economic growth softens further after a weak H2 2016, and if core inflation remains below the Reserve Bank of Australia’s (RBA) target band.

Although most Asia Pacific markets are unlikely to put up interest rates in the short term, Hong Kong, Singapore and South Korea are facing more pressure following the Fed’s move, largely reflected in higher mortgage rates. The increased burden on mortgage payments is small and yet to impact real estate investment. However, investment demand could weaken later this year if upward interest rate movements in the U.S turn out to be steeper.

Figure 3: Policy interest rates in Asia Pacific



Source: Various Central Banks, Monetary Authorities, CBRE Research, December 2016.
 Note on policy rates: Australia – Cash rate; China – 1-yr lending rate; Taiwan – Discount rate; India – Repo rate; Indonesia – BI rate; South Korea – Base rate; Thailand – 1-day repo rate; New Zealand – Official cash rate; Japan – Overnight call rate; Hong Kong – 3M HIBOR; Singapore – 3M SIBOR; Vietnam – Refinancing rate; Malaysia – Overnight rate

(3) ASIAN FX DEVALUATION IN A WORLD OF POSITIVE U.S. GROWTH

With the interest rate gap between the U.S. and major economies in Asia Pacific likely to widen further in 2017, currency devaluation is set to continue. If Asian currencies devalue in a scenario where expected fiscal stimulus results in stronger U.S. economic growth and low unemployment, the gains to the balance of trade may be ignored and thus go unhindered by tariffs. Conversely, if devaluations occur amid a stagnant or stalled U.S. economy suffering from rising unemployment, the repercussions from any trade retaliation could be far more disruptive. Meanwhile, higher interest rates and weaker Asian currencies could pose a challenge for emerging markets with high external debt.

The implications for the region are twofold. Firstly, China will face an outpouring of capital, which could prompt authorities to impose regulations to limit funds heading abroad. Secondly, currency devaluation would boost the export sector as well as the overseas businesses of regional corporations, particularly Japanese firms.

(4) NARROWING OF PROPERTY YIELD SPREADS AND RISING INFLATION

Government bond yields in Asia Pacific have already risen by 60-70 bps over the last three months, consistent with the upward movement in the U.S. Overall, the positive bond yield spreads over property yields are narrowing quickly, leading to concerns over asset pricing in the region.

Coincidentally, inflation could pick up this year as a result of rising commodity prices and the weakening of currencies against the U.S. dollar towards the end of 2016. In Asia Pacific, inflation in emerging markets is forecast to revert back to 3% or above, although this remains well below historical levels. China has already recorded an increase in its CPI and PPI, which began in October 2016. Any increase in global inflationary pressure due to the expected expansionary fiscal stimulus from the incoming Trump administration in the U.S. will reduce flexibility for central banks in emerging markets. However, mature Asia continues to see mild inflationary pressure as domestic demand remains weak. It will therefore be very challenging for Japan to achieve its 2% inflation target, despite the Bank of Japan's (BoJ) continuous increase in money supply.

Figure 4: Inflation Rates in Asia Pacific



Source: Oxford Economics, CBRE Research, January 2017.



Office Sector

WORKPLACE EFFICIENCY WILL BE KEY



- Occupiers are set to focus on improving space efficiency and portfolio optimisation, resulting in a further decline in net absorption
- Rental growth will be stagnant and remain low for longer
- Landlords are expected to focus on placemaking to attract tenants

OCCUPIERS TO REMAIN CAUTIOUS

While economic growth in Asia Pacific remains above the global average, competition is intensifying across various industries, making it increasingly difficult for companies to exploit fast-expanding market segments. Business confidence in 2017 is expected to remain subdued, with only 28% of Asia Pacific CEOs, the same percentage as last year, expressing confidence in near term revenues, according to PwC's Asia Pacific CEO Survey 2016-17.

The coming year will see companies place a stronger focus on improving operational efficiency and more caution towards corporate investment and expansion. This will drive the adoption of more prudent real estate strategies

and greater effort to build in flexibility enabling occupiers to react quickly to changes in the business environment. The portfolio planning and review process for larger occupiers will be extended from the typical 12 months to 24 months ahead of expiry.

Occupiers will invest more in market and labour analytics enabling them to strategically allocate their budget to cost-efficient office locations, while maintaining employee satisfaction regarding accessibility and workplace. Some occupiers will focus on committing to new projects in weaker markets at an earlier stage in order to secure attractive leasing terms.

STRONGER FOCUS ON PORTFOLIO OPTIMISATION

Occupiers will continue to increase their focus on portfolio optimisation, not only in terms of occupancy costs, but also by reviewing the following strategies:

- **Space utilisation:** Tenants will increase workplace density and/or increase desk sharing ratios by adopting address-free workstations. This strategy will be especially relevant to markets with tight availability and high rental costs.
- **Flexible working:** More companies are adopting or considering mobile working policies for staff and implementing activity based workplaces (ABW) to match space usage with the type of work activity. Other options include the use of serviced offices or co-working space as extended resources outside core real estate portfolios.
- **Headcount planning:** Occupiers should conduct a comprehensive analysis of headcount growth and different space requirements depending on their business nature and functionality. The appeal and accessibility of office locations should also be considered so as to attract and retain talent.
- **Location selection:** As technology enables mobile working and better infrastructure increases the appeal of decentralised office locations, occupiers will have a greater choice of office locations to improve portfolio cost efficiency. Occupiers are also turning more proactive towards evaluating market availability and future supply to help them negotiate better terms. In markets with a large volume of decentralised office supply, such as Hong Kong and tier I cities in India and China, occupiers are relocating to non-core areas. In the weaker markets of Singapore, Seoul, Brisbane and Perth, high incentives in the CBD will encourage tenants to remain or relocate to core areas.

SLOWER ABSORPTION OF OFFICE SPACE

Net absorption is forecast to register a further decline of between 5-10% in 2017, following a contraction of 16% in 2016, as occupiers remain cautious and the focus on portfolio optimisation drives an emphasis on more people in equal or less space and higher quality offices.

The overall decline in net absorption will mainly be driven by markets in China, where growth is slowing as the country continues to experience an economic transition. Demand in Australia, particularly in Sydney, will also weaken due to tighter office availability that will restrict occupier activity. Japan will experience a slower 2017 as occupiers in Tokyo turn more cautious due to ongoing currency volatility that is increasing the likelihood of a negative impact on profitability.

Net absorption in India will remain solid on the back of sustained demand from the back-office segment across industries including IT, BFSI and engineering and manufacturing. However, the National Association for Software Companies (NASSCOM) has recently lowered its growth projections for the IT-BPO sector to 8-10% in 2016/17 from 10-12% projected at the start of the year, due in part to the potential impact of protectionist measures from the incoming administration in the U.S. Domestic occupiers are expected to play a more prominent role in absorbing office space in 2017. The greater variety of occupancy options and favourable economic growth will drive an increase in leasing activity in Auckland, offsetting the negative impact of portfolio optimisation. Singapore is forecast to enjoy a substantial improvement in net absorption on the back of strong pre-commitment rates in new projects.

Grade A buildings will outperform Grade B properties as occupiers demonstrate a strong preference for space in the highest quality properties, particularly in China, South Korea and Singapore. This will increase leasing risk in Grade B buildings.

OFFICE SECTOR

TECH SECTOR TO LEAD DEMAND

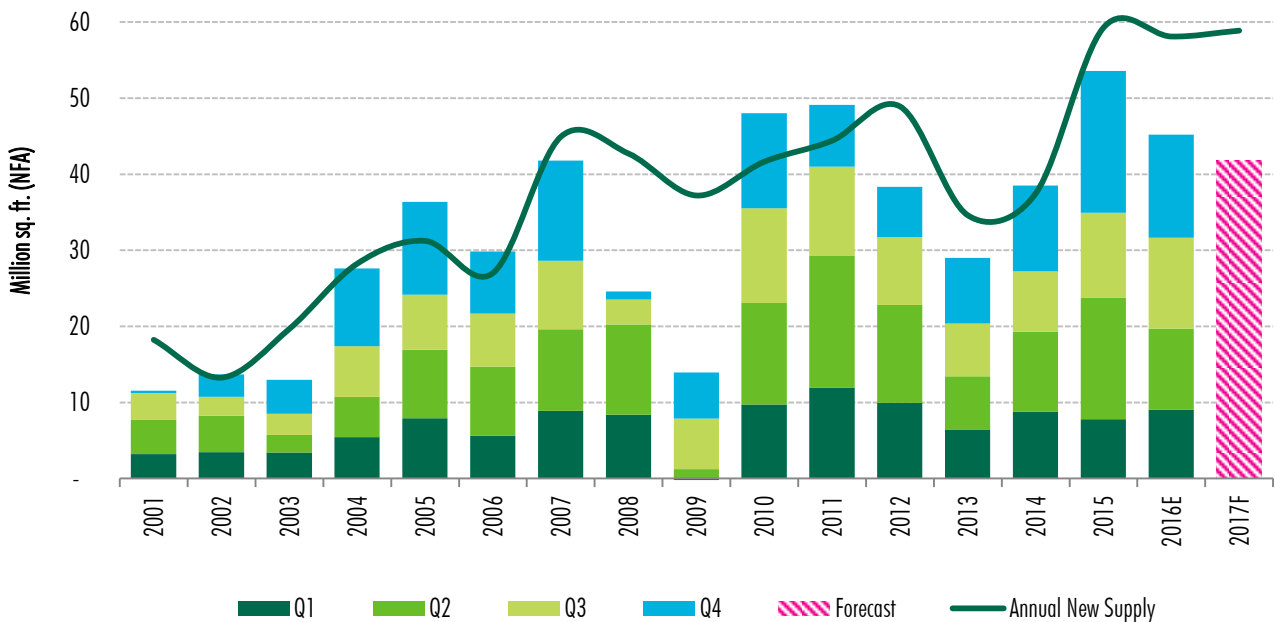
Tech firms will continue to lead office leasing demand across the region in 2017, supported by solid revenue and headcount growth. However, performance within the sector will vary, as some companies which have over-expanded in recent years could reduce space, while M&A activity among other firms will drive the consolidation of operations and office premises.

Leasing demand from the financial sector will continue to diverge. Domestic financial companies, particularly those in the banking and insurance industries, will retain a solid appetite for space in China, Japan and India. In contrast, western financial companies will remain cautious across the region, with the exception of some markets such as India, along with some smaller requirements in Hong Kong and Singapore to house compliance and / or technology functions.

The business services sector, which includes legal, accounting, consulting, property and marketing, as well as educational firms, will be more active in the Pacific in 2017 due to Australia and New Zealand's economic structure. Demand from this sector will be stable elsewhere.

Co-working space will continue to emerge as an important new source of office leasing demand. International and regional co-working space providers are expected to step up expansion in prime areas and Grade A buildings across major markets. Large corporations will increasingly consider using co-working space for their short-term requirements and as part of a more balanced portfolio.

Figure 5: Asia Pacific Office Net Absorption and Annual New Supply



Source: CBRE Research, January 2017.

OFFICE SECTOR

MORE SUPPLY BUT LIMITED CHOICE

Asia Pacific will remain in the midst of a supply peak in 2017, with around 59 million sq. ft. NFA of new office space forecast for completion in 2017, a marginally higher figure than in 2016, which represents a 6.2% increase in total stock. This will be the third consecutive year that new supply is close to 60 million sq. ft. NFA, a trend that is forecast to continue for the next three years.

The strong pipeline of new supply will ensure the overall regional vacancy rate continues to increase over the course of the year, eventually reaching 11%. Gurgaon, Shenzhen and some Southeast Asian markets such as Singapore and Jakarta will see the highest increases in Grade A vacancy, to over 6%.

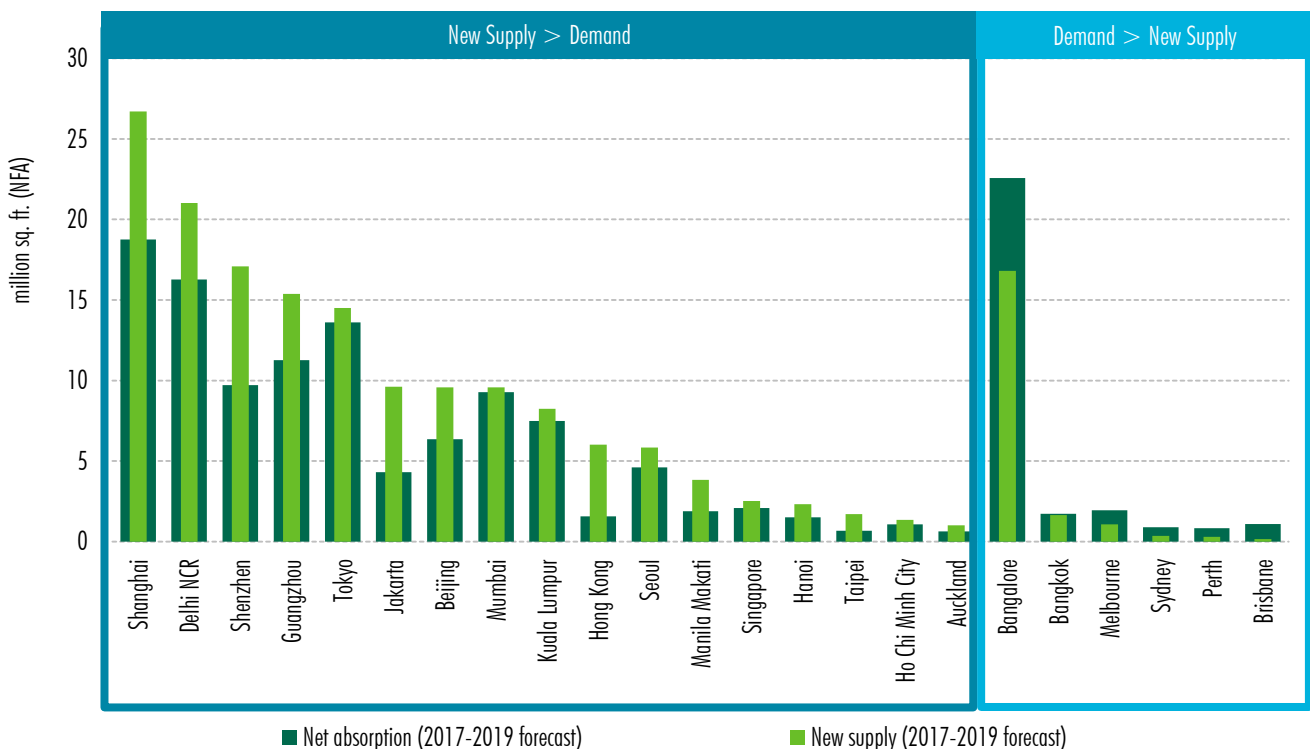
New supply will remain polarised, with 70% of total new supply located in tier I markets in China and India, mainly in decentralised locations. New Grade A supply will be limited in the Pacific. Tokyo and some Southeast Asian markets including Bangkok and Hanoi will see a

manageable level of new Grade A supply in 2017, before the pipeline increases again in 2018.

The polarisation of new supply will not only occur between different markets, but also within individual markets. The vacancy rate in the CBD's of gateway cities will remain below 5% in 2017 as most occupiers are expected to retain a strong preference for prime core space. Concerns over infrastructure and transportation will continue to ensure occupiers remain cautious towards committing to space in decentralised locations in emerging Asian markets such as India, the Philippines, Vietnam and Indonesia.

Occupiers are displaying a stronger appetite for space in prime buildings in core locations, with pre-commitment rates for new buildings scheduled to be completed in major markets in H1 2017 already approaching 50% by year end 2016. Tokyo is the exception, with pre-leasing slowing towards the end of 2016 as occupiers turned more cautious.

Figure 6: Asia Pacific Grade A Office Net Absorption and Development Pipeline Forecast



Remarks: Grade A new supply for Asian markets; total grade net addition for Pacific markets
Source: CBRE Research, January 2017.

OFFICE SECTOR

RENTAL GROWTH TO REMAIN WEAK

Office rental growth in Asia Pacific will remain weak in 2017 and is forecast to slow further to around 1%. Growth is expected to remain stagnant over the next three years.

Sydney and Melbourne will continue to lead rental growth due to the reduction in incentives. While there will continue to be opportunities to lock in relatively attractive high incentives and longer lease terms, occupiers are advised to act quickly as landlords have been turning more aggressive in these increasingly tight markets.

The rental correction in Singapore will moderate in 2017 as the market approaches the end of the downward cycle. Occupiers are recommended to expedite decisions before rents begin to recover.

Rents in Bangalore and Gurgaon have enjoyed robust growth over the past four years and momentum is expected to grow at a slower pace in the coming year. Elsewhere, rents in Auckland are likely to show a mild improvement on the back of the country's positive economic environment. Occupiers in these markets are advised to request a rental cap when negotiating lease terms. Tenants in India should also evaluate cost effective space in emerging decentralised locations for leases expiring in 2017 and beyond.

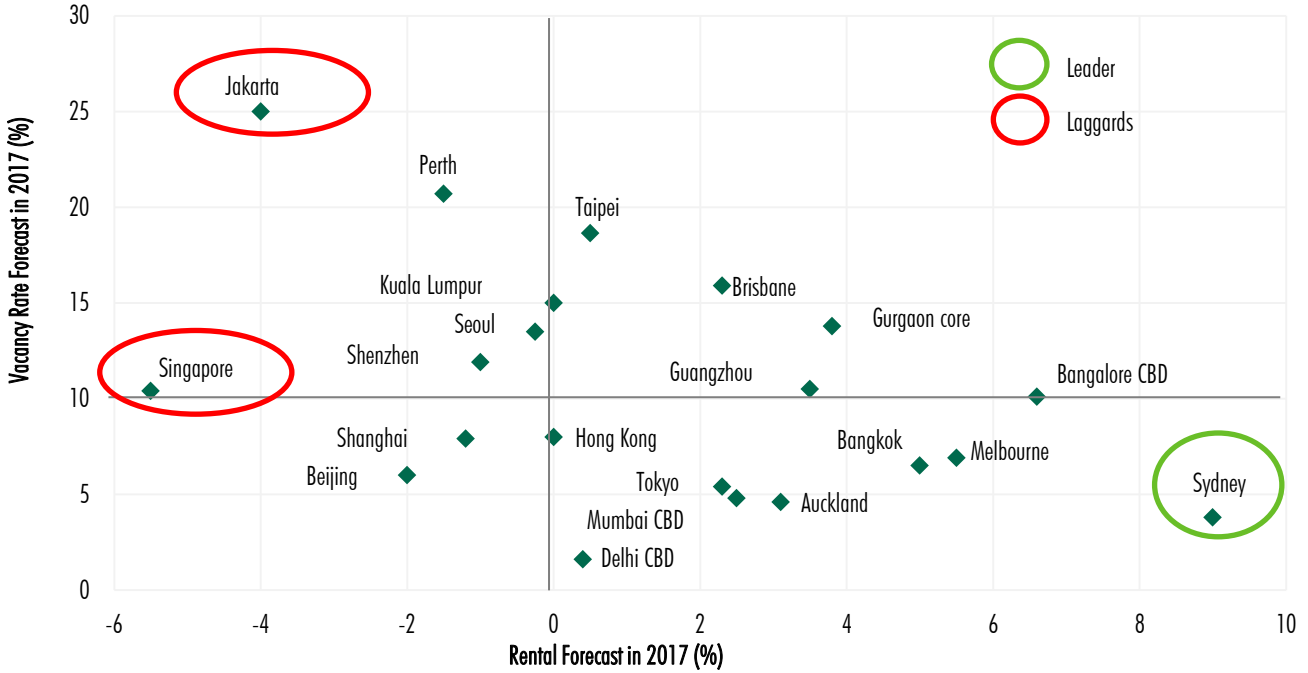
Occupiers in Beijing, Shanghai, Shenzhen, Hong Kong and Tokyo will enjoy the upper hand as landlords in these markets are expected to become more flexible. Rents in tier I cities in China will enter the downward cycle; will be flat in Hong Kong; and will reach the peak in Tokyo in H2 2017.

Figure 7: Grade A Office Rental Outlook



Remarks: Rental growth refers to Grade A offices in CBD areas only
Source: CBRE Research, January 2017.

Figure 8: 2017 Vacancy Rate and Annual Rental Growth Forecast



Source: CBRE Research, January 2017.

STRONGER FOCUS ON PLACEMAKING

Occupiers' requirements and satisfaction with the workplace is evolving along with their increased focus on workplace flexibility. The rise of co-working centres in Asia Pacific is also influencing occupiers' thinking around the use of both internal and external space, as well as how leases are structured. Landlords will need to rethink their strategies to retain tenants and refine their tenant mix to protect their future income.

Landlords and developers are advised to carefully design and manage their properties and surrounding areas to create a distinct identity and destination. This will improve connectivity among tenants and the staff who use buildings, and help attract and retain tenants. Key elements of this strategy will include:

- **Agility:** Understanding occupiers' requirements at an early stage and factoring this into building design. This is expected to drive the development of smart buildings, which can help both landlords and tenants improve energy efficiency, sustainability and space management.

- **Amenities:** Providing a wider range of F&B facilities to cater to different needs, ranging from high end dining to cafes; bookable shared facilities for meetings and events for tenants; and converting underutilised space to gyms, spas and childcare facilities. A stronger overall retail element will also be essential
- **Analytics:** Improving systematic data collection and analysis by investing in technology to better understand building usage and leasing risks.
- **Smart community:** Strengthening the landlord-tenant relationship by developing the physical community via various measures. These include hosting events such as sporting and charity drives and launching apps or online systems that facilitate the use of common facilities. Overall, landlords must be more creative and proactive in managing their tenant community.



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三達八

Retail Sector

CREATING THE TOTAL RETAIL EXPERIENCE



- Retailers will be more disciplined towards store expansion. More resources will be dedicated to opening and/or upgrading flagship stores in core locations.
- Shopping centres will spend more on events and marketing and replace general retail tenants with experience-based retailers to increase footfall.

SLOWER RETAIL SALES GROWTH

Consumption sentiment in Asia Pacific is expected to be positive in 2017 on the back of the weaker macro outlook and rising geopolitical tensions. eMarketer forecasts² retail sales growth in most markets will be on par or slightly lower than in 2016, resulting in 9.2% y-o-y growth for the whole region in 2017.

While retail sales growth in Asia Pacific is forecast to be well above the global average of 6.3%, the knock on effect

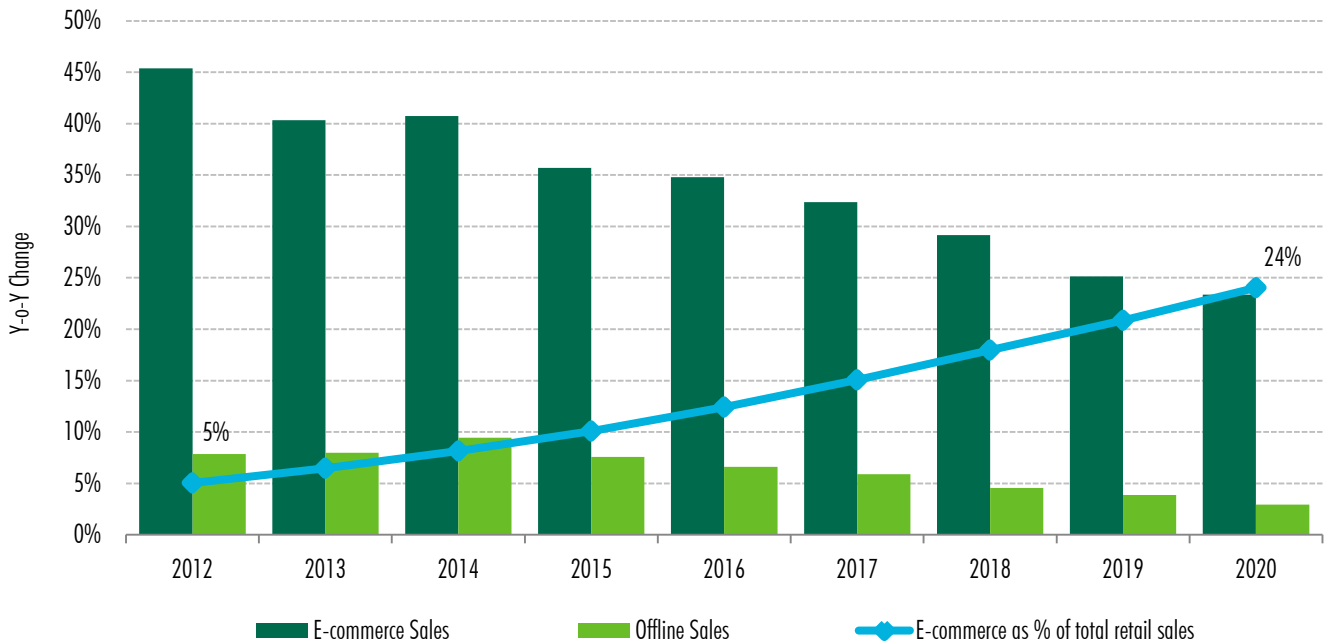
for the retail property sector will be limited as e-commerce sales are set to grow by 32.4% y-o-y in 2017, accounting for a 15% share of the total retail market. In-store retail sales are forecast to grow by just 5.8% y-o-y (Figure 9).

India and China will remain the main growth markets, with retail sales growth in 2017 projected to be 15% and 12%, respectively. However, the rate of retail sales growth in China is already slowing.

² eMarketer, December 2016.

RETAIL SECTOR

Figure 9: Y-o-Y Growth in Asia Pacific E-commerce Sales and Offline Sales



Source: CBRE Research, January 2017.

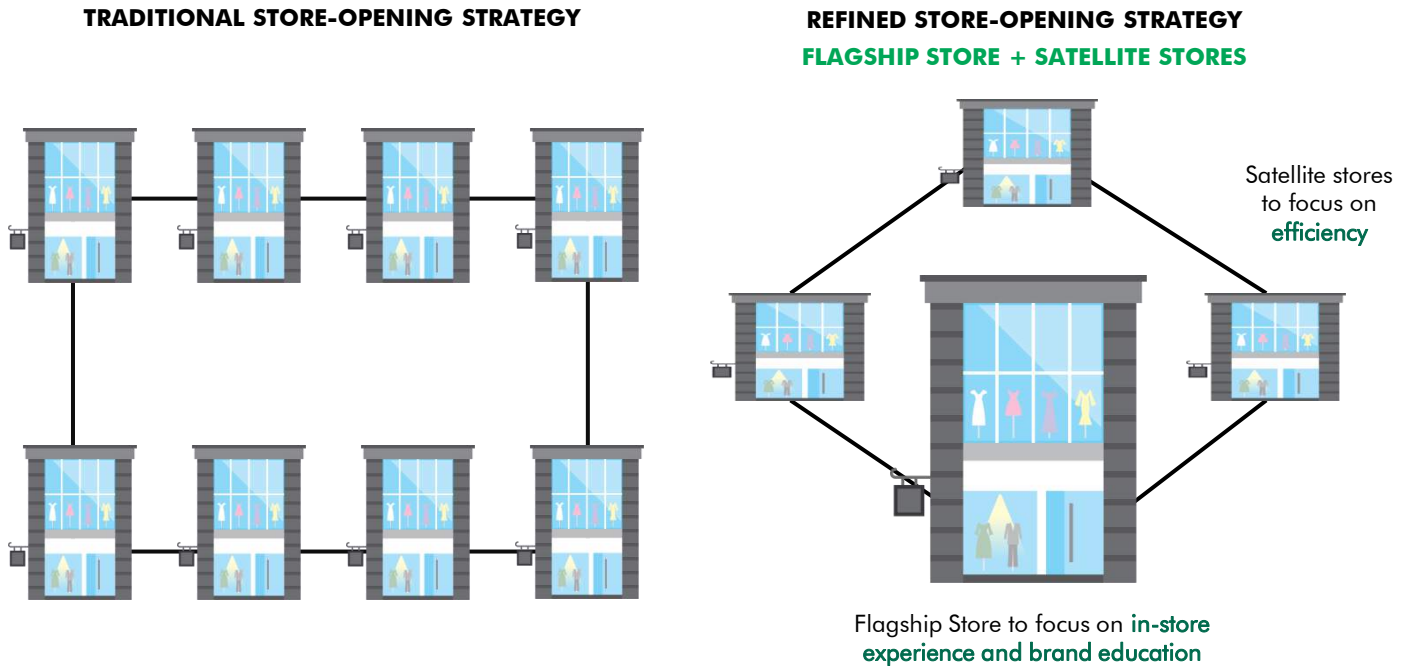
RECONFIGURE STORE NETWORKS

Retailer sentiment is expected to remain subdued in 2017. The competitive retail landscape and fast-changing consumer preferences will ensure retailers retain a strong focus on agility across all aspects of their operations, including real estate. Retailers will swiftly withdraw from loss-making markets, but are set to adopt more aggressive strategies towards profitable locations.

International retailers are expected to remain highly sensitive towards location and cost and will adopt a disciplined approach to store network planning. They will invest more on market studies and location analytics as well as engaging real estate services providers for professional advice and utilising data from e-commerce to gain a comprehensive understanding of market dynamics. Expansion will be focused on strategic locations, with most retailers content to wait for the right space in the right location to become available.

More CAPEX will be allocated to opening and/or upgrading flagship stores in core locations as retailers seek to showcase their products and brand history by incorporating novel features and enhancing the customer experience. This will help retailers move up the value chain and cultivate new consumer demand. While they strengthen their presence in core areas, retailers are expected to maintain fewer stores in non-core areas as they look to increase sales efficiency.

Figure 10: Traditional vs Refined Store-Opening Strategy



Source: CBRE Research, January 2017.

CAREFUL AND CAUTIOUS EXPANSION

Retailers will refrain from significant expansion in 2017. The cautious trend will be most prominent among luxury brands, which are expected to continue consolidating in Greater China after over-expanding in recent years. Fast fashion retailers will also turn more selective towards expansion by narrowing their focus to Southeast Asia and India and introducing sister brands in gateway cities. In the Pacific, international retailers are expected to continue to expand in core locations but growth is set to be limited by the lack of suitable space and high rental costs.

F&B retailers will retain their status as the key demand driver, supported by shopping centre landlords' strategy of increasing the retailtainment offering in their malls to offset the impact of e-commerce. Within this sector, demand will be led by casual dining and cafes. The trend for general retailers such as fashion brands and bookstores to venture into the F&B sector by adding cafes will continue. The emphasis on retailtainment is also set to support the expansion of movie theatres, gaming centres and indoor sports activities, all of which are large-space occupiers.

Leasing demand from sportswear brands is forecast to accelerate on the back of growing interest in health and fitness. Major global brands retain a strong appetite for very large retail spaces which can also host in-store training classes and events. Smaller niche sports brands are also expected to be active in opening new stores in core locations as they seek to strengthen brand awareness.

The steady flow of international brands into Asia Pacific is expected to continue in 2017 as retailers are lured by the region's long-term consumption growth story and positive demographic trends.

Intra-regional expansion is set to gain momentum, led by retailers from South Korea and Japan looking to diversify away from their home markets, which are suffering from sluggish consumption growth. Fashion and skincare/cosmetics brands are leading the way, with gateway cities such as Hong Kong, Singapore, Shanghai and Beijing their first port of call. Japanese brands are set to turn more active after recording strong overseas revenue growth, while South Korean retailers are enjoying popularity on the back of their country's successful entertainment industry.

RETAIL SECTOR

MORE SUPPLY BUT LIMITED CHOICE

New retail supply is forecast to stand at 43.3 million sq. ft. in 2016, a decline on the 59.6 million sq. ft. of new stock completed in 2016.

China will continue to suffer from significant new supply pressure, with Shanghai and Shenzhen accounting for 45% of total new regional supply in 2017. This is expected to ensure retailers in these cities display greater caution towards committing to space in new projects. Landlords are already under severe pressure to extend pre-leasing

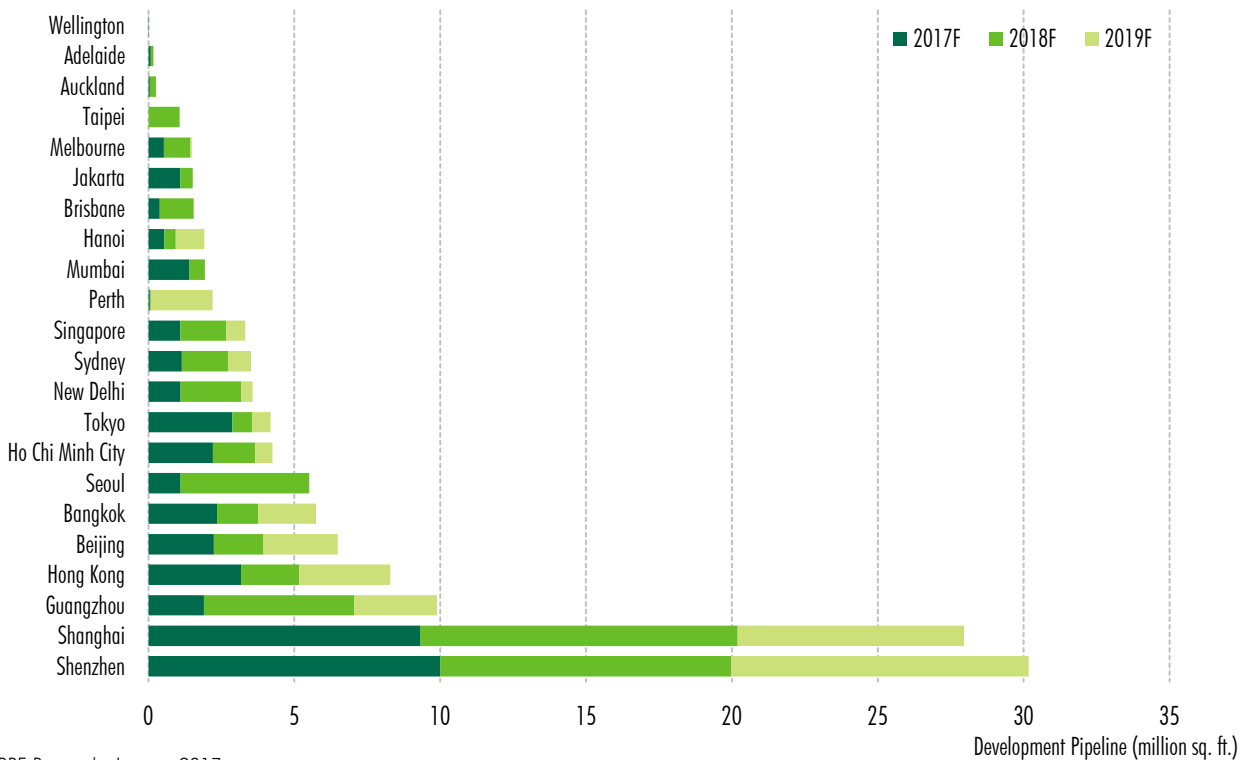
periods, particularly in Shenzhen where pre-leasing for new projects now begins 25 months ahead of the scheduled completion date. Under these circumstances, the quality of new shopping malls' tenant mix is likely to be negatively affected.

Southeast Asia, India and New Zealand will continue to see positive demand and limited quality stock. Only Bangkok and Kuala Lumpur will see the addition of a large volume of organised retail supply in 2017. In India, demonetisation is negatively impacting retail sales in the short term but will not dampen the long term consumption story. The further relaxation of FDI in the retail sector in 2016 will ensure the wave of new entries by international brands continues.

Tight availability in prime locations will not be alleviated by the new supply pipeline. Much of the new retail supply due for completion this year consists of retail space in office and residential projects, and not the major new retail schemes in core areas preferred by retailers. In weak markets such as Hong Kong and Singapore, vacant stock in core locations has been taken up by upgrading demand from mid-range retail brands, but secondary space has been left idle.



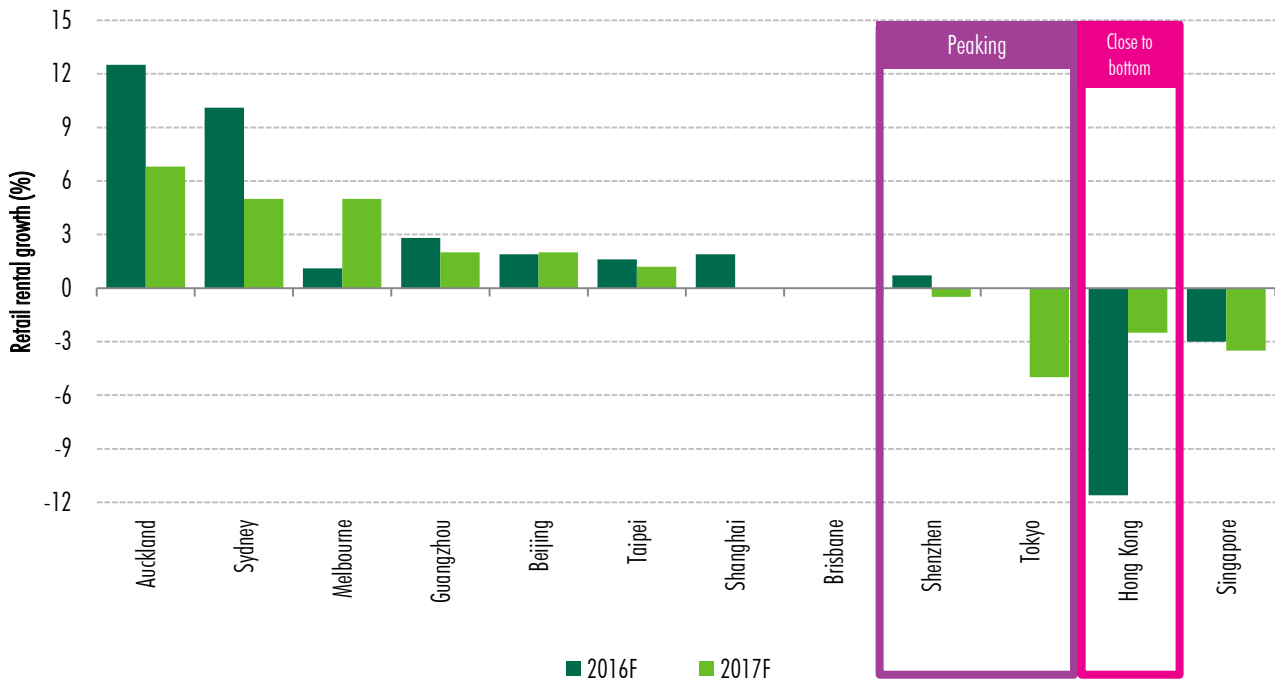
Figure 11: Asia Pacific Retail Development Pipeline



Source: CBRE Research, January 2017.

RETAIL SECTOR

Figure 12: Asia Pacific Retail Rental Outlook



Remarks: Shopping centre rents for China and Singapore only, the rest is high street shops in core districts
Source: CBRE Research, January 2017.

RENTAL GROWTH SET TO REMAIN FLAT

The combined effects of cautious retailer expansion, the still considerable retail supply pipeline and the growth of e-commerce will ensure retail rents in most Asia Pacific markets remain flat in 2017.

Rental growth will be led by Pacific markets, with prime CBD rents in Auckland forecast to increase by 6.8%, followed by 5% in the Sydney and Melbourne prime CBDs. Most other markets expect rents to grow at inflation rates, if not lower. Rents in Tokyo and Shenzhen will peak this year and then begin to fall, while the rental correction in Hong Kong will moderate. Annual growth in Asia Pacific retail rents will rebound to positive territory, albeit by just 0.4%.

Asia Pacific retail rents will register limited growth in the coming years, with average growth between 2015 and 2019 forecast to be around 1%, well below the 4.7% achieved during 2010 to 2014.

SHOPPING MALLS AS ENTERTAINMENT DESTINATIONS

The challenging retail environment will continue to drive shopping centre landlords to improve their facilities to ensure they stay competitive. Many owners have already enhanced their malls by renovating their properties, adding more F&B facilities and making space for new entrants.

However, consumers continue to demand more entertainment facilities such as events, performances and exhibitions³. Other than shopping, these elements have become one of the key reasons driving footfall to shopping centres, making it crucial for landlords to utilise more of their retail space for such activities.

³ CBRE Research (2014) – Asia Pacific Consumer Survey – How We Like To Shop



Logistics Sector

NICHE SECTORS TO TAKE OFF



- Logistics rents are expected to hold firm as regional trade is stabilising.
- In an era of low and slow growth, efficiency has taken on greater importance as companies seek to sustain profit margins, especially in the logistics industry.
- Manufacturers have to be more proactive in employing advanced technology in their portfolios to stay ahead of the competition.

The Asia Pacific industrial market is expected to be stable in 2017 with the fundamentals of demand, supply, and rents all pointing to steady but solid growth. Demand will hold steady as manufacturing output recovers and consumption remains firm. Industrial production in Asia Pacific is forecast to grow at 3.4% in 2017, roughly in line with the 2016 figure of 3.5%⁴.

The recovery in investment spending in China and Japan is helping the manufacturing sector. In the Pacific, the production phase of many energy projects in Australia and slight recovery of commodity prices is buoying the industrial sector.

Regional private consumption is forecast to grow by 4.9% in 2017, according to Oxford Economics, roughly equal to the average growth rate of 5.2% recorded since 2013. This base level of demand remains supportive of the industrial

market as export demand remains weak and producers rely more on the domestic economy.

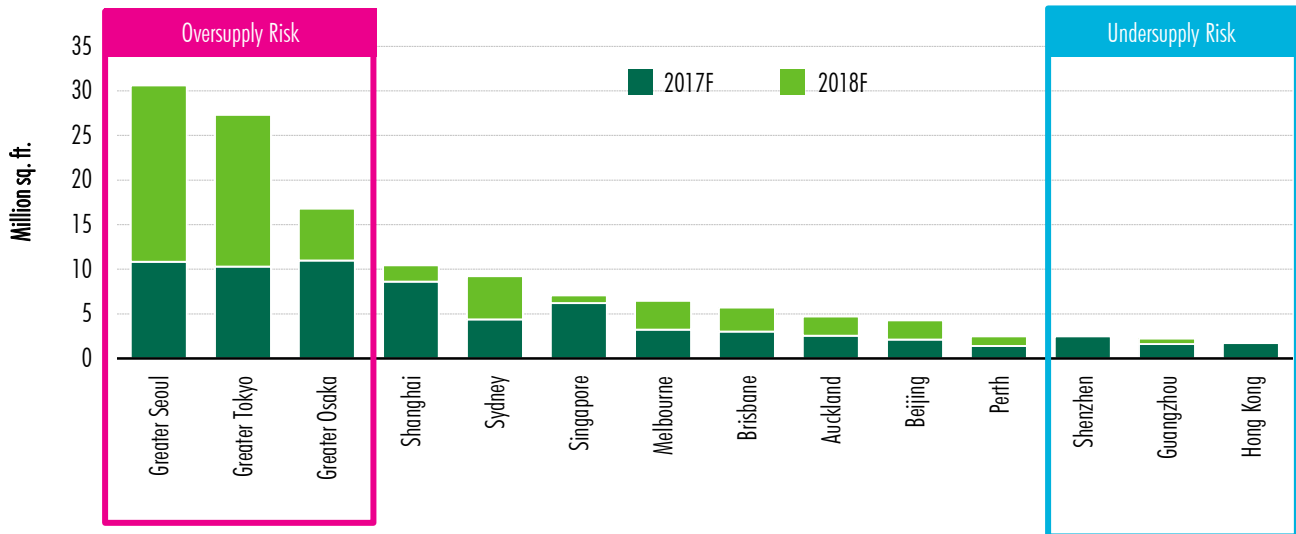
Logistics supply is expected to become more balanced this year, helping to support overall rental growth. With the exception of Japan and Greater Seoul, all major markets in Asia Pacific⁵ are forecast to have an average 2017/18 supply pipeline equal to their five-year historical yearly average. Additionally, there are undersupply risks in southern China as land remains difficult to obtain, forcing occupiers to consider nearby logistics hubs.

As supply levels regain equilibrium, rental growth will follow suit. Asia Pacific logistics rents are forecast to grow 1.4% y-o-y in 2017, roughly in line with the 2016 growth of 1.9% (1.3% if adjusted for the one-off rental increase in Beijing/Shanghai due to VAT changes).

⁴ Oxford Economics numbers; CBRE weighting of major APAC markets.

⁵ China, Japan, South Korea, Hong Kong, Singapore, Australia, and New Zealand

Figure 13: Asia Pacific Logistics Development Pipeline



Source: CBRE Research, December 2016.

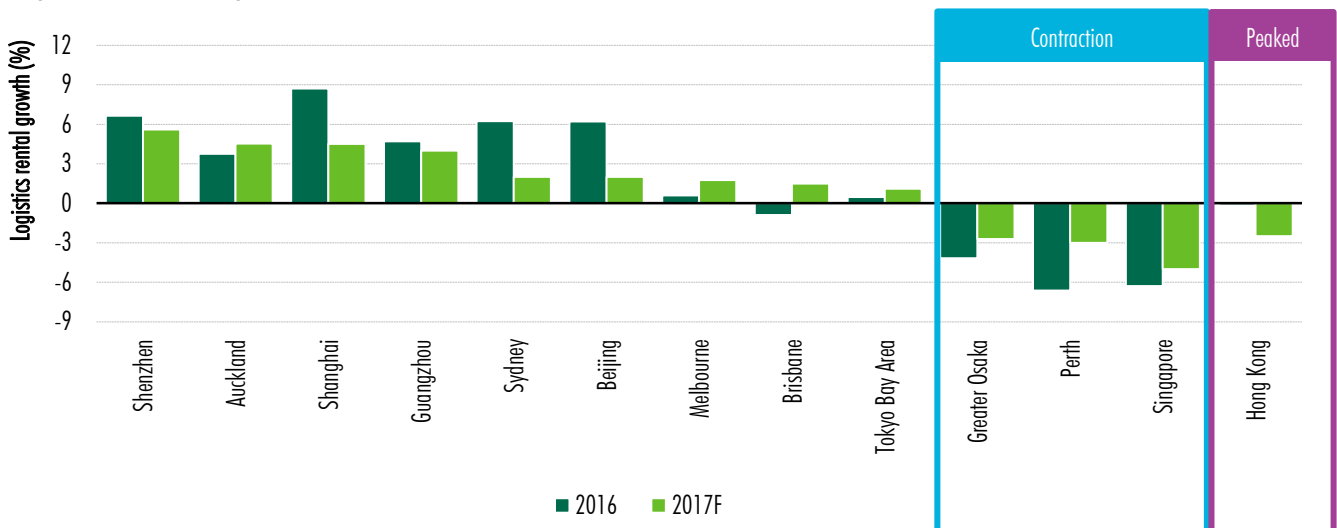
MORE BALANCED SUPPLY EXPECTED

China will continue to lead rental growth prospects, with rents in tier I cities expected to increase by between 4-6% over the next three years. Rents are expected to be pushed upwards in Auckland as rising construction costs are passed on by developers. In Australia, Sydney was the first city to see rental growth in 2016, and Melbourne and Brisbane are set to follow in 2017. These markets are projected to register slow but steady rental growth over the short term, buoyed by infrastructure projects and the tail-end of the housing boom. At the other end of the spectrum, Perth and Singapore will continue to face

headwinds in 2017 but should stabilise in the following year. In Hong Kong, rents have peaked and are slated to decline over the next two years. However, the structural lack of supply in this market will ensure rents recover rapidly if demand can rebound.

Overall demand is projected to remain broadly stable as supply returns to historical levels. The Asia Pacific logistics market is therefore expected to experience a low growth period, mimicking the static economic environment.

Figure 14: Asia Pacific Logistics Rental Outlook



Source: CBRE Research, December 2016.

Figure 15: Transport Industry & Industrial REIT – M&A Transaction Value by Target Company Region



Source: S&P Capital IQ, December 2016.

PORTFOLIO OPTIMISATION

Industrial occupiers and investors are striving for efficiency in the supply chain, driven by industry consolidation, physical location reconfiguration and technology implementation. In an era of low and slow growth, efficiency has taken on greater importance as companies seek to sustain profit margins, especially in the logistics industry. Industry consolidation has been gathering speed as operators and investors attempt to build more economies of scale, with M&A transaction value steadily increasing over the past two years.

M&A transaction value in the transportation industry and Industrial REIT sectors totaled US\$23.9 billion⁶ in 2016, following on from a banner year in 2015. This figure was 21% higher than the average transaction value of US\$19.8 recorded since the onset of the Global Financial Crisis (GFC) in 2008. Industry consolidation usually brings opportunities for portfolio optimisation as companies reorganise multiple and often conflicting logistics locations and hubs.

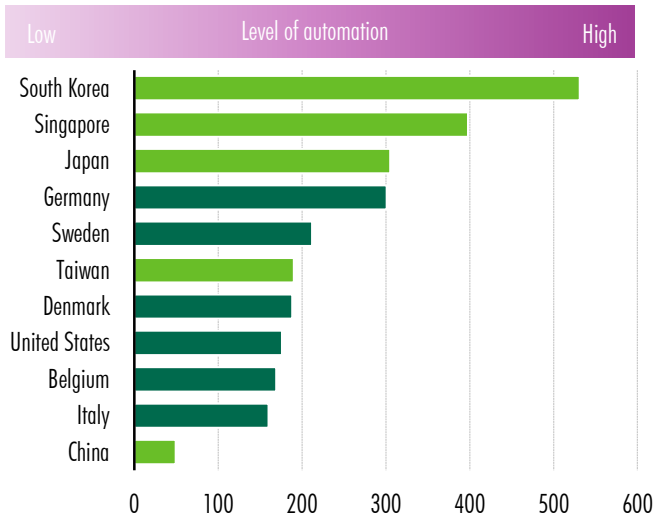
In addition to industry consolidation, individual operators have continued to focus on streamlining their supply chain, driven by both economic and regulatory factors. Consolidating multiple warehouses into a single

larger location or pursuing cost effective options such as new logistics facilities in satellite locations are some of the typical strategies that have been adopted by occupiers. Cities with large supply pipelines will provide more opportunities for individual operators to engage in portfolio optimisation as landlords compete for quality tenants.

The more transparent and open regulatory framework is modifying supply chain configurations in several markets. For example, the new Goods & Services Tax (GST) bill in India, which is scheduled to be implemented in April 2017, but may potentially be delayed until September 2017, is prompting 3PLs and manufacturers to optimise their supply chain for logistical rather than tax efficiency. The GST will unify national tax policy and remove numerous layers of compliance and tax barriers. In a period of slow growth, authorities in emerging markets may be inclined to reduce the regulatory burden on companies to sustain growth.

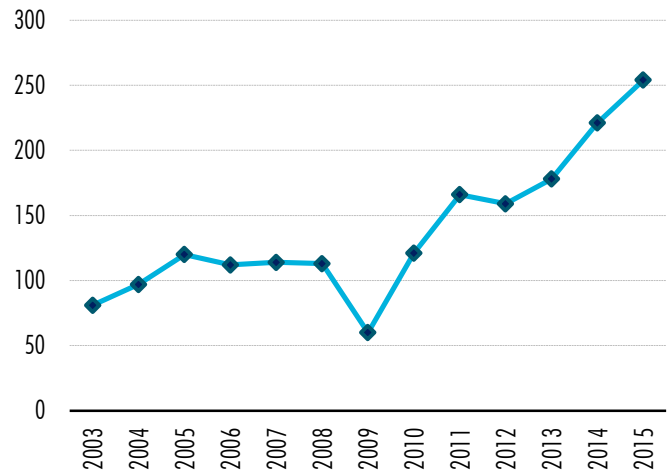
⁶ US\$ Historical Exchange Rate

Figure 16: Industrial robots per 10,000 persons employed in manufacturing



Note: Industrial Robot as defined by ISO 8373
Source: International Federation of Robots, September 2016.

Figure 17: Estimated annual supply of industrial robots ('000)



Source: World Robotics, 2016.

AUTOMATION TO CHANGE THE LOGISTICS LANDSCAPE

Finally, new technology is being implemented in response to the structural changes (e-commerce and Industry 4.0⁷) in the Asia Pacific economy, helping occupiers to optimise their logistics portfolios. E-commerce continues to enjoy robust growth in Asia Pacific as consumers demand the rapid delivery of an increasingly diverse array of goods. According to eMarketer, Asia Pacific e-commerce sales as a percentage of total retail sales are forecast to more than double from 10.1% in 2015 to 24.0 % in 2020. E-commerce companies and 3PLs are adopting automation technology to cope with higher customer service levels. Older facilities may not have the required specifications to employ new technology such as automated storage and retrieval systems (AS/RS) adopted by the e-commerce sector. This is expected to drive a new wave of logistics development to satisfy demand for modern warehouses.

As manufacturing becomes more customised and design cycles tighten, suppliers need to be more responsive to the changing landscape and adapt their portfolios accordingly. Advanced manufacturing is becoming

smarter and more connected as more robotic solutions are employed in the production process. For example, industrial robots are being utilised by capital intensive industries to reduce labour costs and increase throughput. South Korea, Singapore, and Japan lead industrial robots per capita (10,000 manufacturing employees) as they are large exporters of automobiles, heavy machinery and electronics. China is also moving up the manufacturing value chain, with Chinese manufacturers purchasing roughly 68,000 industrial robots in 2015—over a quarter of total global sales—according to the International Federation of Robotics.

As low cost manufacturing shifts to Southeast Asia and developed Asia and China utilises more advanced manufacturing techniques, logistics occupiers will need to adjust their supply chain accordingly. New warehouses will need to be constructed to supply light industrial manufacturing in Vietnam, India, and the Philippines, while a leaner, higher-value supply chain will be oriented towards developed Asia and China. However, in both the low and high cost manufacturing industries, the production cycle is declining, necessitating a more efficient supply chain set up.

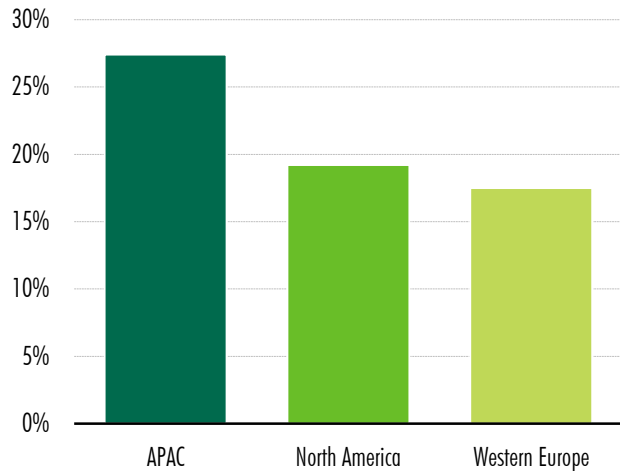
⁷ Industry 4.0 refers to the fourth Industrial Revolution that is occurring because of a digitally interconnected manufacturing process. The heart of Industry 4.0 is digitization and collaboration where everything is interconnected from company operations to product design to interaction with customers. The digitization of company operations will allow for a leaner supply chain where all the actors of the supply chain are sharing data in real time. The digitization of product design will allow for predictive maintenance procedures (products out in use will be digitally connected to detect any upcoming failures) and iterative production cycles (feedback from current models sold to customers can be improved upon immediately on the production line). The digitization of customer interaction can allow for products to be sold as a service as customers shift capital expenses to operating expenses.

NICHE SECTORS

While the Asia Pacific industrial and logistics market is mimicking the region’s static economic growth, not all industrial sectors are experiencing low and slow growth. Selected niche sectors including data centres, cold storage and last mile facilities are experiencing rapid growth as they ride on structural alterations in the economy and favourable demographic changes. Data centres are the supply chain of the modern economy with demand being driven by both consumers and businesses using the internet, mobile phones and applications. According to Cisco’s Global Cloud Index, total data centre workloads⁸ are expected to increase from 48.6 million workloads in 2015 to 163.4 million workloads in 2020, representing a CAGR of 27.4%. This is greater than the growth rates forecast in North America (19.2% CAGR) and Western Europe (17.5% CAGR). Given the strong demand forecast for data in Asia Pacific, prospects for the data centre sector look favourable. Large and small companies are increasingly creating, analysing and storing more data, helping to drive growth into this niche sector.

From the online realm to the offline reality, cold storage is a growing and important sub-sector in the industrial market, driven by the strong growth of the F&B sector in developed Asia Pacific economies and the expansion of supermarkets and hypermarkets in India and China.

Figure 18: Total Data Centre Workloads, Compound Annual Growth Rate (CAGR) between 2015 - 2020



Source: Cisco Global Cloud Index: Forecast and Methodology, 2015–2020.

According to market research firm MarketsandMarkets, Asia Pacific was the largest market for cold storage in 2015, thanks primarily to strong demand from India and China. Globally, growth in cold storage is expected to experience a 12.1% CAGR from 2016-2020, according to P&S Markets.

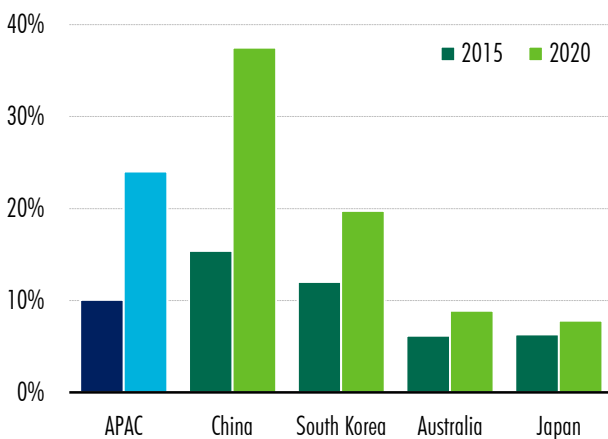


⁸ Workload: A server workload is defined as a virtual or physical set of computer resources, including storage, that are assigned to run a specific application or provide computing services for one to many users. A workload is a general measurement used to describe many different applications, from a small lightweight SaaS application to a large computational private cloud database application. For the purposes of quantification, we consider each workload being equal to a virtual machine or a container. Source: Cisco Global Cloud Index, 2014-2019.

Driven by the robust growth of the e-commerce industry, last mile facilities are becoming increasingly important in the supply chain and a valuable niche asset class serving urban population centres. The last-mile is defined as the last distribution point to the end-user's hands. This shortest leg of the logistics journey is the most expensive, especially for e-commerce, as a wide variety of goods needs to be delivered to numerous different locations. According to a report by the Singapore Management University, the last mile can comprise up to 28% of the total logistics cost⁹.

Last mile facilities are an ideal defensive asset as they are located close to the urban core and hard to replicate in location. While modern logistics facilities will continue to be built to serve the greater part of the supply chain, goods need to eventually flow to end users living in densely populated cities. As such, last mile facilities are an integral part of the supply chain.

Figure 19: E-commerce sales as a percentage of total retail sales



Source: eMarketer, December 2016.

Transport companies can try to mitigate the cost of the last mile but will continue to need the last mile facility to keep up with the increased service levels such as quicker delivery times, wider variety of goods and reverse logistics that customers require. Some innovations include drop boxes/pick-up centres, vertical logistics or start-up courier services.

In utilising drop boxes/pick-up centres, multiple different delivery points are consolidated into one destination, saving the carrier costs. Drop boxes are already present in Hong Kong shopping malls and have also been utilised in Singapore since 2013. In terms of vertical logistics, city centre land prices are often high, necessitating a higher density use of the land. Vertical logistics buildings may be able to serve as a cost effective distribution point for the last mile journey. Already heavily employed in dense cities in Asia (Hong Kong, Singapore, Tokyo, and Seoul), vertical or multi-storey logistics facilities may have niche uses in other highly populated cities in Asia Pacific.

Finally, newer start-up courier services that deliver small parcels, foods, and people are springing up in response to the growth of e-commerce. These new courier services either implement new technology or tap into the “sharing economy” to lower the cost of transport and unlock underutilised capital. For example, in China, some e-commerce companies are contracting small shop owners to deliver parcels utilising the company's technology infrastructure to coordinate logistics. Traditional 3PL companies have typically outsourced the last mile to national postal service carriers but are often choosing these newer courier services to supplement demand. Overall, last mile facilities are a niche part of the supply chain that are expected to enjoy increasing demand and therefore represent an opportunity for growth.

⁹ Collaborative Urban Logistics – Challenges, Current Practices and Future Research. Lau, Hoong Chuin. Singapore Management University.

A teal-tinted photograph of a busy city street. Tall buildings with glass facades line the street, reflecting the sky. In the foreground, the silhouettes of pedestrians are visible, some walking across a crosswalk. The overall scene is captured with a motion blur effect, giving a sense of a fast-paced urban environment.

Capital Markets

CREATIVITY VITAL TO UNLOCKING HIDDEN VALUE



- Investors will retain a strong appetite for real estate but activity is expected to moderate
- The yield compression cycle will be slower due to the narrowing yield spread
- Investors must formulate creative investment strategies to achieve target returns

INVESTMENT ACTIVITY SET TO MODERATE

Although investors will retain a strong appetite for real estate in 2017 amid low interest rates in Asia Pacific, investment activity this year is expected to moderate due to tight pricing and the limited availability of investable stock.

The total number of commercial real estate transactions in Asia Pacific in 2016 declined 22% y-o-y to around 1,240,

in spite of transaction volume being slightly higher than in 2015. The year saw several major assets in key markets such as South Korea and Australia change hands, a trend that will restrict availability over the course of 2017. The Chinese government's recent steps to increase scrutiny of capital outflows will inhibit overseas investment by Chinese buyers. In particular, larger sized deals may take longer to process.

CAPITAL MARKETS

Funds set to expire during 2016/2017 have completed most of their disposals, further limiting the number of assets available for sale. Real estate funds raised over the past two years will display stronger demand as some will approach the end of their capital deployment period in 2018.

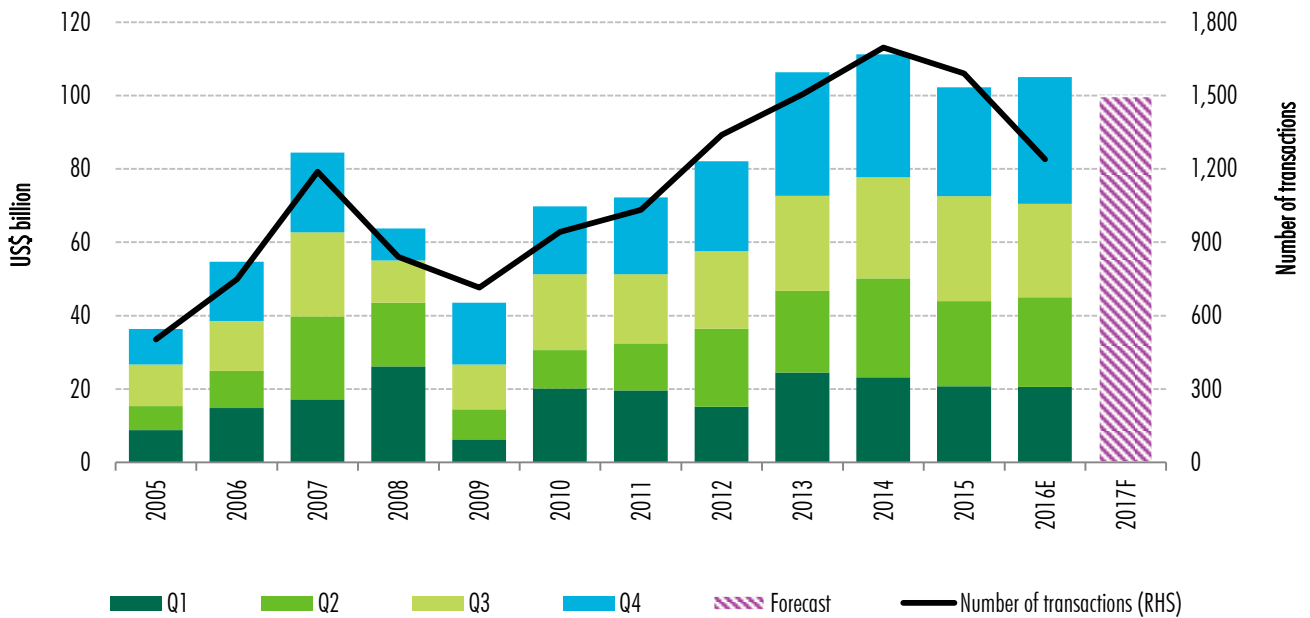
While Asian institutional investors continue to increase their allocations to real estate, there is mounting concern that tighter capital controls in China could restrict purchasing activity by Chinese institutions. Nevertheless, Chinese companies' appetite for global real estate investment will remain solid. This year is also expected to see Japanese investors step up their investment in overseas property markets, although they may not necessarily be active in Asia Pacific.

LOW YIELDS TO PERSIST

Strong liquidity and falling policy rates placed downward pressure on yields in 2016. This year, the yield compression cycle will slow as the yield spread narrows. Some mild compression may still occur in the office and logistics sectors, but this will mostly be driven by liquidity and be confined to gateway cities. Retail yields are expected to stay flat amid weaker investment demand.

The present downward cycle for yields has already lasted for the past seven years alongside the decline in bond yields and interest rates. Although yields have compressed by about 170 bps on average during this period, yield spreads over 10-year government bonds in Australia and New Zealand are largely close to those in 2008.

Figure 20: Total Commercial Real Estate Investment Turnover in Asia Pacific



Remarks: Transactions include deals above US\$10 million in the office, retail, industrial, hotel, mixed and other commercial sectors. Residential and development site are excluded.
Source: CBRE Research, RCA, January 2017.

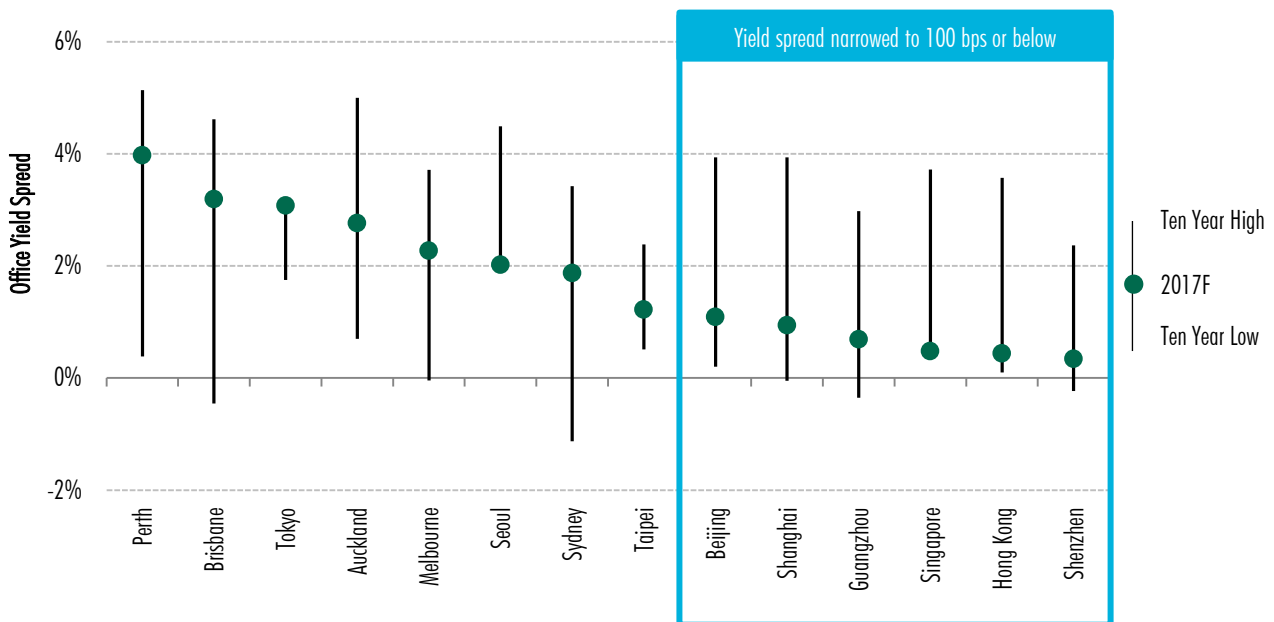
CAPITAL MARKETS

However, 10-year government bond yields in major economies including China, Australia and South Korea spiked by over 60-70 bps in the final three months of 2016, consistent with the upward movement in the U.S. The buffer for the positive spread is weakening, with the yield spread for China, Hong Kong and Singapore narrowing quickly to below 100 bps. Although most markets in Asia Pacific are not expected to follow the U.S. in increasing interest rates, the rapid re-pricing in the bond market will alter investors' expectations towards real estate pricing, although this will involve a time lag.

With slimmer yield spreads, property pricing could become more sensitive to future interest rate movements.

While the interest rate differential between the U.S. and markets in Asia Pacific could persist throughout 2017, the region is close to entering the upward interest rate cycle. The pressure on real estate yield re-pricing could therefore gradually build over the course of the year.

Figure 21: 2017 Office yield spread forecast



Remarks: Office yield spread equals to difference between prime office yield and 10-year government bond yield
Source: CBRE Research, Oxford Economics, January 2017.

INVESTMENT OPPORTUNITIES

CREATE AND UNLOCK PROPERTY VALUE

With yields set to remain low, there is less room for yield accretive acquisitions. At the same time, strong income growth is expected in only a handful of markets including the office sectors in Melbourne and a few Indian cities, as well as the logistics sector in tier I cities in China.

Counter cyclical markets and sectors, such as Singapore offices and Hong Kong retail, could provide investors with opportunities to ride on the rental recovery in 2017 or 2018. However, capital values have not fallen as much as rents.

Investors are expected to be more creative in formulating their investment strategies in 2017 in order to achieve target returns. Potential strategies include unlocking property value by asset reposition or asset enhancement. It is crucial that such projects consider occupiers' requirements so as to better understand the building's future use and minimise leasing risk, thereby protecting future rental income.

With occupiers increasingly focused on the end-user experience, investors should consider incorporating additional elements into their properties to attract and retain tenants. Examples include converting the lower floors of an office building to retail use or adding amenities to increase tenant engagement, and introducing more retailtainment elements such as F&B and exhibitions to shopping centres to increase footfall. In South Korea, many landlords have added retail elements to office buildings, while in China investors have converted the upper floors in underperforming shopping malls to office use in order to improve occupancy.

Apart from tenant or asset enhancement, investors can also consider repositioning their assets to capture the price differential among sectors. Other similar options include converting old buildings into alternative use. In recent years, Australia has seen investors converting older office buildings into student accommodation amid the surge in demand for university housing.

In China, the recovery in the residential market has prompted investors to sell off service apartment units on a strata-title basis. However, the recent reintroduction of cooling measures in the residential sector has encouraged investors in tier I cities to convert service apartments to co-living spaces to cater to the growing demand from Chinese millennials unable to afford the high rents for apartments in city centres.

INVEST OUTSIDE GATEWAY CITIES

As most investors are primarily focused on gateway cities and have similar investment criteria, the market in these locations has become overcrowded, leading to very tight yields. Investors with a stronger appetite for risk should explore higher yield opportunities outside gateway cities in locations which are priced reasonably or offer prospects of a recovery. For example, the Brisbane office market is showing signs of bottoming out, with rents forecast to improve in the coming years thanks to stronger white collar employment growth and limited new supply. In Auckland, the office sector continues to offer comparatively high yields to investors, underpinned by solid income growth.

Selected tier II cities in China such as Hangzhou and Chengdu, which have potential to develop into tier I locations and enjoy relatively balanced fundamentals, are also set to become more attractive to investors. While landlords in these markets have already adjusted their pricing to reflect real estate risks, investors should be selective as oversupply still exists. Well-managed community shopping malls supported by large residential catchments continue to provide attractive opportunities for investors.

Regional cities in Japan such as Osaka, Nagoya and Fukuoka will remain on investors' radar. Office rents in these markets are anticipated to outperform those in Tokyo in 2017 as they will experience comparatively less pressure from new supply.

CONSIDER NICHE SECTORS


The low yield environment has prompted many investors to seek opportunities outside conventional asset classes as they look for higher yields, guard against real estate cycles, and capture new demand resulting from changes in consumer behaviour.

Modern logistics facilities will continue to benefit from e-commerce growth, but the rapid expansion in this sector is bringing with it a need for faster delivery at lower cost. This is stimulating demand for last mile facilities located near city centres. Apart from home delivery, there is also growing demand for locations for customers to collect their goods themselves. Such facilities can be housed in lower grade offices in major districts or in light industrial buildings.

Assets in niche sectors often provide protection against real estate downturns. For example, the rapid increase in data usage from consumers and businesses in recent years has underpinned demand for data centres. While it is challenging for investors to directly enter this sector given the operational expertise required, indirect routes still exist, such as forming a partnership with an experienced operator, or by investing in a data centre REIT or a private equity real estate fund.

Student housing has already attracted strong demand from institutional investors amid the rapid increase in international students in many markets. The bulk of investment in student housing to date has been in Australia, with opportunities in Asia yet to be explored.

The ageing population has been a prominent theme in the Asia Pacific real estate investment market for some time. While senior housing has attracted attention from investors, the lack of a successful operating model in the region has limited investment activity to date. The coming year may see investors shift their focus to the medical and healthcare sector, as more elderly and more people with health insurance¹⁰ means higher demand for quality and affordable medical services. This is creating demand for healthcare and medical centres. As this sector requires specialised technical knowledge, partnering with an experienced operator will be crucial. There may also be opportunities for investors to team up with universities and other similar institutions. In addition, investors may consider converting office space for medical clinics.



“Investors will need to be creative to unlock a property’s hidden value. They should also extend their focus outside conventional asset classes and gateway cities to achieve their target returns”

¹⁰ According to a Swiss Re sigma study 3/2016, aggregate non-life insurance premiums including health insurance in Asia grew by 137% to around US\$406 billion between 2005 and 2015, a compound annual growth rate (CAGR) of 9%.

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