

Asia Pacific Real Estate Strategic Outlook

Mid-Year 2024

IN A NUTSHELL

- We believe the real estate repricing cycle in Asia Pacific could reach its bottom by the end of 2024, coinciding with an easing of financing conditions by year-end.
- Our Houseview investment themes include Repriced Logistics, Built-to-Rent/Multifamily across Australia and Japan underpinned by structural growth drivers, as well as tactical opportunities such as Sydney Office, High-street Retail in Japan and Structured Equity & Debt opportunities.
- Investors may also consider regional value-add opportunities such as asset repositioning strategies, while selective investments in higher risk operational real estate and emerging markets could drive higher returns.

1 / Economic Update

Current economic conditions remain soft across Asia Pacific, with consumption expenditure moderating from the post-pandemic revenge spending rebound and higher cost-of-living pressures. However, bright spots persist including signs of turnaround in global trade and easing inflationary pressures. The latest DWS CIO view expects Asia's economic outlook to be uneven, with China's growth to slow further to 5.0% this year and 4.4% in 2025, while Japan's economy should pick up starting next year in comparison to more subdued growth expectations of 0.3% in 2024. Other major APAC economies of Australia, South Korea and Singapore could see their economies expand by between 2% to 2.5% in 2025.

Within Asia Pacific, country-specific themes continue to influence the investment climate. The Bank of Japan's expected interest rate policy normalisation hinges on addressing the challenges of inflation volatility, higher wage growth expectations and a significantly weaker yen vis-à-vis its major trading partners. In China, risks persist from macroeconomic uncertainties, and a prolonged residential property crisis undermining investment sentiment. Outside China and Japan, inflation levels have moderated from peak levels but remain above central bank targets, keeping policy rates status quo at multi-year peak levels.

Elevated real estate financing costs are still a key impediment to investment activity and pricing stability, with senior loan rates in Australia, South Korea and Singapore staying at 5% to 6% levels, limiting the participation of institutional investors to discounted pricing or value-added opportunities. Meanwhile, current analyst expectations are for central banks to start cutting rates later this year with policy rates in Australia and South Korea falling almost 100 basis points¹ by the end of 2025 – though less than the US and Europe. Nonetheless these forecasts should be viewed with caution considering significant volatility in current financial conditions.

¹ Retrieved from Bloomberg, as of 6 June 2024

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2 / Real Estate Outlook

Office:

The office leasing environment in Asia Pacific has seen improvement from last year. Regional leasing volumes grew 12%² year-on-year (y-o-y) in the first quarter of 2024, with growth recorded across most markets. Tokyo continued to see a recovery of office leasing demand – led by the upgrading requirements of domestic corporations, particularly service-oriented industries – with occupancy recovering slightly though a strong supply pipeline has kept the vacancy rate above 5%. Office rents in Singapore turned around to reach a 15-year high, driven by strong leasing enquiries for newer high-quality space, although some financial services firms have been reducing their CBD office footprint. Seoul remains among the top performing office leasing markets with strong rental growth underpinned by healthy leasing demand driven by the technology industry keeping vacancy at record lows.

On the other side, overall office vacancy levels in Australia continued to climb above 12% in Sydney and 16% in Melbourne as net absorption remained negative, particularly for lower grade buildings. Though Australia has been lagging regional peers in the return-to-office trends, peak office utilization rates have notably improved reaching 75% - 95%³. Meanwhile the outlook for the office markets in China and Hong Kong remain bleak along with weak leasing volumes and subdued market sentiment, as rents continued to decline due to near term supply pressures and rising vacancies.

Tenant preferences remained skewed towards high-quality green buildings which have outperformed older commodity buildings in secondary locations. A good example is in Australia where net absorption for premium grade buildings has remained positive in contrast to the negative absorption trends seen across grade B buildings. Similar trends can be observed across the region outside China and Japan which continues to face strong pressures from new builds.

Industrial:

The strong leasing momentum in warehouse assets experienced post COVID appears to be normalising amid softer economic conditions this year. Prime logistics vacancy rates in Australia have picked up from the record low levels seen a year ago, though national vacancy rates remain tight at just 1%⁴. Across Greater Seoul, new supply is expected to ease from the elevated levels seen in 2022-23, though rental growth is still likely to be constrained in the short term. Logistics in Japan faces short-term headwinds of record new supply in 2023 and 2024, leading to rising vacancies even though occupier demand remained relatively strong. Singapore is still a bright spot where prime warehouse availability remains tight particularly for occupiers with larger space requirements, which should support the strong rental growth momentum seen after COVID.

Longer term, rising construction costs are likely to limit future supply across the region, while in Japan a lack of truck drivers underpins demand for infill locations. Other long-term structural factors remain at play: growth of e-commerce retailing, post-pandemic diversification of supply chains within Asia Pacific, increased nearshoring practices and upgrading demand towards higher-quality leased warehousing suited for increased automation demand, combined with a structural undersupply of modern facilities in the region. As such, we retain a constructive outlook on logistics with rental growth expectations at around 3% per annum across our core market calls.

Retail:

The APAC retail sector has generally benefited from the rebound in international tourism, yet the recovery remains uneven across the region. High-street retail locations in Tokyo, Seoul, and Singapore with their significant exposure to inbound tourism, continue to benefit from rental growth along with the recovery in leasing sentiment. On the other hand, slowing growth in discretionary spending in Australia is still weighing on leasing, with incentives at record high levels, while retail rents in China continued to decline on subdued domestic consumption. We believe that while the retail sector could present

² JLL REIS 1Q 2024

³ CBRE Research, as of May 2024

⁴ CBRE Research, as of January 2024.

selective opportunities for recovery in rents and occupancy, structural and cyclical factors including rising ecommerce, higher cost-of-living and rising operational costs for retailers could constraint rental growth prospects.

Residential:

The APAC Living sector remains attractive as investors look to diversify away from the traditional office and retail sectors, while residential assets provide resilient cashflows tied closely to inflation and fundamental housing needs rather than cyclical economic factors. The sector has also benefited from strong rental growth, with Australia recording a 9.5% y-o-y increase in May 2024⁵. Investors have been actively looking at Built-to-Rent (BTR) models across the region, particularly in Australia due to housing shortages, elevated housing prices and low mortgage affordability while rising construction costs and high interest rates have exacerbated the lack of new supply.

Japan’s residential market remained buoyant, driven by positive net migration, as well as strong household formation around major city centres. Rising record-high prices of for-sale condominiums continue to drive aspiring first-time home buyers towards rental units, while larger units remain popular particularly for households with hybrid work arrangements. The rental growth outlook has been further boosted by the low vacancy and constrained condominium supply arising from elevated construction costs.

Hospitality:

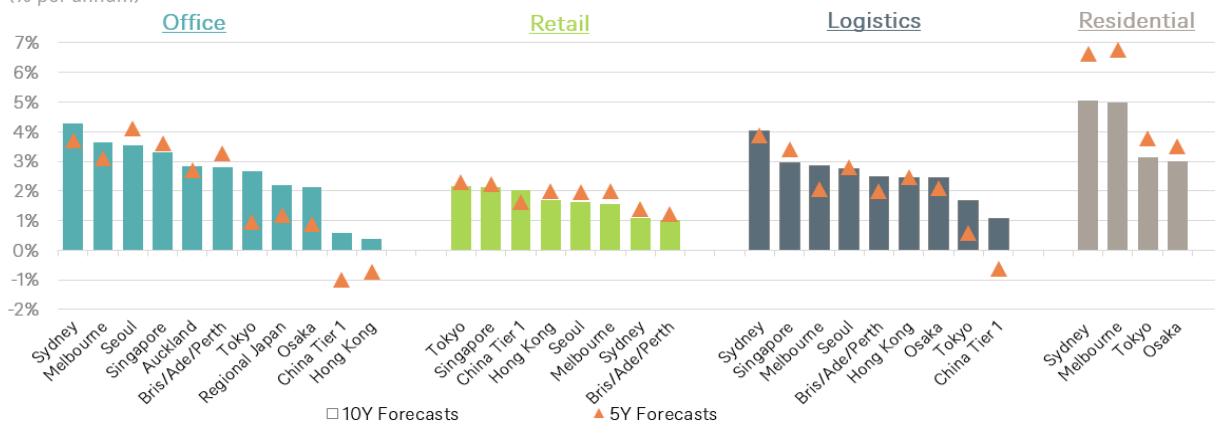
International travel in Asia Pacific continued to recover with demand rising 39% y-o-y⁶ in March 2024. Meanwhile, APAC hotel occupancy rates and average daily rates benefited from single digit growth in 2023, with RevPAR projected to grow by over 7%⁷ in 2024. Japan continues to be a major beneficiary of the tourism rebound, with the upscale limited-service hotel in key Japanese regional markets highly sought after by investors given rising demand for upscale accommodation from travelers, as well as this segment’s higher profitability.

Rental Outlook

Based on our Houseview forecasts, the residential markets in Australia and Japan (multi-family, built-to-rent) could provide the region’s strongest rental growth opportunities, particularly over the next few years. We also have a favourable rental growth outlook for Logistics in Australia, Singapore and regional cities in North Asia, as well as select office markets in Australia, Seoul and Singapore.

Exhibit 1: Net Effective Rental Growth Forecasts (2024-2033F)

(% per annum)



Note: Rents shown are on net effective basis after incentives. China Tier 1: Beijing/Shanghai/Guangzhou; Regional Japan: Nagoya/Yokohama/Fukuoka
There is no guarantee the forecasts shown will materialize. Source: DWS. As of June 2024.

⁵ SQM Research, 28 May 2024

⁶ IATA Press Release No 16, 1 May 2024

⁷ STR Gopal, March 2024

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3 / Investment Trends

Capital Flows

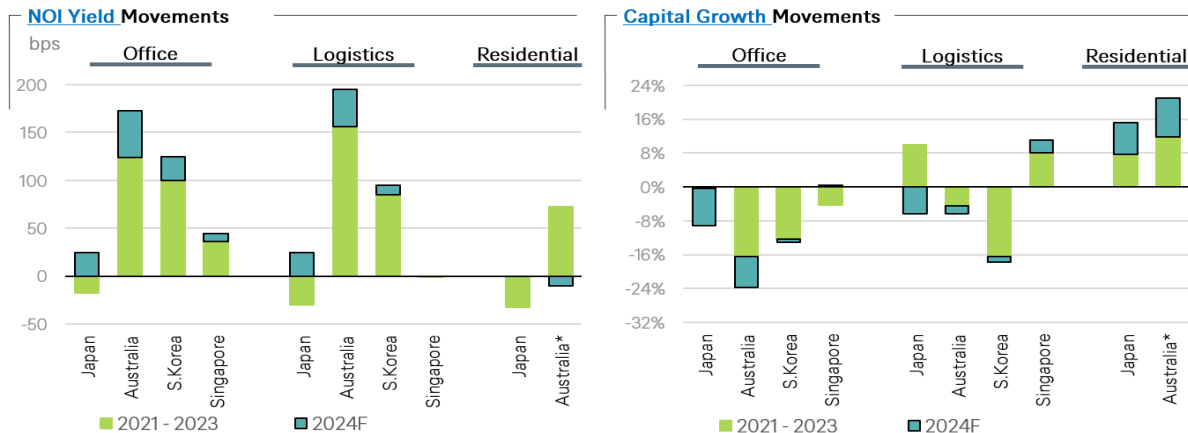
Transaction activity for income-producing assets in Asia Pacific remains lackluster. Quarterly volumes remained above the US\$30 billion level⁸ during the first quarter of 2024, but nonetheless there were early signs of stabilisation including anecdotal evidence of increased bidder participation for on-market deals, and a stable pipeline of deals undergoing due diligence checks prior to completion. The core markets of Japan, China, Australia, and South Korea led investment flows. While domestic investors were still the dominant source of capital, regional cross-border investors have also been active with their share of transaction activity increasing from the pandemic lows of 11% to 15%, driven by investors from Singapore and Hong Kong. Notably cross-regional investors from U.S and Europe have remained on the sidelines, with their share of transaction volumes remaining near a record low 10%.

Pricing Trends

Asset repricing in Asia Pacific commenced around mid-2022 along with rate hikes experienced globally, but the standoff between buyers and sellers mostly persisted until around the second half of 2023. Australia is a good example where asset revaluations has now become increasingly evident from the write-downs of portfolio book values across Australian REITs, particularly office assets. Furthermore, with confirmed sale transactions of prime CBD office assets at a discount of 15%-20% to prevailing book value, the process of revaluation has picked up pace over the past twelve months ago. The price discovery process in Asia Pacific is more advanced compared to 6-12 months ago, with bid-ask spreads narrowing as more transactions reflected downward pricing, however market participants should heed caution in interpreting regional trends. Japan for example being the notable exception, having seen little price correction to-date.

We estimate that between 2021 to 2023, prime yields in Australia and South Korea have expanded by around 80 to 160 basis points (bps) reflecting price declines of over 15%. The sharpest rise in yields occurred in Australia, with the expansion of logistics yields by 160 bps and office yields increasing 125 bps from the historic lows of 2021-2022. As a result, office NOI yields in Sydney and Melbourne currently stand at around 6.2%-6.4%⁹, a level last seen a decade ago. Meanwhile, the price correction cycle in Singapore was less severe due to low market leverage, strong landlord balance sheets, as well as an active presence of both domestic and foreign investors, including new sources of private wealth.

Exhibit 2: NOI Yield and Capital Value Changes since Q4 2021



*2021-2023 figures for Private Rented Market / Built-to-sell market. F=Forecast. There is no guarantee the forecasts shown will materialize. Source: DWS. As of June 2024.

⁸ MSCI-RCA, as of May 2024

⁹ Colliers data, as of May 2024

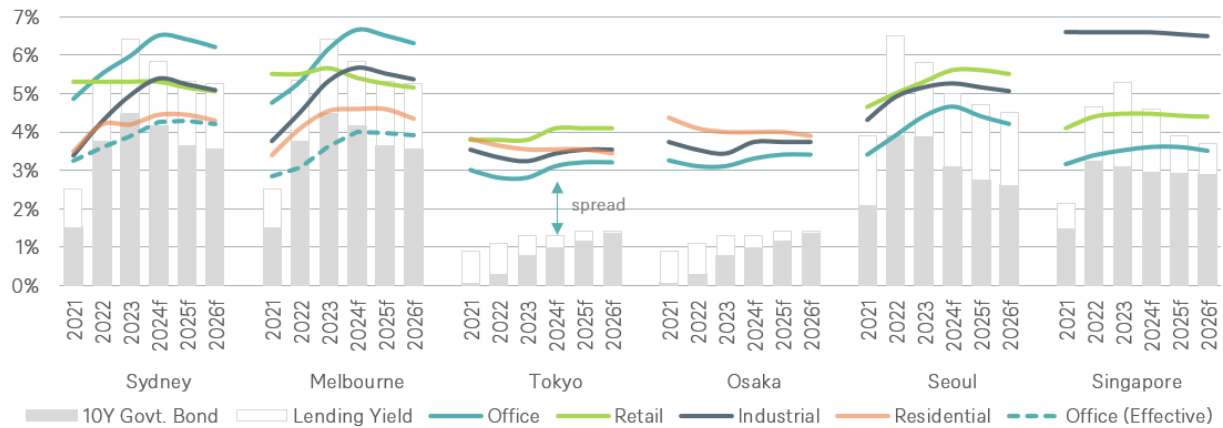
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Given the level of markdowns that have already occurred, we think the repricing cycle is approaching the advanced stages, with further yield expansion of 25 to 50 bps accompanied by price depreciation of up to 8% in 2024, led by Australia (though mostly front-loaded) and Japan. For several years Japan has been a major beneficiary of strong capital inflows and cap rate compression owing to its negative-interest rate policy, yet with further interest rate hikes expected, coupled with rising supply pressures and weakening office rents, we see a pricing reversal in Japan within the next 6-12 months led by Tokyo and Osaka office which face weaker demand-supply dynamics.

From a sector perspective, while office assets have been more vulnerable to pricing adjustments, the industrial sector has shown more resilience in this cycle, driven by strong rental growth which helped offset rising yields. We believe logistics prices could be close to stabilising with potential for pricing recovery, although long-WALE assets in secondary locations facing significant pipeline supply are more vulnerable to further price corrections compared to institutional-grade warehouses in transport nodes with low vacancy levels. The institutional residential sector is also forecast to benefit from potential pricing upside due to strong demand drivers and continued rental growth, particularly for Australia where the urgency for more rental housing stock and favourable tax changes is expected to drive the institutionalisation of the BTR sector.

At the same time, given a growing investor focus on high quality, ESG compliant assets, we believe owners of non-prime stock with high capital expenditure requirements could increasingly look towards divestment and recycle capital into the prime space. This could sustain the divergence in pricing trends with weaker performance in lower quality assets against prime.

Exhibit 3: NOI Yields vs Bond Yields



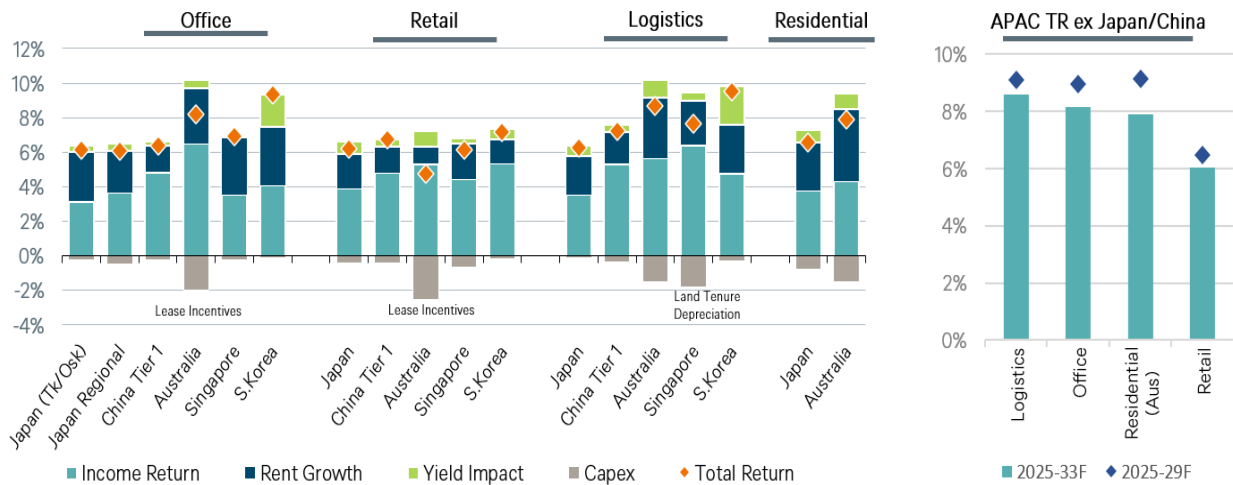
f=forecast. There is no guarantee the forecasts shown will materialize. Source: DWS, Colliers, Miki Shoji, Oxford Economics. As of June 2024.

4 / Returns Outlook

Combining our house view rental growth and yield forecasts, we believe APAC Logistics could outperform providing aggregate annual unlevered total returns above 8%, along with the residential sector (Australia BTR) driven by the strong rental growth outlook. We also retain our positive outlook for Regional cities in Japan and South Korea (not included in the forecasts below) and office assets in gateway cities outside Japan should also perform well in the long run with a potential recovery in asset values over the next 12 months or so, though submarket differentiation and asset selection will be increasingly critical.

Critically, our current expectations are for property returns over the next 5-10 years to be predominantly driven by income yields and rental growth rather than aggressive cap rate compression trends. Monetary policies in the APAC region are likely to ease from current restrictive levels, but we believe long-run neutral interest rates could remain higher than pre-pandemic levels.

Exhibit 4: APAC Total Return Forecasts, (2025-2033F, p.a., Unlevered)



F = forecast. Projected returns are based on compounded basis There is no guarantee the forecasts shown will materialize. Source: DWS. As of June 2024.

5 / Investment Strategy

Overview

Combining our house view forecasts and strategic investment themes, here are key themes for investors to consider:

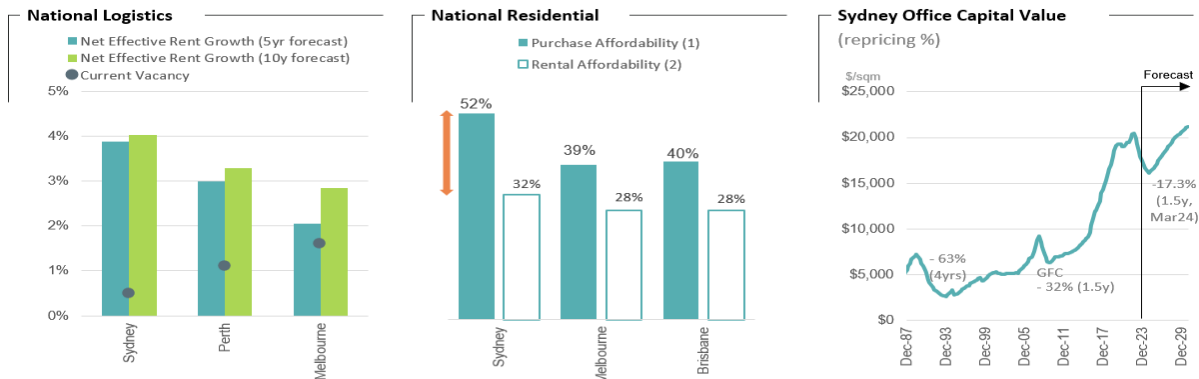
Australia: Sydney Logistics, Build-To-Rent (BTR) and repriced Sydney Office

The Australian industrial sector is forecast to benefit from attractive rent growth, continued investment demand and positive long term drivers: 1) National vacancy has increased but remains low at 1.1%, notwithstanding a marginal increase in sub-lease and speculative supply; 2) Strong investor sentiment towards industrial assets continues to support liquidity; 3) National supply remains largely constrained though differs at precinct levels; 4) Industrial demand is supported by strong population growth (5 sqm of traditional space warehouse space per head added) and rising ecommerce (70,000 sqm of dedicated space per \$1bn in online turnover), with around 2-2.5 million sqm per annum required over the next five years. Sydney looks to have the strongest fundamentals with tight vacancy, high levels of pre-commitment and limited serviced land. Longer term we expect infill markets close to population catchments and locations around key/future infrastructure to fare better.

Australia’s residential BTR sector is forecast to benefit from strong rent growth underpinned by favourable market conditions and supportive legislation 1) Strong population growth stemming from an influx of net overseas migration against weaker dwelling completions has seen national vacancy trend lower to 1%; 2) Rising home prices has eroded purchase affordability, with the economics of renting more attractive than ownership; 3) Supply is expected to remain constrained with the current BTR pipeline accounting for only 4% of the national housing target with majority of projects either awaiting planning approval or funding. Capacity constraints and numerous construction bankruptcies look to challenge supply targets. Another tailwind is the revision in legislation introducing tax concessions for new residential BTR projects from July 2024 onwards, which is expected to open the sector for foreign investors. We expect city wide apartment rents in Sydney and Melbourne to grow by around 6.5%-7% per annum over the next five years.

The Sydney office market has been challenged over the past couple of years, however improving fundamentals amid a turn in the cycle presents an attractive buying opportunity. 1) Improving occupancy rates and a decline in sub-leasing signal that businesses have become more certain on flexible working arrangements and space requirements. 2) A strong preference for prime grade assets in core locations will continue to support leasing activity. 3) A limited outlook for supply will see a material improvement in vacancy, incentives, and future rental growth. Over the past three decades there have only been two other repricing cycles. With yields approaching the 6.5% level and a potential pricing bottom over the next 6 months, this could present a tactical buying opportunity for investors.

Exhibit 5: Structural and Tactical Opportunities in Australia



(1) Based on % of gross household income required to service a 90% LVR mortgage for a term of 30 years. Prices are based on condominium prices (2-bedroom units).
 (2) Rental affordability = Average weekly asking rents / Median gross household income (2021 Census figures have been adjusted by state WPI to March 24).
 There is no guarantee the forecasts shown will materialize
 Source: DWS, Colliers Research, SQM Research. Australia Bureau of Statistics. As of June 2024

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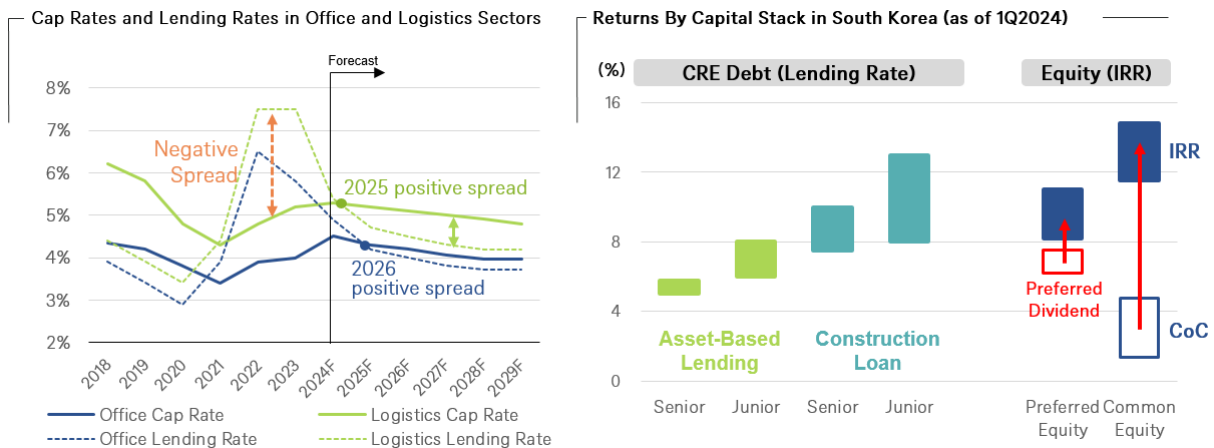
South Korea: Repriced Logistics and Structured Equity/Debt Strategies

While Seoul’s logistics market experienced a huge supply wave over the past 24-30 months, we retain a positive long-term outlook on the sector given leasing fundamentals remain healthy while new supply is expected to fall off sharply from 2025 onwards on the back of elevated construction costs. With logistics assets having repriced 10-20% from the recent peak and income yields hovering at 5%-5.5%, investment opportunities should look attractive assuming the negative carry environment turns around along with falling borrowing costs over the next 6-12 months.

Seoul’s office market fundamentals remain strong with its vacancy rate of 3.6% among the tightest globally, driven by limited supply and strong leasing demand from the buoyant technology industries. We expect the Seoul office market to outperform in the long run, notwithstanding the ongoing price correction due to higher interest rates. Given the current challenges in sourcing standard equity deals, with many sellers remaining firm on their asking prices, investors could seek out alternative deal structures such as preferred equity investments to potentially gain access to prime office stock; and to benefit from higher cash-on-cash yields (currently 6%-7.5%¹⁰) while maintaining target IRRs at 10% and above.

The real estate debt sector in South Korea presents another investment proposition, with a peak in maturing real estate debt this year highlighting an immediate need for new lenders to step in and ease constraints in the credit markets. In addition, the influx of upcoming development projects and rising investment volumes should create attractive debt investment opportunities. Lenders also appear favourably rewarded from a risk-adjusted angle with interest rates on construction loan financing currently sitting at elevated levels of around 8-14%.

Exhibit 6: Repriced Logistics and Real Estate Equity/Debt Returns in South Korea



f=forecast. There is no guarantee the forecasts shown will materialize
 Source: DWS, JLL, Oxford Economics, Bank of Korea. As of June 2024

Japan: Focus on Multifamily and High-street Retail amid broader market repricing

With the Bank of Japan tightening policy, coupled with rising vacancy pressures, we think the office and logistics sectors could finally experience a modest correction in capital values over the next 6 to 12 months, especially in Tokyo where pricing has remained extremely tight. Our previous Houseview over the past 12 months projected the peaking of asset prices, which could present a window of opportunity for investors to divest fully valued assets and optimise their portfolio. We now believe that investors seeking out offices and logistics assets should await better entry points which may potentially extend into 2025 and beyond.

Meanwhile, the retail and living sectors may present more attractive immediate investment opportunities. Within the Living sector, the multifamily market in Tokyo and Osaka continues to see strong leasing demand from working couples and

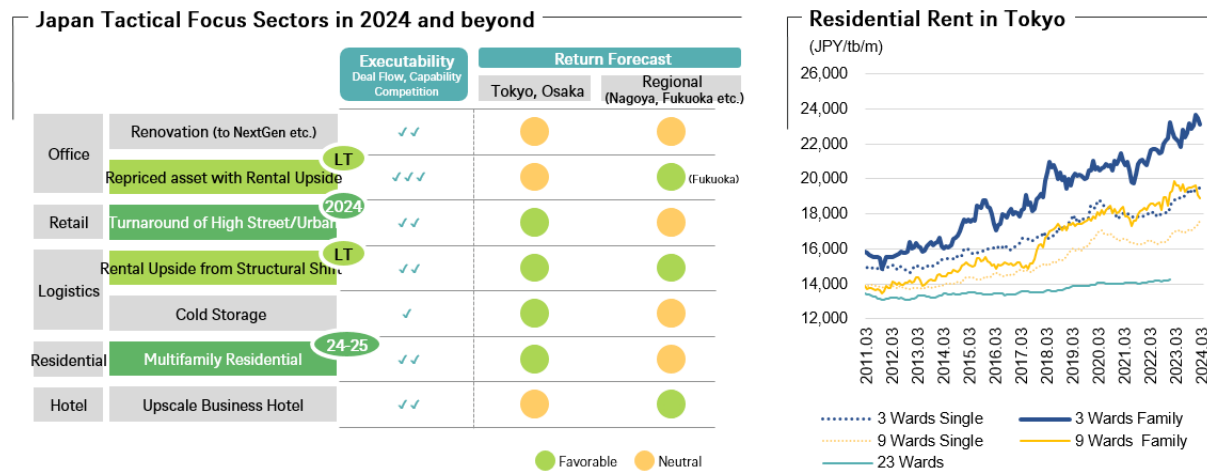
¹⁰ DWS analysis of market transactions sourced from CBRE, Deloitte, Savills, JLL as of May 2024

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professionals with preferences of larger living spaces for their work-from-home arrangements, while elevated for-sale condominium prices amid low supply and rising construction costs limited their options to the rental market. Other structural growth drivers include positive net migration flows from both overseas and domestic sources to the major cities, which is forecast to underpin rental growth of over 3% over the next few years.

With Japan among the top tourist destinations globally, tourism has rebounded strongly in Japan with 11.6 million visitor arrivals during the first four months of 2024, which is 5.7%¹¹ higher than the pre-pandemic peak in 2019. High-street retail has been a major beneficiary of increased tourism with rents climbing sharply as demand from retailers remain robust while vacancy has fallen to tight levels of 2% or less in several prime districts in Tokyo and Osaka. With retailers such as luxury brands actively seeking out acquisitions for their own stores, high-street retail in tourist-driven locations could present a tactical investment opportunity for immediate rental growth.

Exhibit 7: Tactical Focus for Japan



Source: DWS, CBRE, JLL, METI, LMC, REINS. As of June 2024.

Regional: Value-Add Strategies:

The major challenge in the current investment environment is that straight forward buy-and-hold core strategies may not meet the steeper returns hurdle institutional investors are increasingly seeking, even among core-focused investors. Faced with higher financing costs and risk-free rates, we have seen investors turn towards value-added deals offering at least double-digit returns. One example is the Australia BTR strategy as identified above. We outline below a few other investment strategies which investors seeking higher risk-adjusted returns may also consider:

Tactical Investments

Compared to a year ago, we have seen more advanced repricing occurring, with some real estate owners either facing loan refinancing challenges or collateral calls due to significant appraisal devaluations (particularly on secondary assets) leading to a breach of LTV or interest coverage covenants. This would require recapitalization or loan refinancing at a time when bank lending availability is limited. CBRE had estimated a debt funding gap of US\$5.1 billion by 2025 across Asia Pacific, led by Australia, Japan and South Korea, particularly in the office space.

As such, investors could seek out structured deal opportunities in bridging the funding gap, which could involve additional capital injection through preferred equity, mezzanine lending or a combination of both. The investment quantum for these types of structured deals would be relatively small, with a short investment period. However, with the opportunity to achieve repricing discounts from weak sellers facing liquidity issues, investors could potentially achieve higher risk-adjusted returns

¹¹ Japan Tourism Statistics, as of May 2024

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compared to common equity or senior lending. We view the logistics sector, and selective office segments underpinned by strong demand-supply fundamentals in core locations as favourable targets, through development funding, forward purchases or completed sale opportunities.

Asset Repositioning

The evolving real estate landscape has witnessed structural shifts in stakeholders' requirements – tenants, landlords, financiers, particularly in a post-COVID environment where a multitude of factors such as flexible working arrangements, ESG features, and portfolio de-risking takes centre stage.

Investors could seek older but well-located office buildings with upgrading potential to bring the development up to date through asset enhancement initiatives. Having next-generation office features such technological features, biophilic design and collaborative spaces appeal strongly to the millennial worker while re-leasing with the accompanying rental uplift could potentially yield higher returns on the capital outlay if executed well and outperform a buy-and-hold core strategy. For example, in Australia, spec fitouts and leasing up of furnished spaces increases the prospects for landlords to attract tenants and advance leasing progress when market vacancies remain elevated.

Operational Real Estate

As investors look to focus away from traditional asset classes such as retail and office, interest has grown in alternative real estate such as data centres, purpose-built student accommodation (PBSA), senior housing and co-living among others. These segments are often driven by long-term technology or demographic trends from specific demand segments while their nascent market maturity indicates that investors could seek higher returns from a combination of higher yields or additional operating margins through active management. For example, PBSA assets can command a yield premium of 50-75 bps¹² over comparable residential build-to-rent developments in Australia.

While investments in these niche segments may appear more appealing than traditional asset classes, investors would need to conduct further industry due diligence and consider some factors including operational risks, in-house management capabilities and achieving product scalability at the platform level.

New Markets

Beyond the developed countries in Asia Pacific, the emerging economies of China, India and ASEAN serve large population bases offering operational scalability and growth potential for new investment frontiers including real estate. Ongoing geopolitical tensions have accelerated the 'China Plus One' strategy which could speed up supply chain diversification and increase manufacturing activities in the region.

With medium-term GDP growth expectations of 6%-7%, India's rapidly expanding manufacturing and services sectors coupled with a large available pool of talented workforce have driven occupier demand for various real estate sectors including office, logistics, retail, residential and data centres. Major challenges such as regulatory red-tape, transparency and liquidity issues remain a hurdle for most core investors, with India contributing only about 2%-3% of investment volumes in Asia Pacific. However, core asset investments could potentially yield mid-teen returns driven by a combination of income yields of 7%-8% and rental growth, exceeding most other APAC markets.

¹² CBRE: Accommodating the growth in students, August 2023

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