# Real estate in Asia

September 2024


# Introduction

## Over the past year, marked by unprecedented developments, we witnessed notable macroeconomic shifts, including record-high inflation rates and aggressive monetary policy tightening across advanced economies.

These headwinds precipitated a global downturn, injecting significant uncertainty into markets. Private markets, in turn, faced substantial pressure, with some notable exceptions across strategies and regions.

As we move into the latter half of 2024 and into 2025, a more optimistic landscape emerges. Major economies are seeing disinflationary trends, increasing the likelihood of interest rate cuts. A few central banks, including the Bank of Canada, the European Central Bank (ECB), and the Bank of England (BoE) have already implemented policy loosening in recent months. The U.S. is expected to follow suit, making progress on inflation despite signs of persistence, with at least one rate cut anticipated this year.

Optimism surrounding a more accommodative borrowing environment sets the stage for a potential resurgence in private market activity. However, broader uncertainty is expected to linger due to geopolitical tensions, the prospect of significant shifts in the global political order amid numerous elections in 2024, and persistent macroeconomic challenges.

Against this intricate backdrop, we examine how these conditions will influence the outlook for private markets in the latter half of 2024 and into 2025. Our comprehensive series of reports will scrutinize the prospects for three specific asset classes – private debt, private equity, and real estate – across diverse geographical regions. We provide insights into how investors can navigate current market dynamics and leverage opportunities strategically to their advantage.

# Macroeconomic overview

## The Asian region continued to show strong growth in Q1 2024, with initial slowdown concerns revised downward due to increasing optimism.[1] This growth is led by several countries, notably India, projected to be the fastest-growing economy among G-20 countries in 2024.[2]

The region's growth is primarily fuelled by strong domestic demand, similar to the U.S. and unlike Europe and the UK. With spare capacity to reach its peak, the Asian region has room for further economic expansion, including the growth of private market assets.

Inflation in most Asian economies is now within respective government target ranges. However, China remains an outlier with poor consumer price growth and bouts of deflation due to lack of domestic demand and property sector corrections. Despite this, the overall inflationary pressures are expected to dissipate, leading to a more optimistic growth outlook and favourable investment opportunities.

The major risk to the real estate sector remains China's property downturn, posing a substantial downside risk, potentially causing broader economic and financial stress in the region and deteriorating asset quality.

The political landscape is influenced by upcoming elections in eight countries and ongoing geopolitical tensions, which can create supply-side risks and upward inflationary pressures. Despite these challenges, Asia's resilience reinforces its status as the fastest-growing region globally, highlighting its significance in the global economic landscape.

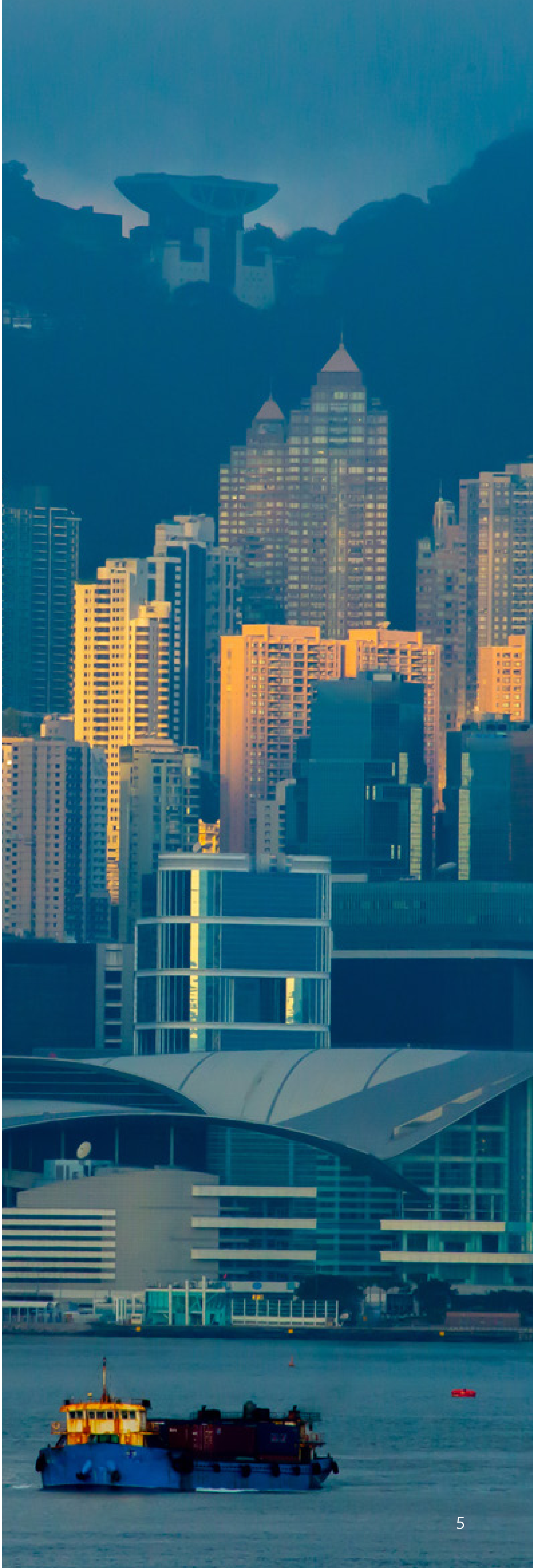
# Overview of the global real estate market

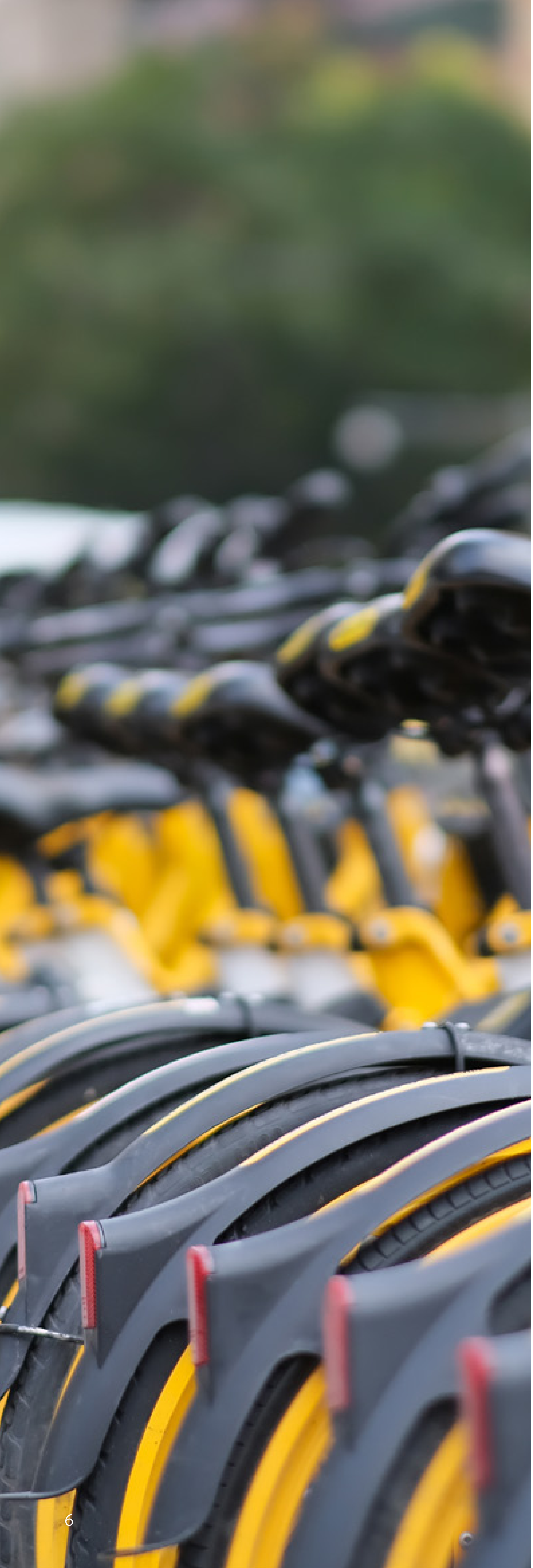
In 2023, subdued fundraising within the real estate sector persisted due to historically elevated interest rates, which raised borrowing costs and limited financing availability.

This trend appears to have continued into the first half of 2024, exacerbating challenges faced by key players in the real estate asset class. Coupled with valuation uncertainties, these factors led to a significant decline in global deal activity, hitting a decade-low of $645 billion across 2023[3]. The subdued transaction environment also impacted closed-end fundraising, which dropped by 34% to $125 billion in 2023, compared to 2022[4]. Overall, global fundraising for real estate declined by 26% in 2023[5], with Q1 2024 seeing only $19.8 billion raised, marking the lowest quarterly figure since 2011[6].

Throughout 2023, every strategy within the real estate investment sphere experienced a decline. Specifically, there was a notable shift away from core and core-plus strategies, known for their low risk but stable returns, with fundraising pertaining to this strategy dropping by 51% in 2023[7]. This shift reflects investors' increasing demand for liquidity amidst constrained exit opportunities due to wider bid-ask spreads. Consequently, capital has been tied up for longer periods with delayed returns. In contrast, opportunistic strategies saw a smaller decline of 18%, benefiting from the shift away from traditional core and core-plus investments[8].

In the first quarter of 2024, the trend away from core and core-plus strategies continued, with such strategies accounting for only 3% and 9% of funds raised[9], respectively. Investor preference for higher returns remains evident, with a strong inclination towards value-added strategies, which accounted for 71% of funds raised in Q1 2024[10].





In addition, global fundraising for both closed-end and open-end funds fell in 2023. For closed-end funds, this reflected a preference among investors for allocating their capital to larger, well-established funds, a trend similar to that observed in private equity. Indeed, funds exceeding $1 billion accounted for over 64% of overall fundraising, marking a notable increase from 51% in 2022.[11] Returns on this asset class witnessed weak performance, recording a -3.5% internal rate of return (IRR) through the first three quarters of the year. This represents the first occurrence of negative returns for this class since the Global Financial Crisis (GFC). Open-end fund performance also declined considerably, with NFI-OE funds returning -12.2% on a net basis, experiencing the first annual decline since the GFC.[12]

## The real estate sector is grappling with the dual impact of tighter monetary conditions and pandemic-induced shifts in behaviour, including reduced office occupancy and urban migration trends.

These changes have disproportionately affected certain property types, notably offices and retail spaces. In 2023, the office sector saw the sharpest decline in annual returns among all real estate sectors, plummeting by 17.6%. Fundraising for office spaces continued its downward trend, with no capital raised in Q1 2024, contrasting sharply with the 8% share of capital raised in 2019.[13] In contrast, the hospitality sector has demonstrated notable improvements, contributing 15% of total fundraising in Q1 2024, highlighting a shift in investor preference.

Despite lower fundraising, the real estate asset class accumulated capital throughout the year in 2023. Dry powder in closed-end real estate funds surged by 19% in the first six months of 2023. Indeed, dry powder in this asset class has grown by 13% per year over the past half-decade, reflecting a pool of funds ready for investment, even amidst a backdrop of diminished fundraising efforts.[14]

Looking ahead to the second half of 2024 and into 2025, indications point towards the market potentially having bottomed out in the first half of the year. This sets the stage for a potential normalisation in the real estate sector, aligning with post-pandemic trends and amid tightening monetary policy. However, investors will encounter ongoing challenges and opportunities as they navigate evolving preferences, macroeconomic shifts, and the dynamics reshaped by the pandemic.

# Navigating fundraising and exit strategies in Asia amidst prevailing macroeconomic conditions

The real estate landscape in the Asia-Pacific region witnessed a downturn in 2023, with deal volume plummeting to $94 billion, marking a 29% decline from the previous year.[15] Fundraising in Asia specifically saw a steeper decline, amounting to 38%, dropping from $29 billion in 2022 to $18 billion in 2023.[16]

This decline in activity and fundraising can be attributed to a combination of factors, notably the tighter monetary condition environment and woes associated with the property downturn in China. However, the start of 2024 has shown signs of optimism, with the Asia-Pacific region overtaking Europe as the second most popular region for capital raised for private real estate funds in Q1 2024, highlighting the growth potential within the region more broadly.

Capital raised in the region stood at $2.2 billion in Q1 2024, driven by capital raised for China, amounting to $1.4 billion by GLP Capital[17].

The stagnation in buying activity across Asia markets, particularly in Chinese assets, has dissuaded limited partners (LPs) from investing new capital in regional real estate strategies. This has led to a decline in fundraising, with real estate private capital fundraising in Asia Pacific down by 35% year-on-year in the first three quarters of 2023.[18] Fundraising in the real estate sector in Asia totalled only $15 billion in 2023, reflecting a 41% decrease from the previous year[19]. However, if fundraising for Q1 2024 is indicative of the trend for rest of the year, the outlook for 2024 and 2025 appears relatively rosier than before.

The prolonged lack of transactions due to the subdued global market and the tighter monetary policy campaign has left funds invested in markets for extended periods, leaving LPs unable to access their capital. This situation mirrors the challenges faced in the private equity asset class, where exit avenues have been blocked. Additionally, the absence of a mature secondary market in the region further complicates efforts to offer deals and provide liquidity for investors. However, as the global market continues to recover, this subdued situation is likely to improve in the coming months, which bodes well for the outlook of the real estate sector going into 2025.

Elevated interest rates are triggering asset revaluations across the Asian region, further clogging up exit avenues due to wider bid-ask spreads across buyers and sellers. As financing costs escalate, investors are demanding higher yields to offset the increased investment expenses. This should theoretically lead to a shift away from ultra-compressed cap rates, a common feature across Asian markets, resulting in downward revisions of asset values. However, many asset owners have been slow to adapt to this new reality, largely due to the lack of pressure from regional banks to enforce loan covenants or adjust pricing. With fewer opportunities offering returns due to the absence of asset revaluations, investors are opting to sit on the sidelines waiting for markets to reset.

Moreover, investors are increasingly withdrawing from the region due to the prevalent focus on traditional asset types, particularly large, core and office assets. However, the changing landscape of this asset class has led to a decline in the appeal of these traditional investment opportunities. The reluctance of asset owners to adjust cap rates to match buyer expectations has led to a bid-ask standoff, particularly in the office sector. Additionally, concerns over declining utilisation rates, have further dampened investor sentiment, tarnishing the attractiveness of certain asset classes.

A pivotal factor influencing the region's real estate dynamics is property downturn in China, a key player in the Asian market. Forecasts suggest that property sales in China are undergoing an L-shaped recovery trajectory throughout the year.[20] Essentially, this implies that while there may be some gradual improvement, the sector's activity is unlikely to rebound to pre-downturn levels anytime soon. However, several measures have been taken to address this crisis, notably significant fiscal stimulus, which could accelerate the recovery and minimise any spillover effects from the crisis for the wider Asian region. Nevertheless, investors and stakeholders should navigate the evolving landscape with caution and strategic foresight.

## References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6 PERE (2024), Q1 2024 fundraising remains at a 12-year low

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# Degree of opportunity for real estate markets posed by macroeconomic conditions

| Development | Degree of opportunity for asset class | | |
|---|---|---|---|
| **Interest rate cuts** | | | |
| Asia is anticipated to mirror the actions of major central banks in the West, particularly the U.S., by implementing interest rate cuts. This downward trend in interest rates is expected across the majority of countries in the region, with the exception of Japan, which recently raised its interest rates for the first time in nearly two decades Nevertheless, the prevailing sentiment toward looser monetary policy is likely to provide some stability, aiding investors in adjusting to this evolving environment. This, in turn, may facilitate the revaluation of assets, potentially leading to an easing of bid-ask spreads in the asset class and offering relief to subdued deal activity. | ✓ HIGH | MEDIUM | LOW |
| **Navigating ESG dynamics** | | | |
| As the focus on Environmental, Social, and Governance (ESG) intensifies, its impact on real estate has become increasingly tangible. With a growing number of investors prioritising carbon efficiency, buildings with low energy efficiency are losing their appeal. Meanwhile prospective tenants are increasingly hesitant to lease non-compliant buildings. Japan and South Korea stand out as leaders in addressing these transition risks due to their advanced technology and infrastructure, while markets like Singapore demonstrate strong commitments to improving energy efficiency. However, amidst global economic uncertainties and concerns over declining asset values and rising construction costs, some asset owners are scaling back their carbon efficiency initiatives, instead prioritising short-term goals such as refinancing assets and delivering targeted returns, potentially overlooking the increasing prevalence and importance of ESG in the real estate asset class.<br><br>Overall, ESG presents both opportunities and threats to real estate investors in Asia. While addressing environmental and social concerns can enhance asset attractiveness and resilience in the long term, failing to adapt to evolving ESG standards may lead to diminished asset values and regulatory penalties. Therefore, integrating ESG considerations into investment strategies is imperative for navigating the evolving real estate landscape in Asia. | HIGH | ✓ MEDIUM | LOW |
| **Outlook for office spaces in Asia** | | | |
| The changing dynamics in Western markets, characterised by the declining utilisation rates of office and retail space from central business districts, are indicative of a process of creative destruction that will have an impact Asia-Pacific markets. Unlike in the West, where remote work has become entrenched, countries in the Asia-Pacific are generally less inclined towards remote work. Notably, cities like Seoul and Shanghai have already returned to pre-pandemic office re-entry levels.<br><br>However, fundamentals in the office sector remain soft, with utilisation rates still below pre-pandemic levels and oversupply in certain cities. However, despite the prevailing challenges, opportunities for investors in the office space are more prevalent in Asia in comparison to the U.S. or Europe. | HIGH | ✓ MEDIUM | LOW |
| **Data centres emerge as prime investment targets** | | | |
| For real estate investors seeking promising opportunities in the Asian region, data centres emerge as a compelling property type. Despite a decline in deals in 2022, the market remains active, driven by robust demand fuelled by growing data consumption and e-commerce penetration. With significant investments directed towards development projects, particularly in emerging markets like India and Southeast Asia, data centres represent a lucrative avenue for investment in the region. | HIGH | ✓ MEDIUM | LOW |

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