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# Research & Strategy

## "Goldilocks" Global Economy to Broadly Support Asia Pacific Real Estate in 2018

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Buoyant capital markets, strengthening economies and steadily rising demand for real estate in an investment portfolio are likely to continue creating "Goldilocks" conditions for real estate investors globally in 2018. However, lingering geopolitical tensions and economic risks could potentially disrupt these "just right" macroeconomic conditions.

The rising middle class in Asia, the younger demographics of Southeast Asia, and most importantly, the political stability and positive economic momentum of the two largest economies in the region, China and Japan, are expected to continue to anchor the Asia Pacific macro outlook in 2018. Combined with gradual increases in interest rates/inflation and the continued relative calm of capital markets across all asset classes, a wide range of build-to-core and value-add opportunities[1] across the region are likely to be created.

However, real estate investors should remain mindful of and be prepared for the "three bears" scenarios the region could face: geopolitical threats, financial system threats and the side-effects of a "hyper-stimulus" scenario. Within Asia Pacific, China's debt problem, Japan's challenge in stimulating inflation, Australia's over-leveraged households and imbalanced economic structure, low housing affordability in major countries across the region, and the threat from North Korea, all have the potential to disrupt the region's economic outlook.

Asia Pacific is expected to continue its solid growth trajectory relative to the rest of the world in 2018. We remain cautiously optimistic on Asia Pacific economies and real estate fundamentals over the next two to three years. However, regional and global geopolitical risks could interfere with the region's growth, trade and investor confidence. There could be short-term volatility if these risks are combined with pockets of supply/demand imbalance. Interest rates in major Asia Pacific countries are expected to remain largely accommodative in 2018, although rates will eventually head towards "normalization". While the probability of significant yield expansion in most Asia Pacific markets over the near term remains low, there could be pockets of weaknesses or re-pricing. If occurs, it is likely to offer attractive investment opportunities.

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[1] Build-to-core opportunity refers to an opportunity to develop or re-develop a property and stabilize it to become an income-generating asset. Value-add opportunity refers to an opportunity to reposition a property through active asset enhancement, such as physical renovation or leasing.

LaSalle believes that real estate investors who look beyond a deal-by-deal approach and shift towards a wider portfolio view will be best placed to seize the opportunities the region has to offer, such as taking advantage of low-cost debt in Japan, rising demand for logistics space throughout the region, shortages of affordable housing in major cities, and rising tourism levels.

Offices in Sydney and Melbourne, multifamily and non-discretionary retail in Japan, and modern warehouses in key hubs in Asia Pacific remain attractive to core investors. Furthermore, the real estate markets and sectors in the region that are projected to offer growth potential or higher returns in 2018 include the following:

- **Office:** Major regional office markets are currently at different stages of the rental cycle. LaSalle favors Tokyo Grade B offices through repositioning strategies, with a focus on short holding periods and well-defined exit strategies. Additionally, build-to-core and value-add-to-core strategies in highly selective decentralized areas of large or mature office markets in the region, such as Hong Kong, Shanghai, Tokyo, and Sydney, could be attractive to higher-return investors with flexible or long investment horizons.

- **Industrial:** Prospects for the still-maturing logistics sector remain positive in most parts of the region. The expansion of e-commerce in the region and globally will be reliant on state-of-the-art logistics facilities, creating logistics development or value-add opportunities near key population centers. While the lack of modern warehouses is driving occupier demand, increasing supply suggests that market/submarket selection will be increasingly important.

- **Retail:** The threat of an e-commerce impact on retail malls varies by market and retail segment. Investors should focus on non-discretionary retail malls with a high tenant mix in grocery, pharmacy, food and beverage, and services located in strong residential catchment areas due to the defensive position they offer and various government stimulus programs. E-commerce will also further contribute to the ongoing bifurcation between dominant, better-located, and better-configured shopping centers, and worse-located, less-convenient, and outdated shopping centers. Nonetheless, selected retail markets in Asia Pacific are in unique positions where the rise of e-commerce have and will continue to benefit the physical retail sector. For example, some retailers in China have been successful in leveraging off their fast-growing distribution channels from online sales to expand to brick-and-mortar stores. Investors should also look out for opportunities where e-commerce could be a positive growth driver of brick-and-mortar stores.

- **Hotel:** Across the region, the rise of intraregional tourism and growth of middle-income households are expected to drive demand for hotels in the long term. Japan and Australia are expected to benefit the most over the next few years. In 2018, investors should focus on location selection, managing supply risk, and exit timing.

Globally, investments in stabilized, leased real estate are the most direct way to get the asset class characteristics that make real estate a valuable multi-asset portfolio diversifier. At the same time, investors should seek a balance of core and value-add strategies while also setting aside capital for opportunistic and debt strategies.

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