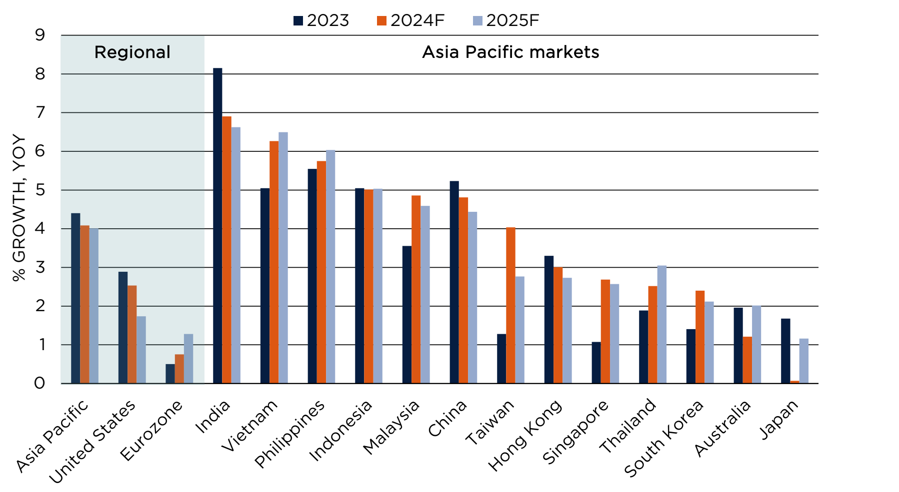
Asia Pacific - November 2024

SPOTLIGHT
Savills Research

Asia Pacific Office Markets

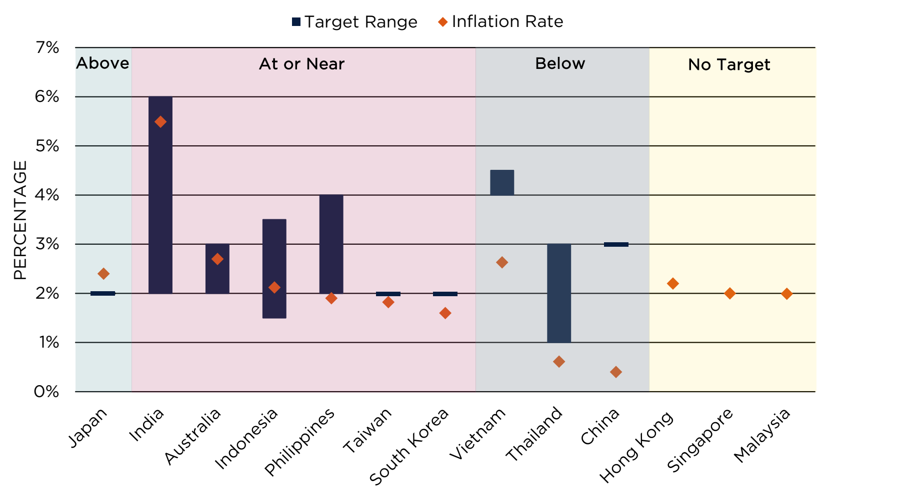
Mixed signals ahead for Asia Pacific's office markets

GRAPH 1: Real GDP Growth by Market, 2023 to 2025F



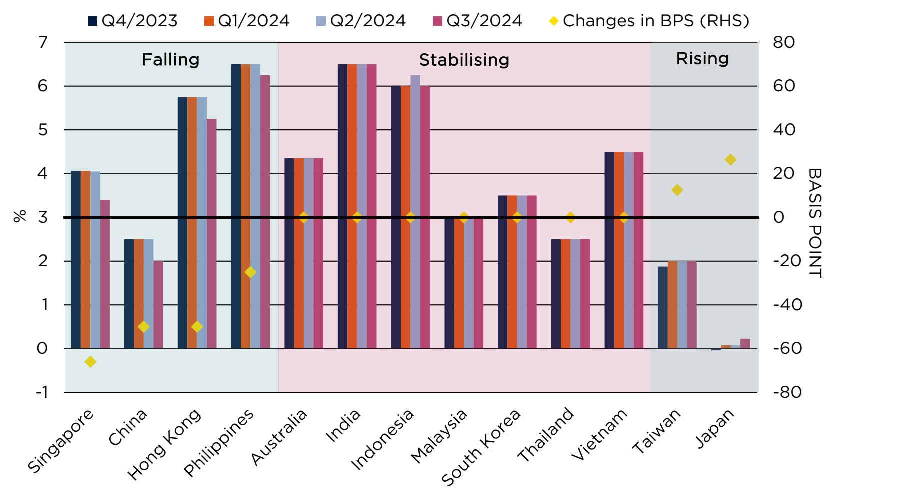
Source FocusEconomics

GRAPH 2: Inflation Rate and Target Range by Market, Q3/2024



Source Oxford Economics, IMF

GRAPH 3: Central Bank Policy Rate by Market, Q4/2023 to Q3/2024



Source FocusEconomics, Oxford Economics

ASIA PACIFIC SHOWS PROMISING SIGNS OF ECONOMIC RECOVERY

As the world emerges from the aftermath of a three-year pandemic, the global economy is beginning to stabilise. The Asia Pacific region, in particular, is on track for recovery, with forecasts from the International Monetary Fund (IMF) suggesting it will account for approximately 60% of global GDP growth in 2024. Much of this upward trajectory is driven by three crucial players, China, India, and Southeast Asia.

Meanwhile, developed markets in the region have also shown signs of improvement, especially in the second half of the year. Overall, the region's real GDP growth is expected to stabilise at a respectable 4.1% in 2024, followed by a slightly slower 4.0% in 2025, surpassing growth rates in both the US and Eurozone.

Inflation has persistently impacted the post-COVID economic landscape initially driven by surging consumer demand coupled with supply chain disruption. Fortunately, inflation rates in most markets are now at or near target ranges reflecting the efficacy of central banks' interest rate hike cycle.

As a result, interest rates have started to fall in some regional economies, stabilising in most cases. Singapore and Hong Kong lowered their rates by 66 basis points and 50 basis points, respectively in 2024, following the lead of the Federal Reserve, with China steadily cutting its policy rate. In Japan and Taiwan, the only outliers, rates rose marginally.

Compared to the beginning of 2024, when many economists were optimistic about a swift decline in interest rates, a generally cautious approach to rate adjustments has failed to translate into the anticipated boost for the real estate investment sector.

OFFICE TRANSACTIONS STABILISE DESPITE GLOBAL SLOWDOWN

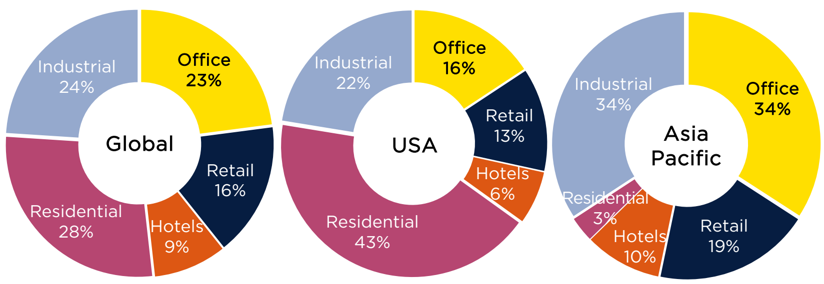
According to MSCI Real Capital Analytics data, transaction volumes for office property in the region recorded a modest 9% YoY uptick during the first nine months of 2024, off a very low base in 2023. Office transactions now account for 34% of overall transactions, a notable decline from the 40% to 50% share seen in the pre-COVID era. This cooling in investment interest is even more pronounced in the global market, particularly in the US, where office transactions account for just 16% of the total, indicative of the structural challenges posed by the hybrid working model.

In contrast, the Asia Pacific market retains a level of resilience, evidenced by sustained investor interest in the mature markets offering ample liquidity and plenty of investment-grade assets. Office investment volume surged by 16% YoY and 18% YoY respectively in Japan and South Korea in the first nine months of 2024 , supported by a tightening vacancy environment and limited future supply.

Meanwhile, despite the emergence of distressed assets and lower interest rates, momentum continued to slow in mainland China due to a weakening economy and uncertainties related to sharply elevated debt levels. Such a trend partly reflects a displacement effect, whereby global investors are increasingly seeking opportunities in mature markets located outside China, leaving domestic buyers as the primary players.

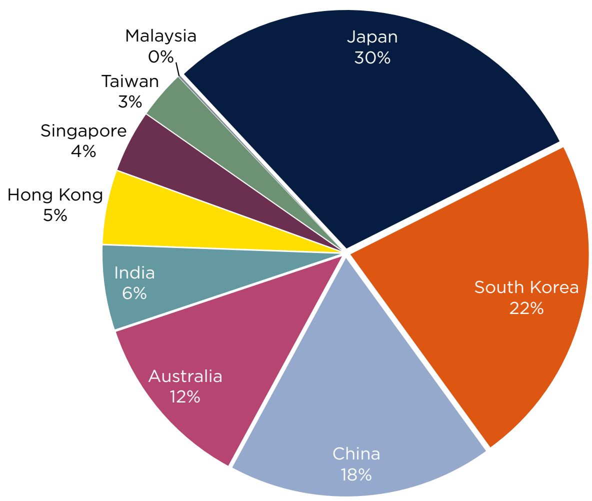
We maintain our cautiously positive outlook for regional office markets outside China/Hong Kong where elevated supply levels and weak tenant demand is expected to result in further rental declines.

GRAGH 4: Investment Volume by Asset Class, Q1/2024 to Q3/2024



Source MSCI Real Capital Analytics, as at 24th Oct 2024
Notes Preliminary data for Q3/2024.
Office, retail, industrial, apartment, hotel, and senior housing & care transactions included.
Entity level deals included. Development sites excluded. Based on independent reports of properties and portfolios US$10 million and greater. Data believed to be accurate but not guaranteed.

GRAGH 5: Asia Pacific Office Investment Volume by Market, Q1/2024 to Q3/2024



Source MSCI Real Capital Analytics, as at 24th Oct 2024
Notes Preliminary data for Q3/2024.
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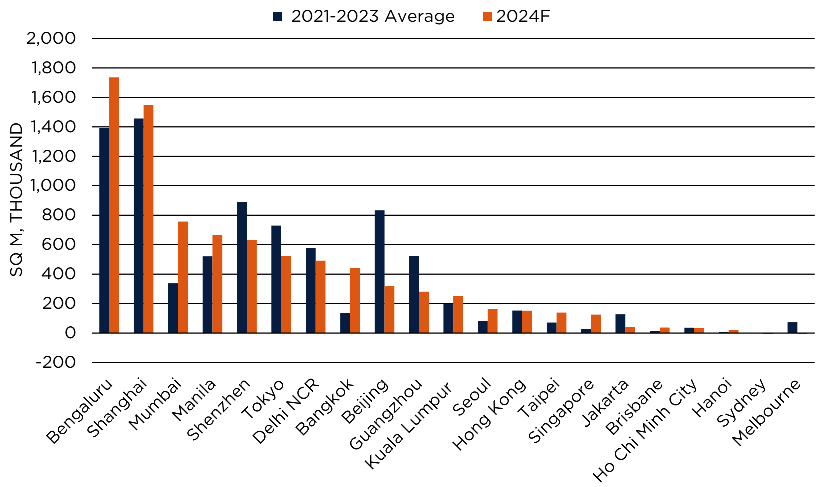
DIVERGENT OFFICE LEASING TRENDS EMERGE

In terms of occupier demand, the market has seen a divergence in office leasing dynamics. In India, cities such as Bengaluru, Mumbai, and Delhi NCR are witnessing a remarkable surge in demand, largely attributed to thriving sectors including technology, pharmaceuticals, healthcare, engineering and business process outsourcing (BPO). Many multinational corporations are setting up global capability centres in the country, capitalising on its affordable, youthful and well-educated labour force. How much of a threat AI poses to the BPO model remains to be seen but currently, robust economic growth is allowing demand to consistently keep pace and even exceed incoming supply.

In stark contrast, major Chinese cities are grappling with significant oversupply issues. Across the four tier-1 cities, an estimated 2.8 million sq m of additional floorspace is expected to come online in 2024. While this figure represents a 25% decrease from the previous three-year average of 3.7 million sq m, it still leaves a substantial amount of space waiting to be absorbed. The continued influx of supply is holding back rental growth and contributing to rising vacancy rates, which currently range from 15% to over 20%.

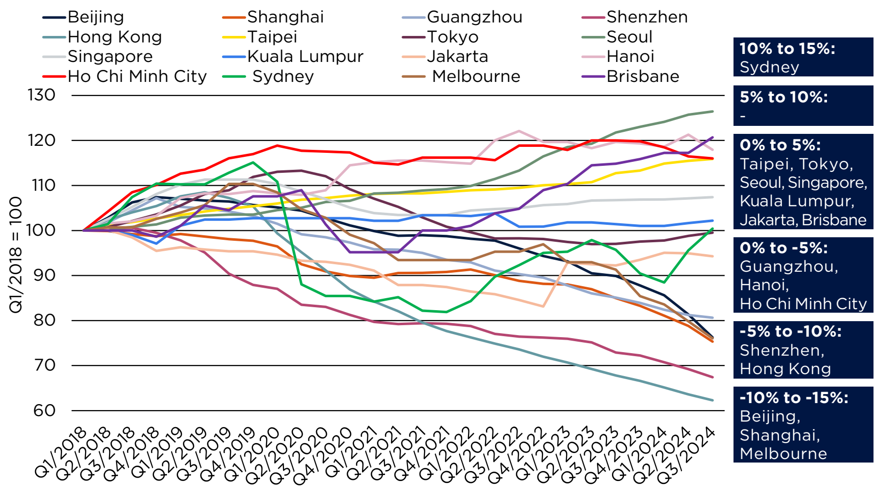
As growth has weakened, so too has occupier demand from both domestic firms and multinationals, some of whom are scaling back China operations. New market entrants are scarce, and foreign direct investment in 2024 is expected to show

GRAPH 6: Grade A Office Supply by Market, 2021 to 2024F



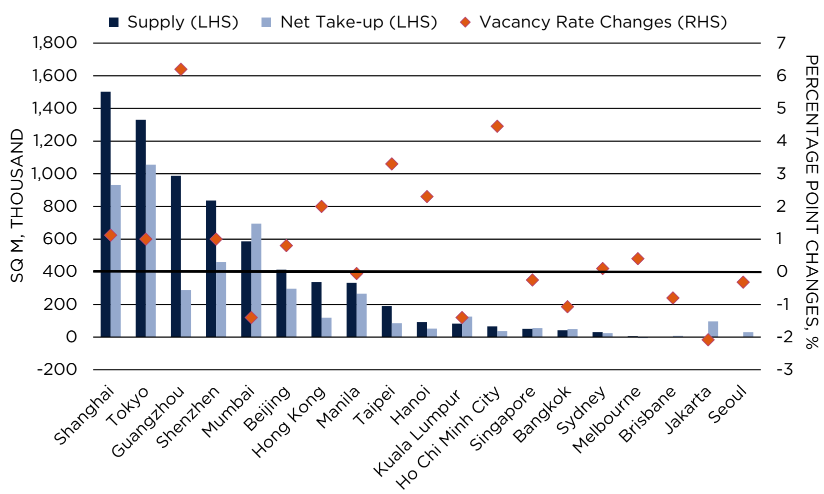
Source Savills Research & Consultancy

GRAPH 7: Grade A Office Rental Index by Market, Q1/2018 to Q3/2024



Source Savills Research & Consultancy

GRAPH 8: Grade A Office Supply Forecast by Market, 2025F



Source Savills Research & Consultancy

an uptick in net annual outflow, marking the second-highest level since 2022. This trend is likely to accelerate, as outbound investment may increase further if mainland firms seek to avoid tariffs.

The rise in vacancy rates is further complicated by the ongoing "flight to quality," where tenants exhibit a strong preference for high-quality, amenity-rich, green certified office environments in mixed-use districts. This evolution in tenant preferences obscures overall vacancy statistics, indicating that aggregate metrics may mask significant variations across different market segments.

RESILIENCE REMAINS THE THEME FOR 2025

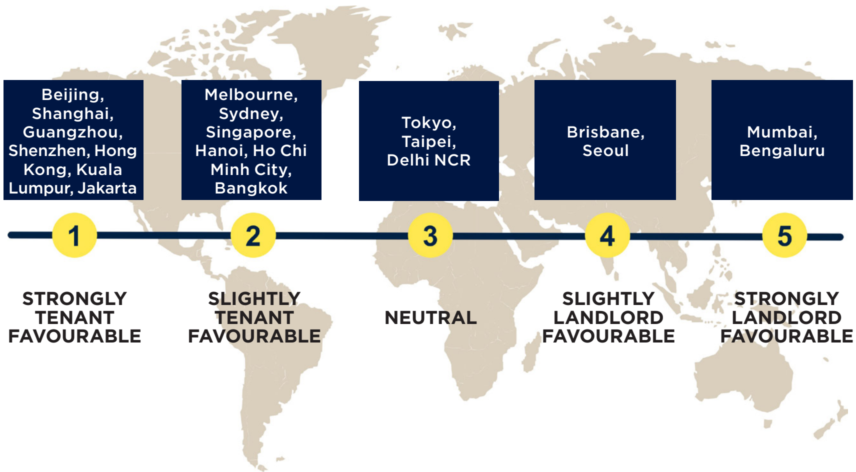
Looking ahead, a Trump presidency, paired with a Republican-controlled Congress, is expected to prompt a new wave of protectionism. If the more radical tariff proposals are implemented, such as a 10% to 20% across-the-board increase on all foreign goods and a 60% targeted rise on imports from China, this could significantly dampen growth in Asia Pacific's occupier markets. Many of these economies are export-driven, with the US serving as a key final demand market.

The overall impact of targeted tariffs on export volumes may be moderated by trade diversification which has accelerated in recent years amid US-China tensions and the pandemic. With 30% of global manufacturing output accounted for by China, many companies see a need for greater diversification amid supply chain concerns and concentration risks among other things.

Furthermore, uncertainty surrounding President Trump's stance on Ukraine and the Middle East raises concerns about further instability in these regions, which could put additional strains on global supply chains. This, combined with protectionist measures such as heightened tariffs and mass deportations of cheap illegal labour, may lead to a prolonged period of elevated inflation and supply chain bottlenecks in the US. Consequently, the likelihood of a 'higher for longer' interest rate environment has increased.

On the occupier front, elevated supply remains a key issue weighing on the region. Overall, Grade A office supply across the 19 markets we monitor is expected to reach 6.9 million sq m in 2025, exceeding demand by roughly 2.2 million sq m. About 54% of this new supply is concentrated in four tier-1 cities in mainland China, with Shanghai leading the way with 1.5 million sq m of new stock, followed closely by Guangzhou at 989,000

GRAPH 9: Asia Pacific Grade A Office Leasing Market Dynamics, 2025F



Source Savills Research & Consultancy

sq m, further intensifying existing vacancy issues. Hong Kong is expecting 337,000 sq m of new supply completed in 2025, the bulk of which will come from the new Kai Tak area. All in all, most of the Asia Pacific markets expect to see vacancy rates rise, with projections ranging from a rise of 0.1 percentage points in Sydney to 6.2 percentage points in Guangzhou.

Given sufficient availability, most Grade A office markets are expected to favour tenants in 2025. According to Savills' forecasts, we anticipate soft rental growth across most parts of the region, in the range of 0% to 5%, over the next twelve months. The laggards are the four tier-1 Chinese cities and Hong Kong, where we are anticipating corrections of 5% to 10%.

Meanwhile, we expect to see stronger rental growth in the Indian markets, as well as cities with very limited future supply like Brisbane and Seoul. While we maintain our perspective on the supply outlook, we have grown more cautious regarding demand expectations. Consequently, we believe some markets with existing high vacancy levels, such as Kuala Lumpur (25.8%), Jakarta (26.2%), Hanoi (14.0%), Ho Chi Minh City (12.1%) and Sydney (12.7%), could potentially struggle to maintain an upward rental trajectory.

MARKET FUNDAMENTALS WILL DRIVE GROWTH IN THE LONG RUN

Despite the short-term headwinds, we remain optimistic about the region's long-term prospects. India and Southeast Asia are poised to maintain their upward economic momentum, driven by favourable demographics and expanding labour markets. The importance of urbanisation and an expanding services sector coupled with advancements in technology, will further stimulate demand across these regions. Additionally, high-quality offices which offer extensive amenities and prioritise sustainability will increasingly shape tenant preferences.

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For more information about this report, please contact us

Cross Border Tenant Advisory

Adam Evennett
Regional Director, Cross Border Tenant Advisory, Asia Pacific
+852 2842 4208
aevennett@savills.asia

Research

Simon Smith
Regional Head of Research & Consultancy, Asia Pacific
+852 2842 4573
ssmith@savills.asia

Nancy Wong
Senior Manager, Regional Research & Consultancy
+852 2842 4281
naywong@savills.asia