CBRE RESEARCH | ASIA PACIFIC

ASIA PACIFIC REAL ESTATE MARKET OUTLOOK 2020

MID-YEAR REVIEW

CBRE

CONTENTS

ECONOMY 03

OFFICE 06

RETAIL 08

INDUSTRIAL & LOGISTICS 10

CAPITAL MARKETS 12

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ECONOMY

ECONOMY CONTRACTS SHARPLY BUT GRADUAL RECOVERY UNDERWAY

Although lockdowns and other strict restrictions in most Asia Pacific markets have largely been lifted and economic activity has resumed, the depth and breadth of the recovery is uneven. According to the CBRE Recovery Index, New Zealand, Mainland China, Taiwan and Vietnam are relatively ahead of the curve, but India lags[1].

Hopes of a sustained economic rebound rest upon the effective containment of the virus and the eventual development of a vaccine. Although the widespread imposition of strict large-scale national lockdowns remains unlikely, recent weeks have seen the reintroduction of local lockdowns and/or social distancing regulations in several markets such as Melbourne and Hong Kong SAR, where there has been a surge in new infections.

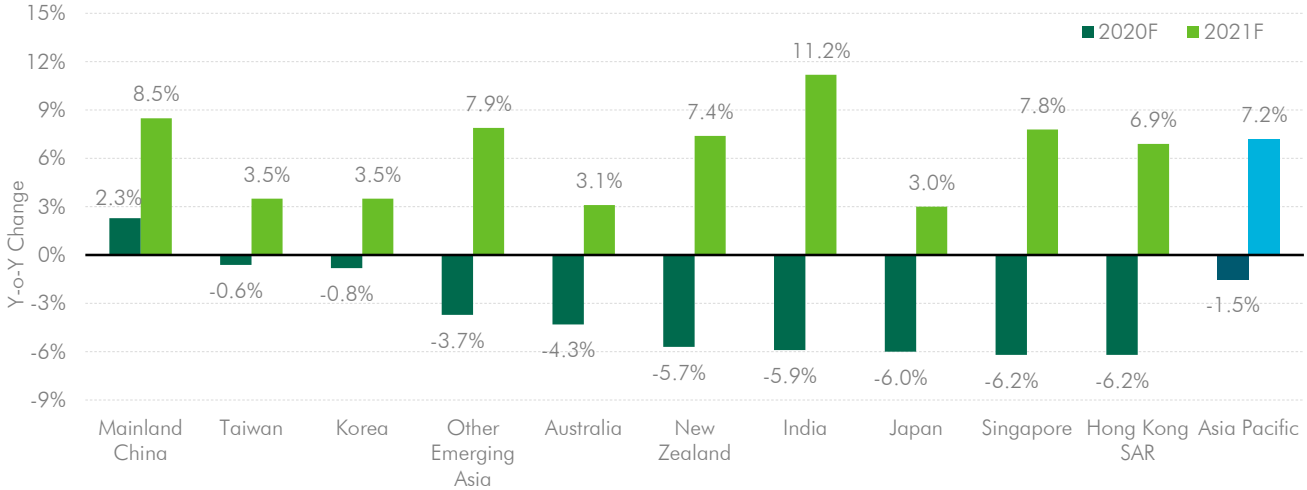
Authorities continue to provide measures to cushion economies from the impact of the downturn and support labour markets. Australia recently extended its JobKeeper scheme to Q1 2021 while Singapore plans to create 100,000 jobs and training opportunities over the next year. Central banks across the region retain a loose approach to monetary policy, with interest rates now at historical lows.

GDP growth in Mainland China returned to positive territory in Q2 2020, registering a gain of 3.2% y-o-y after contracting by -6.8% in Q1 2020. CBRE has therefore upgraded its full-year growth forecast for Mainland China to 2.3%. GDP forecasts for Australia and New Zealand have also been upgraded to a milder contraction in growth following a recovery in commodities prices.

CBRE expects Japan's GDP to fall to -6% in 2020. While retail sales and industrial production registered m-o-m improvements in June, recent Tankan surveys of business sentiment have been mixed. Large corporates expect a moderate improvement in business conditions in H2 2020, but SMEs are relatively more pessimistic.

With most other regional markets facing a slow rebound from the pandemic, CBRE forecasts a checkmark-shaped recovery across Asia Pacific, characterised by a fast downturn followed by a slow rise. However, the likelihood of a prolonged pandemic and further escalation in geopolitical tension between Mainland China and the likes of the U.S., Australia and India, may further weigh on business confidence and delay the economic recovery.

FIGURE 1: CBRE HOUSE VIEW - GDP GROWTH FORECAST 2020 & 2021



Source: CBRE Research, July 2020

1. A system that tracks 12 of the most frequent and consistent recovery parameters including economic activity, transportation/ mobility, tourism, workplace and retail and entertainment activity. A score between 1 to 5 is given to measure their recovery from 2019 levels (1 represents most restrictions remaining in place and 5 represents activity recovering to pre-pandemic levels).

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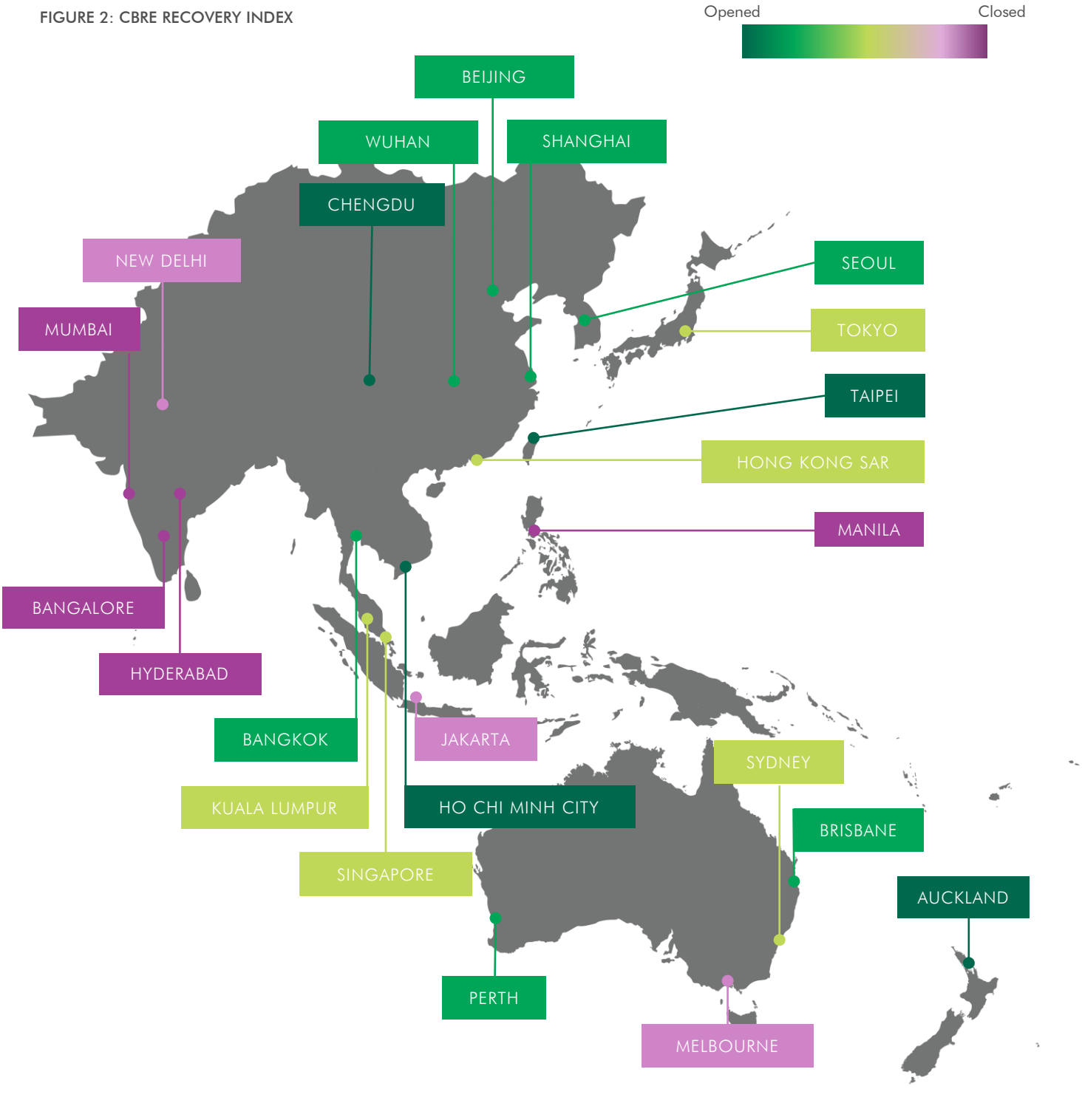
ASIA PACIFIC TOP CITIES

FIGURE 2: CBRE RECOVERY INDEX



Source: CBRE Research, 10 August 2020. (Click Here to Full Report)

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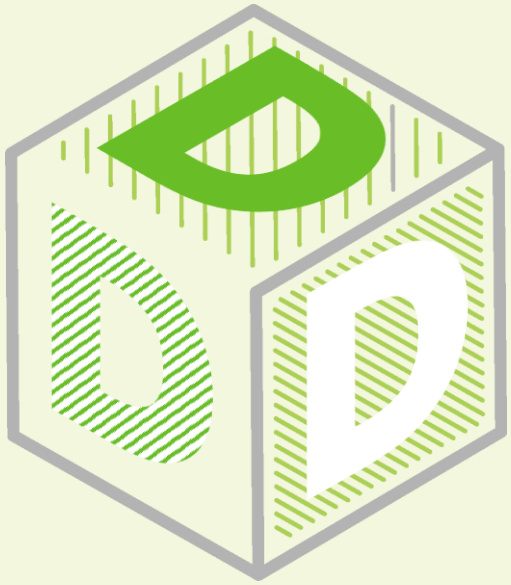
ECONOMY (CONT'D)

TRENDS TO WATCH



Deglobalisation is expected to continue into 2021 as geopolitical tension between China and several other countries escalates further. The "phase-two" trade deal with the U.S. is unlikely to be finalised this year, while Hong Kong SAR's new National Security Law, a border conflict with India and territorial disputes in the South China Sea may inhibit business expansion.

Disinflation: Although supply chain disruption due to the pandemic and rising commodity and food prices will drive inflation in the short-term, overall inflationary pressure in Asia Pacific will remain limited. This will ensure interest rates remain low, creating a favourable environment for yield-accretive asset investments.

Demographics: The accelerated adoption of remote working will lead to the creation of a far more fluid workforce, requiring office occupiers to rethink the workplace experience to attract and retain talent. In the retail sector, the rapid growth of e-commerce will force retailers to reassess the role of brick-and-mortar stores and overhaul their digital consumer engagement strategy.

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OFFICE

OFFICE NEW ABSORPTION FALLS TO LOWEST FIRST HALF TOTAL IN A DECADE

Occupier sentiment has weakened significantly since the onset of the pandemic, resulting in a lack of new expansionary demand. Renewals have accounted for the bulk of leasing transactions as occupiers postpone major decisions unless they have upcoming lease expiries or urgent space requirements. Recent months have seen an increase in the number of major occupiers implementing cost cutting measures such as space disposals, making space available for sub-lease or leasing fully fitted premises.

Asia Pacific net absorption fell 34% y-o-y to 16.3 million sq. ft. NFA in H1 2020, the lowest first half total in a decade. While leasing activity in Mainland China tier I cities began to recover in March as lockdowns were eased, all other major markets, especially Tokyo and major cities in India, saw a significant slowdown in demand in Q2 2020 as restrictions on mobility and business activity came into force. Other weak markets include Hong Kong SAR, which has seen two consecutive quarters of negative net absorption and its lowest half yearly figures on record.

Bright spots include resilient demand in the tech sector, where many firms retain sizable requirements for expansion and upgrading. Demand also remains robust among life sciences companies, some of which are in the market for specialist facilities such as R&D laboratories and cold storage, as well as traditional corporate offices.

Prior to the onset of the pandemic, CBRE forecasted a slight increase in regional net absorption this year relative to 2019 levels. However, the prolonged crisis has led us to revise our forecast to a decline of 30-40% for full-year 2020. A rebound in regional office leasing enquiries is unlikely until midway through H2 2020.

Positives include signs of a strong rebound in leasing activity in Mainland China, which is offsetting declines elsewhere, while negatives include the potential for the reintroduction of lockdowns or other restrictions on movement and business activity in markets seeing an increase in infections.

New supply had been expected to rise slightly to 67 million sq. ft. NFA this year. However, a sizable portion of this total has been delayed due to disruption to labour mobility and materials supply chains, primarily in Mainland China and India.

New Grade A supply has therefore been revised down by 8% y-o-y to 60 million sq. ft. NFA. With occupancy permits also taking longer to receive approval, there is potential for total new supply to fall even further to about 55 million sq. ft., should project handovers be delayed.

CBRE expects Grade A rents to continue to decline in 2020 owing to a sharp decline in demand resulting from the pandemic and excess supply at the beginning of the year. The magnitude of the fall so far this year has been stronger than expected as occupiers request rent relief or higher incentives from landlords.

Taipei and some Japanese regional cities have exhibited relative rental strength thanks to tightening vacancy and limited new supply. Elsewhere, the limited availability in Manila continues to support solid rental growth, with additional demand resulting from the anticipated diversification of BPO functions from India potentially providing a further boost. Weaker markets include Hong Kong SAR, which continues to see subdued demand and rising space availability in core locations.

The biggest revision to CBRE's rental forecast has been to Singapore, Sydney and Melbourne, all of which will see the rental decline accelerate in H2 2020, leading to a full-year fall of 10% or above. Rents in Mainland China will continue to trend downward, but the decline is expected to moderate over the next six months.

Cities in India have not yet recorded any rental adjustments. However, occupiers are seeking better terms through rent reviews and incentive packages, pointing to rental downside.

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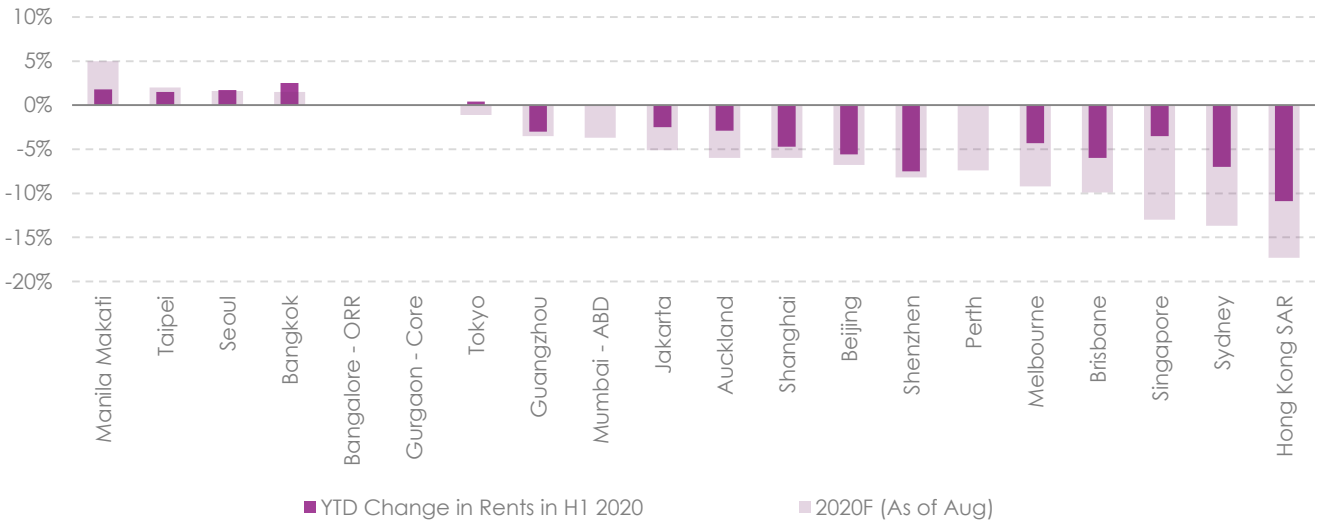
OFFICE (CONT'D)

FIGURE 3: 2020 GRADE A OFFICE RENTAL OUTLOOK



Remarks: Rental growth in each market represents the CBD unless specified. All figures refer to net effective rental growth
Source: CBRE Research, August 2020.

TRENDS TO WATCH

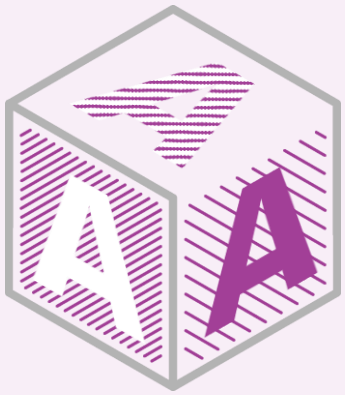
Agility: The largely successful remote working experiment conducted during the early stages of the pandemic has led to broad acceptance of the practice as a key component of corporate real estate portfolio strategy. While many employees will work remotely on a more frequent basis, the gradual return of staff to the workplace will require occupiers to re-configure high-density offices to incorporate social distancing and other health safeguards.

Assessment: Business Continuity Planning (BCP) has surged to the top of the occupier agenda since the pandemic began. As companies look to strengthen their commitment to employee health and wellness, this could lead to stronger demand for buildings with sustainability features.

While there is a definite shift towards remote-working, CBRE expects occupiers to conduct more regular reviews of their office space requirements. CBRE's Global Occupier Sentiment Survey found that more than 40% of respondents expect a slight decrease in the importance of the physical office. Formulating an appropriate portfolio strategy in Asia Pacific will be even more complex as occupiers will need to consider issues such as remote working, de-densification, physical distancing, average household space and power/internet infrastructure.

Alternative: Other components of office portfolios that have taken on greater prominence this year include the hub-and spoke-model[2] ; business parks; and flexible space. Discussions around the hub-and spoke-model are most advanced in Australia and India. However, prior to the pandemic CBRE had already noted early signs of a shift towards leasing space in emerging areas and in other alternative asset types such as business parks. Drivers in mature Asian markets include cost-saving, while in emerging markets the trend is being spurred by the expanding boundaries of new CBDs.

Despite ongoing consolidation among flexible space operators, occupiers continue to view coworking as a viable solution to reduce capital expenditure related to fitout, obtain fitted space at short notice and provide a network of locations to support a more mobile workforce.



2 A real estate model comprised of an urban headquarters surrounded by satellite offices in decentralised areas or in locations closer to employees' homes.

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RETAIL

THIRD WAVE OF PANDEMIC DELAYS RETAIL RECOVERY; SHARP FALL IN RENTS EXPECTED

The negative impact of the pandemic on consumption has now stabilised from the trough in April. While regional consumer confidence remains in pessimistic territory, sentiment has been improving gradually since May as lockdowns and other restrictions have been eased. Retail sales in Mainland China, Japan and Australia rebounded m-o-m in June but year-to-date growth remains negative.

The pace of recovery will remain sluggish, with a recent uptick in new infections in Mainland China, Hong Kong SAR, Japan and Australia set to weigh on retail consumption. The resurgence in new cases will also delay the resumption of inbound tourism, adding to pressure on tourist-centric markets such as Hong Kong SAR, Macau SAR and Thailand.

Vacancy increased across the region in H1 2020 following numerous right-sizing moves and/or market exits by several global fashion brands. Other closures have been observed among retailers in the children's-related services, fashion and restaurant categories. CBRE expects the situation to worsen in the coming months, with further permanent shutdowns likely, especially in Singapore and Australia where temporary regulations preventing landlords from evicting tenants are scheduled to expire later this year.

Despite landlords turning more accommodative and offering higher incentives, leasing sentiment will remain subdued over the remainder of the year. While some retailers may take advantage of prime space becoming available at attractive rents, most brands remain cautious and are likely to delay new store-openings and expansion until 2021.

The sluggish recovery in consumption will see retailers continue to seek relief measures from landlords as well as pursuing lease restructuring. Weak demand will be somewhat offset by the slowdown in new supply, with many development projects having been delayed due to weak preleasing activity. Full-year new retail supply is estimated at around 25 million sq. ft., a decline of 40% from the forecast made at the beginning of the year.

CBRE retains its previous view, issued in May, that all major cities in Asia Pacific will undergo a rental correction this year. However, the decline in the regional rental index will deepen from the -6% estimated previously to over 9%, mainly due to the downgraded forecast for the Hong Kong SAR, where consumer spending has fallen sharply after social distancing measures were tightened. Following a decline of 15% in H1 2020, CBRE expects high street shop rents in the city to fall by an additional 15%-20% in H2 2020, bringing the full-year decline to 30%-35%.

The correction in tier I cities in Mainland China is unlikely to accelerate from the 3 to 5% decline witnessed in H1 2020. Ground floor rents are relatively stable and prime shopping centres are benefitting from an increase in domestic luxury consumption resulting from travel restrictions. However, units on upper floors of shopping malls are seeing higher vacancy – a trend that will exert downward pressure on average shopping mall rents and weigh on landlords' rental income.

The full-year rental forecast for Tokyo (Ginza) has been downgraded from the -0.4% made in January to -6.4%. Secondary streets have seen vacancy rise following lease surrenders by several underperforming apparel brands. Rents for prime locations nevertheless remain resilient on the back of solid leasing demand from luxury brands.

CBD rents in the Pacific are under downward pressure in the absence of office-based employees, international students and tourists. The strongest impact has been in Perth, where rents fell by 10% in H1 2020. Across Australia, regional centres with a large number of fashion, department store and F&B tenants have struggled, but those catering to non-discretionary spending have performed relatively well.

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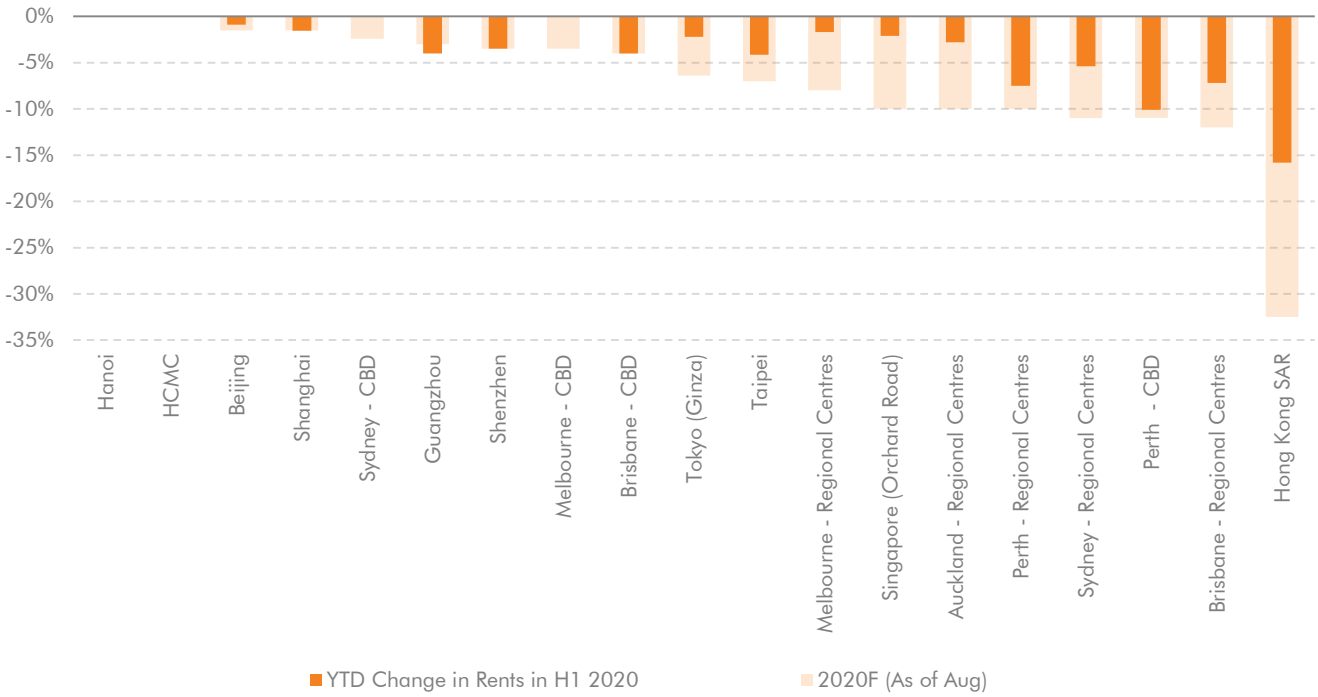
RETAIL (CONT'D)

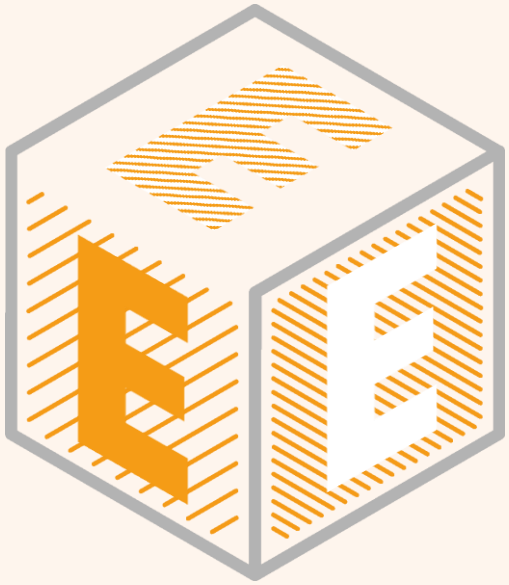
FIGURE 4: 2020 RETAIL RENTAL OUTLOOK



Remarks: All markets track the G/F rental performance of shopping centres in prime areas except Hong Kong SAR, Taipei and Tokyo (Ginza), where the performance of high street shops in prime areas is tracked. Singapore tracks prime floor units of shopping centres. Australia and New Zealand reflect the movement of net effective rents of regional shopping centres.

Source: CBRE Research, August 2020.

TRENDS TO WATCH



Evolution: The pandemic has accelerated the paradigm shift occurring across the retail industry. Online retailing is booming, with several markets witnessing a jump in e-commerce penetration, especially in the grocery segment. This will prompt more retailers to invest capex in creating and extending their online sales channels and fulfilment capabilities.

Entertainment: Many entertainment and experiential-based retailers such as cinemas and children's activity centres have struggled to re-open due to tight social distancing and hygiene requirements, with permanent closures likely in the coming months. While the shift towards online channels such as social media and livestreaming will continue, entertainment and experience in brick-and-mortar stores will remain at the heart of consumer engagement.

Experience: Retail landlords will continue to cap marketing expenditure. However, investment in consumer analytics tools and placemaking will remain at the forefront of business strategy.

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INDUSTRIAL & LOGISTICS

WAREHOUSE DEMAND REMAINS UPBEAT AS PANDEMIC BOOSTS E-COMMERCE

Q2 2020 brought a mild improvement in industrial sentiment in Asia Pacific along with the resumption of industrial activity. Purchasing Managers Indexes (PMIs) for the region's major economies all rose in June, with Mainland China, Australia and Vietnam seeing a return to expansionary territory.

The pandemic has served as a catalyst for stronger warehouse demand from e-commerce related platforms. Together with requirements from grocery and pharmaceutical companies seeking cold/mixed storage space, this has supported a sharp rebound in leasing activity in Mainland China and helped ensure the resilient performance of logistics markets in Japan and Korea.

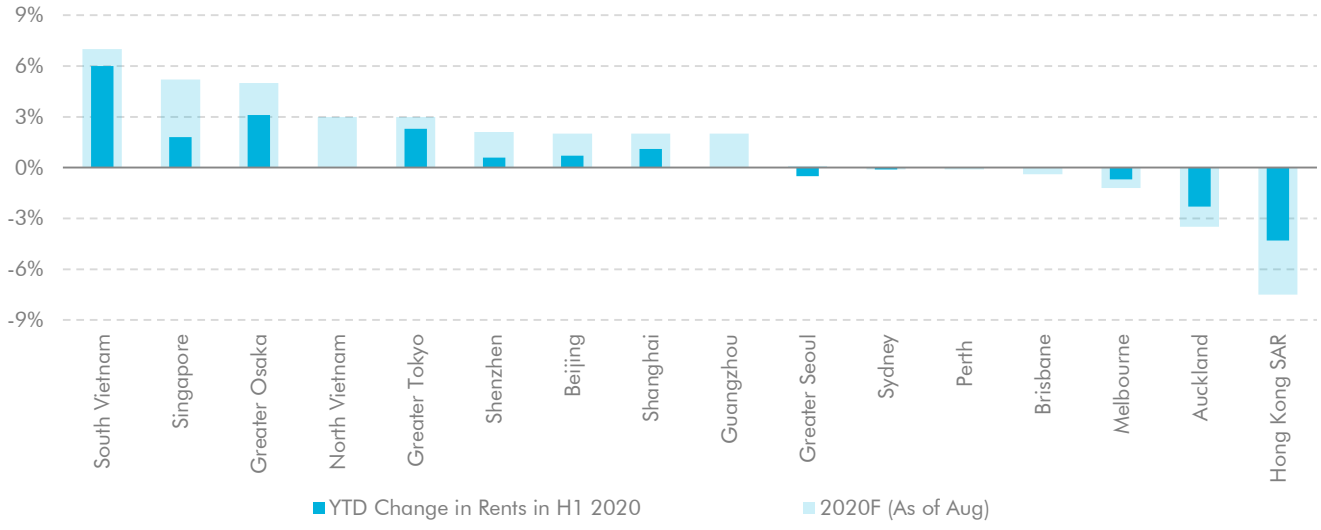
Weaker demand has been observed from export-related occupiers. Optimism generated from the signing of the "phase-one" U.S.-China trade deal has been completely negated by the widespread disruption resulting from the pandemic, with rising geopolitical tension between China and several other countries adding another layer of uncertainty.

The overall picture for the Asia Pacific logistics market nevertheless remains upbeat, with strong leasing demand expected to ensure regional vacancy remains low and providing a solid foundation for rents. However, growth momentum will be mild owing to occupiers' sensitivity around costs and the ample new supply pipeline. Rents in most markets are expected to increase at or around 3.0% this year, in line with previous forecasts issued in May.

Leasing activity in Singapore has been supported by stockpiling demand from the government following the introduction of the 'Circuit Breaker' measures in April; inventory storage requirements due to weaker exports; and last-mile logistics expansion. Prime logistics properties in the west and east of the city-state are near full occupancy and demand has begin to spill over to lower-specification logistics space. This has prompted us to revise our full-year rental growth forecasts from -8.5% to 5.2%.

Hong Kong SAR will be the main laggard in terms of rental performance, with a further correction expected over H2 2020. More occupiers in the city are seeking cost-saving relocations or downsizing moves amid downbeat economic conditions and muted trading activity.

FIGURE 5: 2020 LOGISTICS RENTAL OUTLOOK



Remarks: Pacific markets track effective rental growth while Asian markets track face rental growth
Source: CBRE Research, August 2020

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INDUSTRIAL & LOGISTICS (CONT'D)

TRENDS TO WATCH

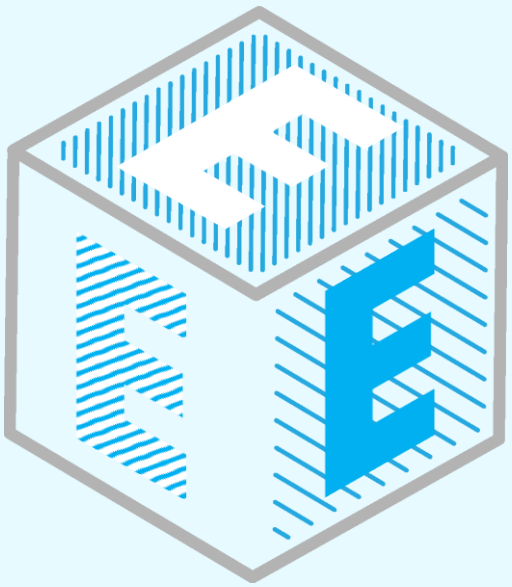
E-commerce: The sector has been one of the major beneficiaries of the COVID-19 pandemic, leading to a surge in warehousing requirements to cater to robust last-mile delivery demand.

Enhancing operations and cost efficiency via the introduction of automation and technology will continue to drive occupiers' business investment and real estate strategy.

Together with rising geopolitical tension between Mainland China and numerous other countries, the pandemic has prompted manufacturers to reevaluate their supply chain networks. CBRE expects supply chain decision-making to be guided by "China for China" and "China Plus One" strategies.

"China for China": Mainland China will remain a base for foreign manufacturers producing goods for local consumers, with production capacity expected to expand along with domestic demand.

"China Plus One": With the pandemic exposing the danger of over-reliance upon a single market, foreign manufacturers will diversify supply chain risk by establishing operations in alternative markets for sourcing or production outside China. Potential beneficiaries include India and Vietnam, and in the high-end segment, Korea and Taiwan.



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CAPITAL MARKETS

INVESTMENT DECLINES BUT INCREASE IN ASSET AVAILABILITY LIKELY TO SUPPORT ACTIVITY IN H2 2020

Since the onset of the pandemic, commercial real estate investors in Asia Pacific have adopted a more cautious attitude towards underwriting and are requesting larger discounts to compensate for weaker fundamentals. While sellers have lowered asking prices, reductions are well above buyer expectations. Combined with the continued imposition of travel restrictions, which have inhibited cross-border deals, these trends pulled down investment turnover by 36% y-o-y in H1 2020.

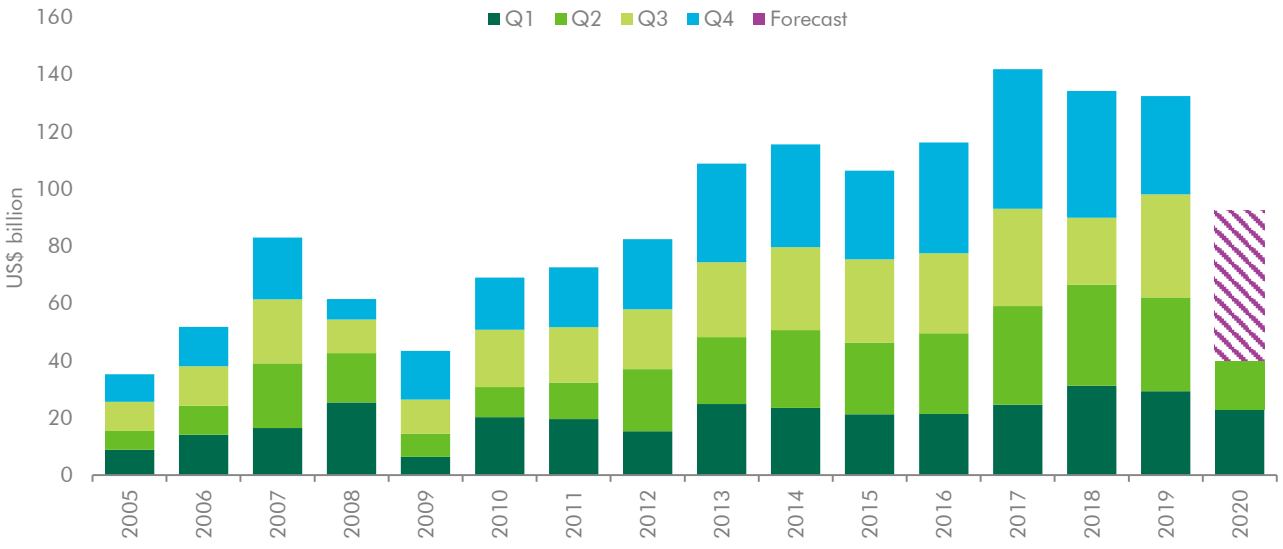
A recent uptick in confirmed COVID-19 cases in several markets, combined with ongoing geopolitical tension, will inhibit investment momentum in the coming months. CBRE expects investment turnover to fall by 25% to 35% in 2020.

However, liquidity remains strong, with real estate funds and institutional investors possessing a considerable volume of dry powder. Investment sentiment is improving along with the resumption of business activity. The major factors hindering investment turnover are the price gap and a lack of attractively priced investable assets.

With the prolonged pandemic set to further impact corporate earnings, more companies will consider adopting an asset light strategy, which may involve selling properties to raise capital. CBRE has already observed several firms engaging in sale and leaseback deals to replenish working capital. Asset availability will also be enhanced by potential asset disposals by highly leveraged developers; a wave of fund expirations by closed-end real estate funds commencing in 2021; and redemption pressure among open-ended funds, especially in Australia.

The pandemic has underlined the importance of assembling resilient portfolios – a trend that will see investors adjust their weighting towards structural and defensive plays. Recent examples include institutional investors forming partnerships with logistics developers or committing capital to logistics funds.

FIGURE 6: ASIA PACIFIC TOTAL INVESTMENT VOLUME



Remarks: Transaction volume includes office, retail, industrial, hotel, mixed-use and other commercial properties. Residential and development site are excluded.
Source: CBRE Research, August 2020.

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CAPITAL MARKETS (CONT'D)

Although yield expansion has been observed for office and retail assets in major cities, movement has been limited compared to that witnessed during the Global Financial Crisis. Logistics yields have been largely stable.

Investment strategy in the coming quarters will be guided by fundamentals such as tenant quality, with investors advised to stay attuned to shifts in occupier trends when sourcing investment opportunities. Business parks are likely to emerge as a key focus amid generally robust levels of demand from tech and life sciences companies.

Although NAV discounts have narrowed since mid-March following the stock market rebound, investors can still pursue public to private opportunities on a case by case basis. With lenders remaining highly selective, real estate debt remains an opportunity for investors willing to provide financing, especially for retail, hotel, property development and assets with high vacancy risk.

The pandemic has triggered a second wave of structural change in the logistics sector, with cold storage, last-mile facilities, the re-development of outdated warehouses and greenfield development all attracting a considerable volume of capital. While data centres are now firmly established as a mainstream investment class among developers and institutional investors, operational risk and securing planning approvals remain a challenge.

TRENDS TO WATCH

Realistic returns : Despite a wider cap rate spread, investors will continue to be guided by cash flow fundamentals such as asset and tenant quality.

Rerouting capital: There will be opportunities for investors to capitalise on corporations disposing of assets or engaging in sale and leaseback deals. Asset availability will further increase as developers lower gearing ratios by selling non-core assets.

Resilient portfolios : Investors are advised to focus on tenant quality as well as occupancy. Portfolios should be weighted towards structural and defensive plays.

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FORECAST RENTAL GROWTH AND YIELDS IN 2020

MARKET	OFFICE			RETAIL			LOGISTICS		
	H1 2020 (%)	2020F (%)	YIELD	H1 2020 (%)	2020F (%)	YIELD	H1 2020 (%)	2020F (%)	YIELD
Beijing	-5.6	-6.8	▶	-0.9	-1.5	▲	0.7	2.0	▶
Shanghai	-4.7	-6.0	▲	-1.5	-1.5	▶	1.1	2.0	▼
Guangzhou	-3.0	-3.5	▲	-4.0	-3.0	▲	0.0	2.0	-
Shenzhen	-7.5	-8.2	▶	-3.5	-3.5	▶	0.6	2.1	-
Hong Kong SAR	-10.9	-15 to -20	▲	-15.8	-30 to -35	▲	-4.3	-5 to -10	▲
Taipei	1.5	2.0	▶	-4.1	-7.0	▲	-	-	-
Tokyo	0.4	-1.1	▶	-2.2	-6.4	▲	2.3	3.0	▶
Seoul CBD	1.7	1.6	▼	-	-	-	-0.5	0.1	▼
Seoul GBD	1.4	1.4	▼	-	-	-	-	-	-
Singapore	-3.5	-13.0	▼	-2.1	-10.0	▶	1.8	5.2	▼
Bangkok	2.5	1.5	▶	-	-	-	-	-	-
Ho Chi Minh City	-1.9	-5.0	-	0.0	0.0	-	6.0	7.0	-
Hanoi	-0.9	0.0	-	0.0	0.0	-	0.0	3.0	-
Manila	1.8	5.0	-	-	-	-	-	-	-
Sydney	-7.0	-13.7	▲	-5.4	-11.0	▲	-0.1	-0.1	▼
Melbourne	-4.3	-9.2	▲	-1.7	-8.0	▲	-0.7	-1.2	▼
Brisbane	-6.0	-9.9	▲	-7.2	-12.0	▲	0.0	-0.4	▼
Perth	0.0	-7.4	▲	-7.5	-10.0	▲	0.0	-0.1	▼
Auckland	-2.9	-6.0	▶	-2.8	-10.0	▲	-2.3	-3.5	▶
Delhi NCR - Gurgaon	0.0	0.0	▶	-	-	-	-	-	-
Mumbai ABD	0.0	-3.7	▶	-	-	-	-	-	-
Bangalore ORR	0.0	0.0	▶	-	-	-	-	-	-

Remarks
(1) Office rental growth refers to Grade A offices in CBD areas only, unless specified.
(2) Retail rental growth refers to high streets in prime areas except China, Singapore, Australia and Auckland where G/F rents of shopping centres are reported. The rental outlook for Tokyo refers to Ginza high street rents while Singapore refers to prime retail along Orchard Road. Australia and New Zealand report the net effective rents of regional centres.
(3) Logistics rental growth in Tokyo refers to the Greater Tokyo Area while Seoul refers to the Greater Seoul Area. In Vietnam, Ho Chi Minh City represents South Vietnam (five provinces) and Hanoi represent North Vietnam (four provinces). Logistics rental growth for Asian markets refer to face rents while Pacific markets refer to effective rents.

Source: CBRE Research, August 2020.

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ASIA PACIFIC REAL ESTATE MARKET OUTLOOK 2020

MID-YEAR REVIEW

CBRE RESEARCH

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