Asia Pacific - September 2022

SPOTLIGHT
Savills Research

Asia Pacific Office Markets

While signs of caution have emerged, Asia Pacific's office markets are proving relatively resilient

MORE WORKERS RETURN TO THEIR OFFICES AS COVID RESTRICTIONS EASE

As the COVID-19 pandemic recedes, workers have once again returned to offices across most of Asia Pacific as the hybrid working trends which accelerated during lockdowns and social distancing are now beginning to unwind. The trend for blended working arrangements (hybrid or remote) is certainly significant, however, and will continue to reshape office demand going forward.

We note that compared to other parts of the world, the remote work potential among the Asia Pacific workforce is distinctively lower than their European and North American counterparts. According to a survey conducted by McKinsey, 79% of the workforce in China and India, the two largest working populations in the Asia Pacific, cannot even work remotely at all, which is a sharp contrast to the 52% and 61% recorded in the UK and US.

Apart from the structural difference between developed and developing economies, where computer-based office employment constitutes a lower percentage, employees in many parts of the region do not have access to reliable internet connectivity or adequate resources to work from home. Smaller average home sizes, multi-generational living arrangements, combined with easier commutes via public transport are also encouraging more workers to return to offices. Capability aside, most corporates within the region prefer to resume traditional ways of working and this is also supporting office demand.

To put this into a more quantitative perspective, Savills World Research predicts an average 8-10% decrease overall in demand for offices across Europe as companies adapt to new ways of working. We believe that it is unlikely that the Asia Pacific markets will be hit as hard in the post-COVID era but changes to working arrangements are being adopted not least as part of talent recruitment and retention strategies. A recent survey conducted by PwC revealed that among the Asia Pacific respondents who can work remotely, 24% prefer to work remotely and 66% prefer to work in a hybrid setting over the next 12 months.

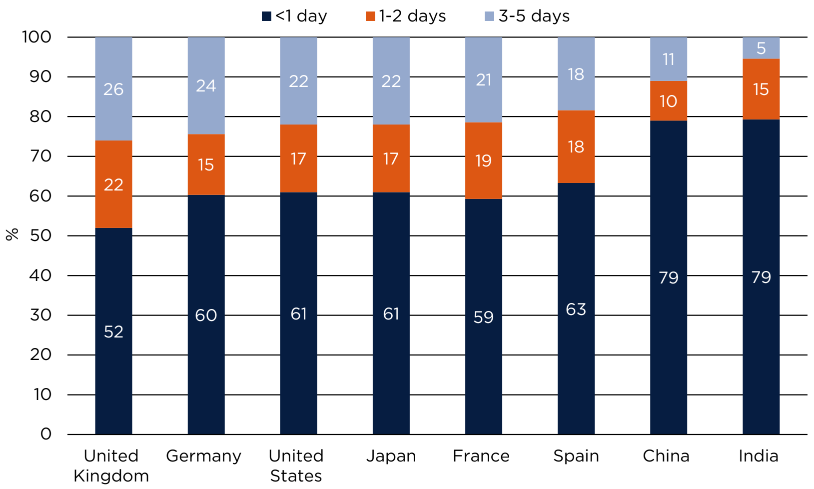
WORKERS DEMAND MORE SPACE

Workers have become more demanding of their working environment and although the pandemic has caused a seismic shift in office life towards the remote, it has also highlighted the importance of face-to-face collaboration, communication, and interaction. As such, more organizations are planning for longer-term workplace changes, reassessing whether their portfolio is fit for purpose and pushing forward initiatives designed to address collaboration, performance and human experience.

Employers are considering providing a greater variety of space within offices, including flexible seating areas, meeting rooms, breakout areas, townhall space and silent working areas. The shift from fixed to mobile workstations typically implies less workspace per worker and lower demand but it is difficult to assess the impact of this occupational strategy on the quantum of floorspace demanded, as the reduction in the number of workstations is partially offset by the increase in open-planned area. According to our office FiT survey of 2021, the average occupancy density in the UK was around 1:8 to 1:10 sq m before the pandemic, and this has moved to 1:12 to 1:14 per sq m based on better air filtration, higher comfort levels, and the rising need for shared spaces.

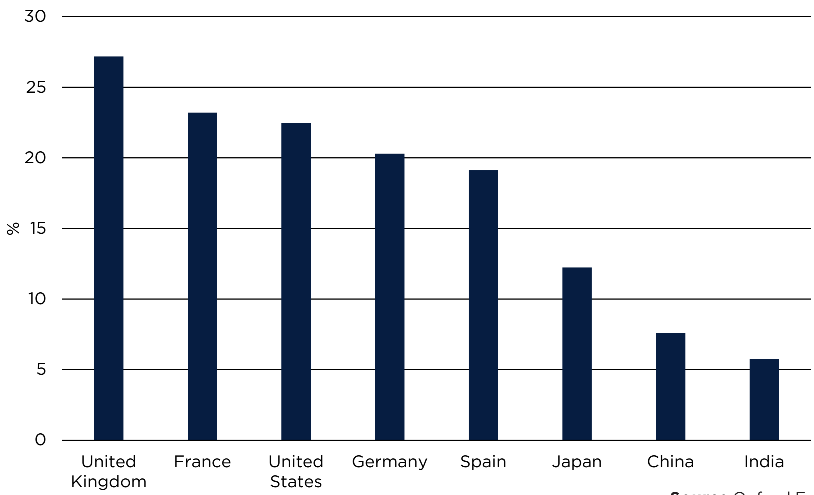
We have observed a similar trend in some developed office markets in the region. For example, our case study in Hong Kong among banking tenants has shown that many have adopted an open floorplan with office densities running between 9.1 and 15.2 sq m per worker and a flexibility ratio of 60% to 80% between mobile and fixed seating. While many multinational corporations in the region have already changed their fit-outs to a flexible arrangement, there are also a substantial number of tenants within

GRAPH 1: Workforces with Remote Work Potential by Market, 2021



Source McKinsey Global Institute

GRAPH 2: Percentage of Office-based Employment, 2021



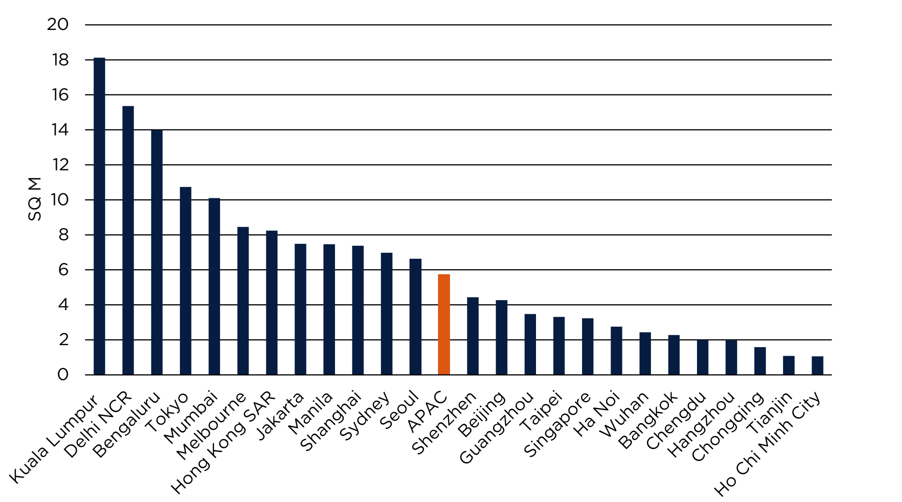
Source Oxford Economics

the region who are committed to traditional layouts.

Meanwhile, demand for satellite offices is also on the rise as hybrid/remote working changes evolve from an emergency measure to a longer-term office strategy. This need is partially filled by coworking spaces, which offer their corporate tenants an opportunity to de-risk their property portfolios with shorter leases and easier get-out clauses, as well as more flexible working arrangements. In Tokyo, an increasing proportion of flexible offices are being introduced outside the central five wards, often located at major transport hubs such as Kitasenju, Omiya, Kawasaki, and Tachikawa. The city saw an addition of 268 coworking locations alone last year, adding about 86,000 sq m of floorspace to the 688,000 sq m market total (12.5%). We have also spotted a similar trend among the major Indian cities. Flexible workspace operators accounted for 17.8% of total take-up in India during 1H/2022 as the leasing volume surged 4.8 times compared with 1H/2021. We expect this sector could account for 20% of total demand by the end of 2022. Against this backdrop, we believe the rising need for flexibility could offset the downward pressure on rents brought by the growing hybrid working trend.

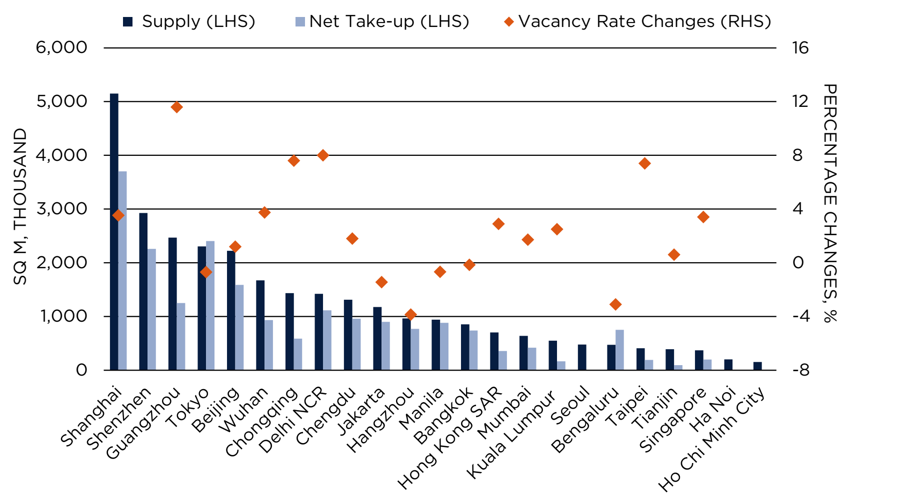
Recovery has been delayed but not derailed, as the region's growth prospects continue to shore up demand.

GRAGH 3: Grade A Office Space per Head by Market, 2021



Source Oxford Economics, Savills Research & Consultancy

GRAGH 4: Grade A Office Supply Forecast by Market, 2022 to 2024F



Source Savills Research & Consultancy
Note Indian markets only include forecast for 2022.
Seoul, Ha Noi and Ho Chi Minh City has no forecasted net take-up and vacancy rate.

DEMAND WILL EVENTUALLY OVERRIDE THE SUPPLY SHOCK

In terms of supply, the region presents a diverse picture across the major office markets we track. On average, each worker occupies about 5.7 sq m of Grade A office area in Asia Pacific, with substantial variation across cities. Kuala Lumpur sits at the top with 18.1 sq m, whereas many populous cities such as some first and second-tier Chinese cities, Taipei, and Singapore tend to fall behind the regional average and reflect room for improvement. Though low ratios in some cities like Ha Noi and Ho Chi Minh City are mainly capped by their limited Grade A stock amid a rapid shift to more services-driven economies.

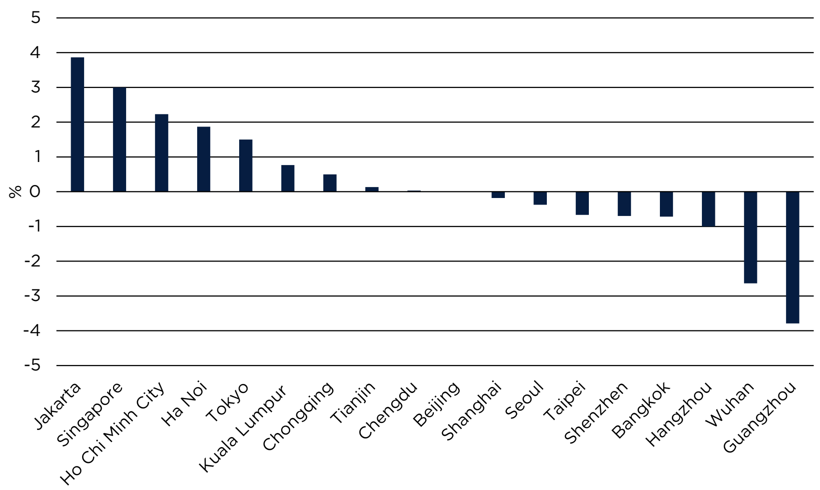
A number of the major markets are facing substantial supply pressures, as many projects scheduled for completion over the past two years have been delayed. Overall, Asia Pacific Grade A office supply across the 23 markets we track is projected to reach 29.2 million sq m between 2022 and 2024. This averages about 9.7 million sq m of additional floorspace per year, which is 16.8% higher than the previous three-year average of 8.3 million sq m.

Of this new supply, 44% is located in four tier-1 cities in mainland China, with Shanghai topping the chart with 5.2 million sq m of new stock, followed closely by Shenzhen (2.9 million sq m) and Guangzhou (2.5 million sq m). Meanwhile, 9% of the new supply is split between the three largest office markets in India, with Delhi NCR seeing the strongest growth. Others such as tier-2 Chinese cities, Hong Kong, Kuala Lumpur and Jakarta should see supply outpace absorption on a three-year horizon, dragging on these markets and aggravating vacancy concerns.

On average, we are expecting to see vacancy rates rise across most Asia Pacific markets, increasing in a range of 0.6 percentage points (pp) (Tianjin) to 11.6pp (Guangzhou) between 2022 and 2024. In terms of rental performance, Hong Kong should see the largest correction over this forecast horizon, retreating by 4.3% per year, followed by Guangzhou (-3.8%), Wuhan (-2.6%), and Hangzhou (-1.0%). While most occupiers in these markets are adopting a 'wait-and-see' attitude, some could consider leveraging their stronger negotiating position during this supply-driven downswing to meet any expansion or flight-to-quality relocation needs.

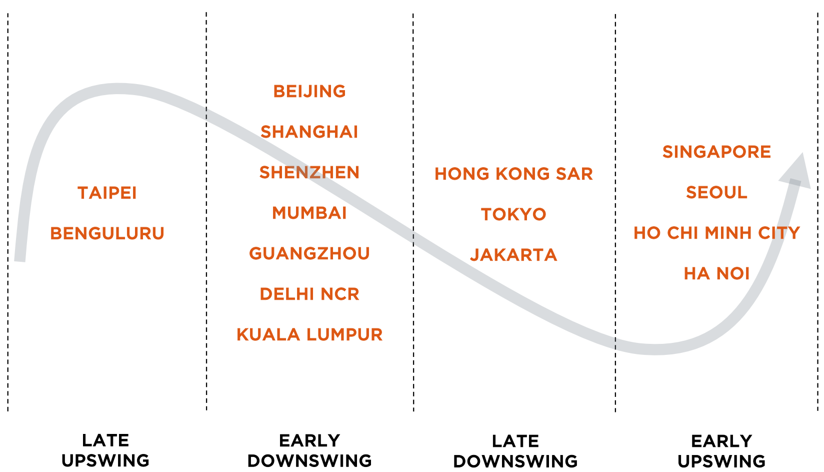
We have already seen this in the Bangkok office market with pre-leasing activity, as the city is expected to welcome a number of high-end office projects such as One City Centre and the office towers of One Bangkok. An annual average of 285,000 sq m of new supply will come online between 2022 and 2024, more than four times the previous five-year average. Apart from offering rental concessions, local landlords are also competing for tenancies by offering sustainable office spaces backed by green credentials with improved energy efficiency, lower operational costs, and for occupants, a better sense of wellbeing.

GRAPH 5: Forecast Grade A Office Rental CAGR by Market, 2022 to 2024F



Source Savills Research & Consultancy

GRAPH 6: Property Cycle Across Asia Pacific Prime Office Markets, 1H/2022



Source Savills Research & Consultancy

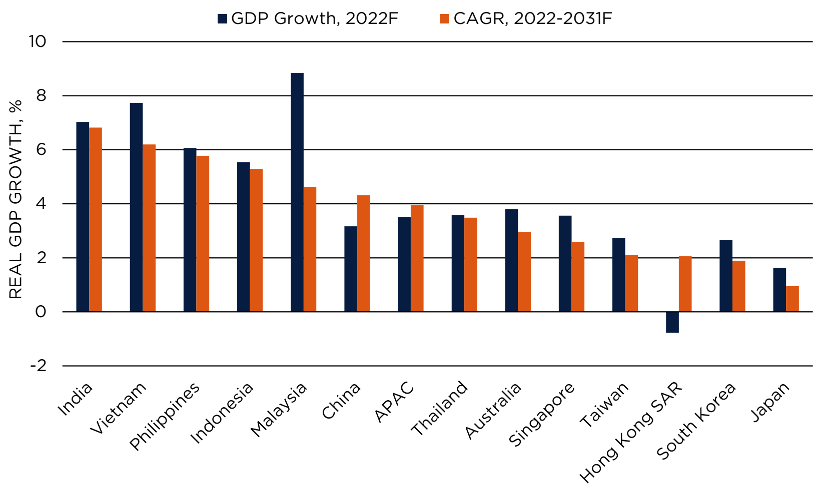
Yet there are still a handful of markets in the region which will buck the trend, with rents standing strong against a backdrop of limited new supply. Seoul is adding about 159,000 sq m of new supply per year between 2022 and 2024, which is 57% lower than the previous five-year average. On the other hand, rental growth in Singapore, Ho Chi Minh City and Ha Noi is being driven by a recovery of local economic growth and a positive demand outlook and have shifted into a rental upcycle from 1H/2022. Grade A CBD Offices in Singapore have been sought after by both family offices and technology firms. Although the former typically occupy smaller spaces of less than 465 sq m (5,000 sq ft), the cumulative demand has been relatively sizeable. This sector is undergoing a rapid expansion as the Monetary Authority of Singapore approved more than 100 family office applications in the first four months of 2022 alone. Meanwhile, tech tenants remain the dominant demand driver although activity levels may cool as evidence is emerging of lay-offs and hiring slowdowns among big tech firms. Still, Singapore Grade A office rents should remain firm registering a 2% to 3% YoY uptick in 2022.

Overall, the region's Grade A office markets are divided into those which will benefit from local economic recovery and those which will suffer the double hit of macro headwinds at a time of substantial supply hikes. In terms of rental performance, 12 out of the 23 markets should see some correction in rents in 2022, though most of them should turn the corner in 2023, as recoveries are delayed but not derailed.

PLENTY OF SHORT-TERM CHALLENGES

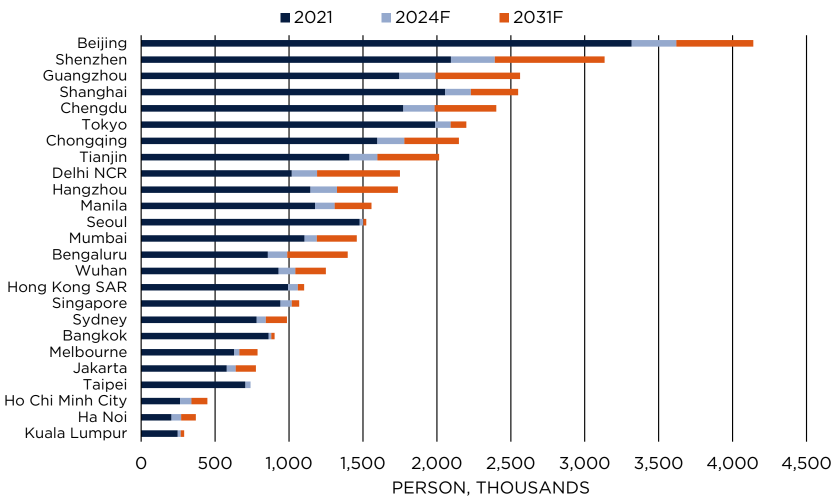
While most Grade A office markets within the region are still in a downcycle, Asia Pacific will remain a global growth engine for at least the next decade. However, the near-term outlook for 2022 is clouded by many downside risks including the future course of the pandemic, slowing global trade, soaring inflation, tightening global financial conditions, and weaker Chinese economic support for the region under its zero-COVID policy. As such, economic growth is poised to be slower in 2022 than previously estimated with regional real GDP expanding by 3.5% YoY, down from last year's 6.3% YoY growth. Looking further ahead, however, Asia Pacific's GDP is forecast to increase by 4.0% per annum between 2022 and 2031, well ahead of the 2.1% and 1.6% CAGR of North America and Europe. According to Oxford Economics, China and India, the two most populous countries in the region, are expected to propel growth over the coming ten years.

GRAPH 7 : Real GDP Growth by Market, 2022 to 2031F



Source Oxford Economics
Note Forecasted as of September 2022

GRAPH 8: Office-based Employment by Market, 2021 to 2031F



Source Oxford Economics

ASIAN MEGACITIES TO LEAD MARKET GROWTH

The rapid urbanisation of Asia Pacific and the growth in office-based employment implies more job opportunities in information & communications, finance, and business services. According to estimates by Oxford Economics, there will be around 3.1 million additional jobs generated between 2022 and 2024 across major cities in Asia Pacific, followed by another 6.3 million by 2031.

In terms of volume, Chinese cities are driving the momentum with four tier-1 cities adding over one million jobs in the coming three years, while Chengdu, Chongqing, Tianjin, and Hangzhou will register about 200,000 additions each. In terms of growth potential, Viet Nam is expected to record the fastest growth, with 9.7% and 9.0% CAGRs in Ha Noi and Ho Chi Minh City respectively. Looking beyond 2024, while Chinese cities will remain the dominant force, other markets such as Delhi NCR, Bengaluru, Mumbai and Manila can expect to see a rapid expansion in the long term. In particular, Delhi NCR and Bengaluru will lead growth with 5.7% and 5.1% increases per year between 2024 and 2031. These emerging markets are likely the most promising in terms of leasing activity, helped by a slower shift to flexible working.

Over the next two to three years, traditional challenges such as over-supply and sluggish economic growth will continue to influence rents and property cycles across the major Grade A office markets, while the impact of changing work practices such as hybrid working should prove less impactful. Looking to the longer term, structural changes taking place in many of the region's first and second-tier cities including urbanisation and the growth of services and office-based employment will continue to drive demand.

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