

# ASIA PACIFIC INSIGHTS

## Key Themes

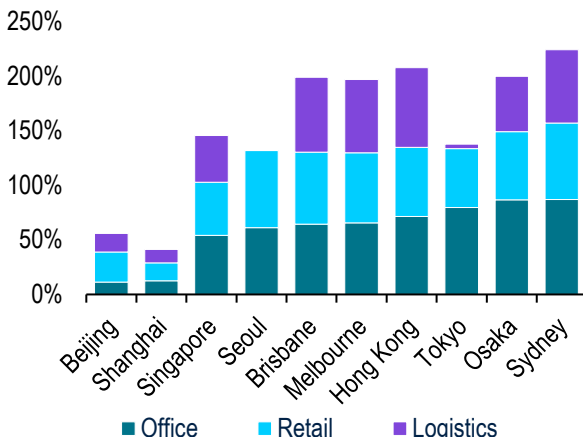
- Can Yield Spreads Help Identify Investment Opportunities in Japan?
- What Do Cash-on-Cash Returns Tell Us About the Investment Outlook?

### Can Yield Spreads Help Identify Investment Opportunities in Japan?

A stand out feature of Japan's institutional office and retail real estate stock is its age. On our estimates, across Asia Pacific, Japan's stock is among the oldest (**Exhibit 1**).<sup>1</sup> For investors this points to opportunities for value-add investing such as refurbishment or repositioning plays. And yet age of stock is not enough in itself to generate investment returns: old stock can and often is modernized through time.

#### Exhibit 1: Japan Has A Lot of Old Office and Retail Stock

Estimated Cumulative Share of Institutional Commercial Real Estate Stock Greater than 20 Years of Age, Major Investment Markets



Sources: JLL, PMA, PGIM Real Estate. As of September 2025.

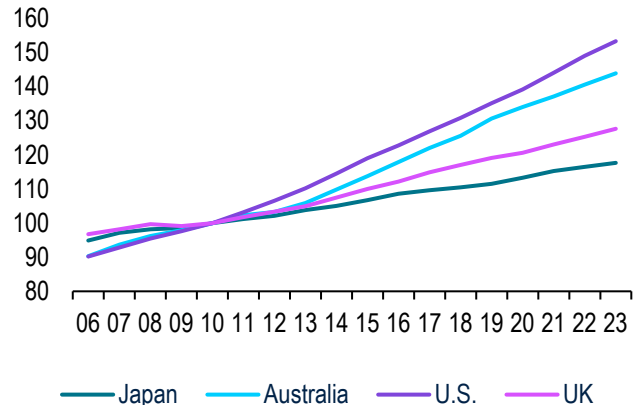
<sup>1</sup> See our [Asia Pacific Value-Add Investing paper](#) for more analysis on the pan-regional age of Asia Pacific stock.

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To help strengthen the case for value-add investing, we can instead lean on capital expenditure data from MSCI – data that, for instance, captures spending on building improvements on institutionally held property. For Japan, this data highlights another stand out – that Japan posts one of the weakest trends in capital spending across most all developed economies. This trend strengthens the investment case – suggesting there is a lot of relatively mismanaged or undermanaged real estate (**Exhibit 2**).

#### Exhibit 2: Japan Has a History of Weak Institutional Capital Expenditure

MSCI Real Estate Capital Spending, Index Values 2010=100



Sources: MSCI, PGIM Real Estate. As of September 2025.

But this weak capital spending trend potentially also shows up in another way. By looking at yield spreads between prime data – data representing the hypothetical best in class for any given market – and MSCI data – data based on the valuations of existing assets – we can argue that the wider the spread the greater the gap in quality between these two real estate markets.<sup>2</sup>

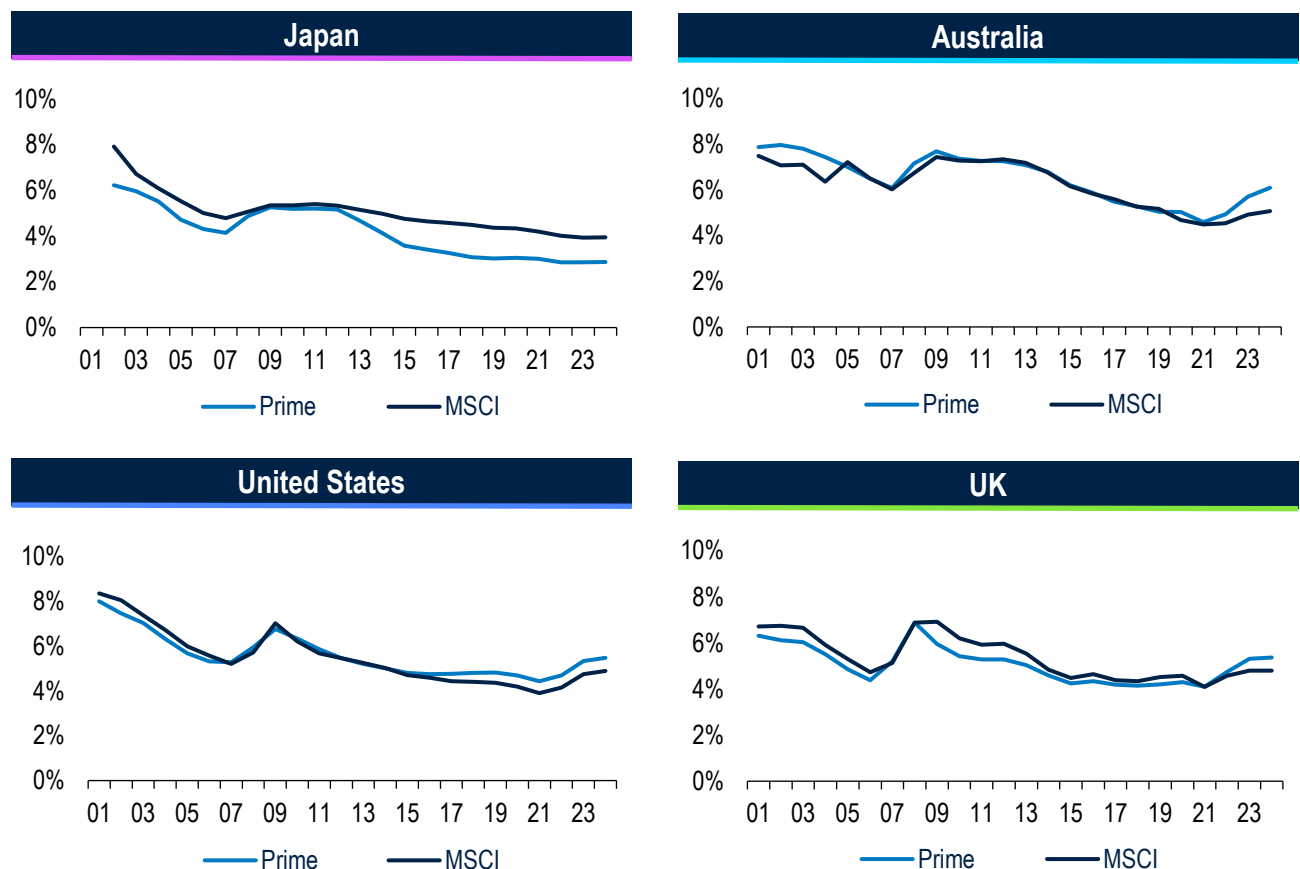
To be sure, such yield spreads don't just reflect differences in quality; other factors such as location, building age, tenant make up, etc. also matter. Moreover, MSCI reports a net operating income (NOI) yield, which is impacted by market conditions

such as rising vacancy rates that will here, for instance, drive NOI lower and vice versa. Even then the mark-to-market nature of prime data means there will be times when prime yields move faster than and even above MSCI.

Nonetheless, if we run this yield spread analysis against capital spending trends for four major investment markets – the United States, UK, Australia and Japan – we can see a pattern. Australia and the United States – countries with relatively higher capital spending – have the narrowest yield spreads (**Exhibits 2 and 3**).

### Exhibit 3: Yield Spreads Can Also Capture Differences in Quality of Real Estate

MSCI NOI Yield on Institutionally Held Real Estate Assets and Prime Net Initial Yield



Sources: MSCI, JLL, Cushman & Wakefield, PGIM Real Estate. As of September 2025.

<sup>2</sup> Technically, MSCI reports the NOI yield, which will be influenced by market conditions. Nonetheless, alone this does not account for the relatively large differences between the two-yield series across countries and time.

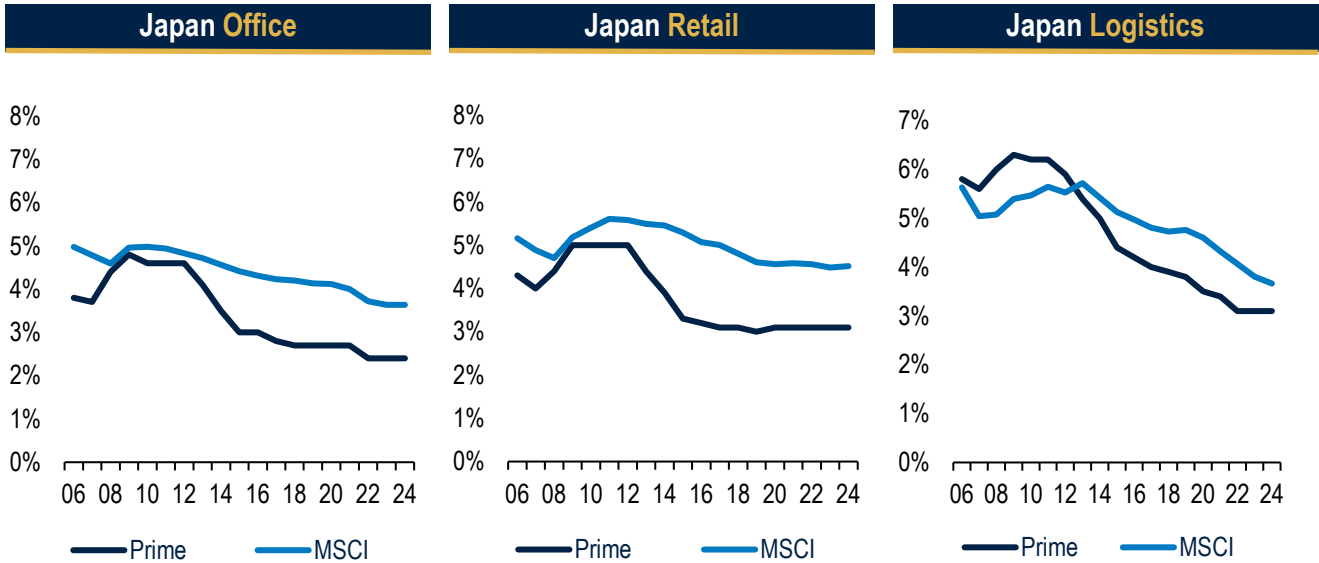
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As an exercise, the notion that these spreads could be capturing quality differences between institutionally held real estate stock and prime is interesting. But it also offers more by way of the potential value catch up an increase in capital spending could have. In Japan, closing the spread between prime and MSCI real estate implies a near 30% increase in the value of institutionally held stock.

For Japan, these spreads vary by sector (**Exhibit 4**). The spreads are higher in the office and retail sectors than in logistics. This implies investors should turn more to opportunities in the office and retail sectors first. And given what we know this makes sense. Despite its shortcomings as a method, these are also the two sectors with the oldest stock.

Exhibit 4: For Japan, the Value-Add Investment Case Looks Stronger for Office and Retail

Prime vs. MSCI Income Yields



Sources: PMA, MSCI, PGIM Real Estate. As of September 2025.

What Do Cash-on-Cash Returns Tell Us About the Investment Outlook?

The cash-on-cash (CoC) return is a tactical metric commonly used to reflect the annual cash yield on equity. With APAC’s real estate returns expected to be largely income driven over the coming years – further exacerbated by protracted rate cuts as projected by Oxford Economics – CoC provides an effective lens to identify outperformers while helping to manage downside risk through stable income that is expected to help preserve returns, even amid valuation pressures.

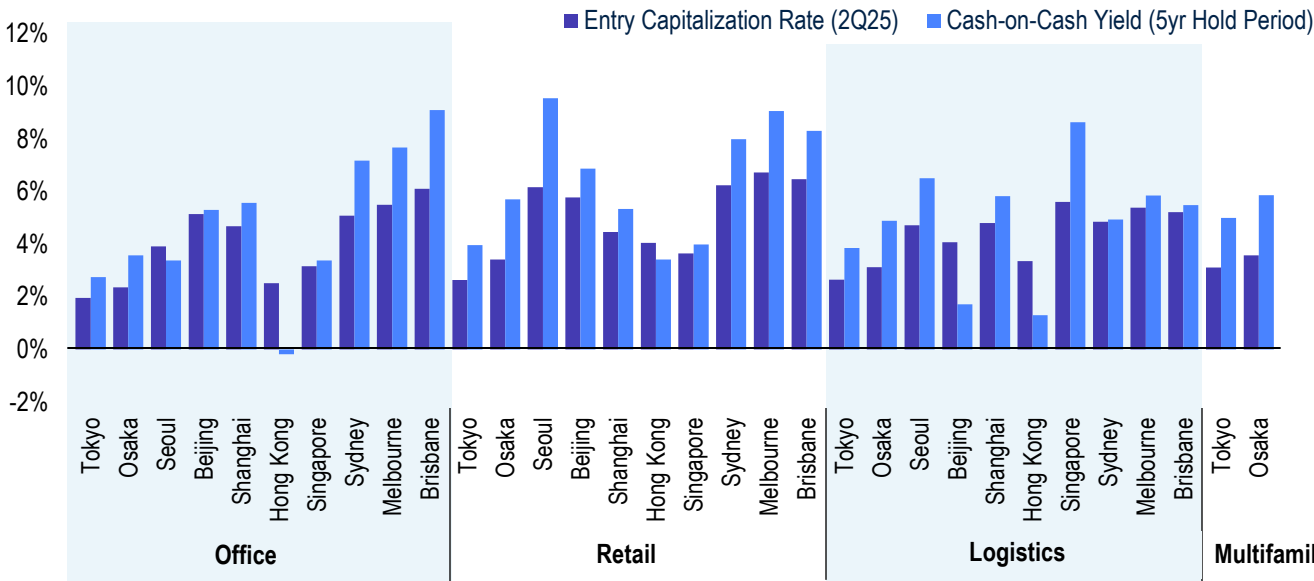
Comparing entry capitalization rates with projected CoC yields, it is observed that positive leverage is anticipated to dominate across most markets and sectors, as demonstrated by the excess of CoC yields

relative to the acquisition capitalization rates across most markets (Exhibit 5),<sup>3</sup> highlighting the leverage-driven yield uplift potential through 2029, as interest rates and borrowing costs are expected to fall in most markets.

Japan is going against this tangent. However, the country is still expected to maintain its positive carry despite the projected benchmark interest rate hikes, while most markets in Australia and South Korea are anticipated to exhibit accretive leverage impact, reflecting the stronger financing-driven yield enhancement. By contrast, Hong Kong and Singapore<sup>4</sup> remain constrained, with tight spreads between the entry yields and cost of debt, limiting the knock-on benefits of leverage.

Exhibit 5: Positive Leverage Is Anticipated to Dominate Across Most Markets and Sectors

Entry Capitalization Rate (2Q25) vs. Cash-on-Cash Yield (5yr Hold Period) (%)



Sources: Oxford Economics, JLL, PMA, PGIM Real Estate. As of September 2025.

<sup>3</sup> Refers to CoC yields based on an investment hold period of 5 years from 3Q25 to 2Q30. The CoC yields are computed based on the projected cash flows with the following cost of debt and loan-to-value (LTV) assumptions: Japan (1.9% / 55%), South Korea (4.3% / 60%), China (3.5% / 50%), Hong Kong SAR (4.5% / 55%), Singapore (3.5% / 55%), Australia (5.4% / 50%).

<sup>4</sup> Singapore logistics assets are based on a 60-year lease hold land tenure. Source: JLL.

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However, country-level trends mask significant divergence across city-sectors. Overlaying anticipated capitalization rate movements with projected CoC yields highlights strategies combining higher income yields with potential capitalization rate compression – most evident in Australian city-sectors and select logistics markets such as Singapore and Seoul (Exhibit 6), which is expected to provide some downside resilience in the current climate.

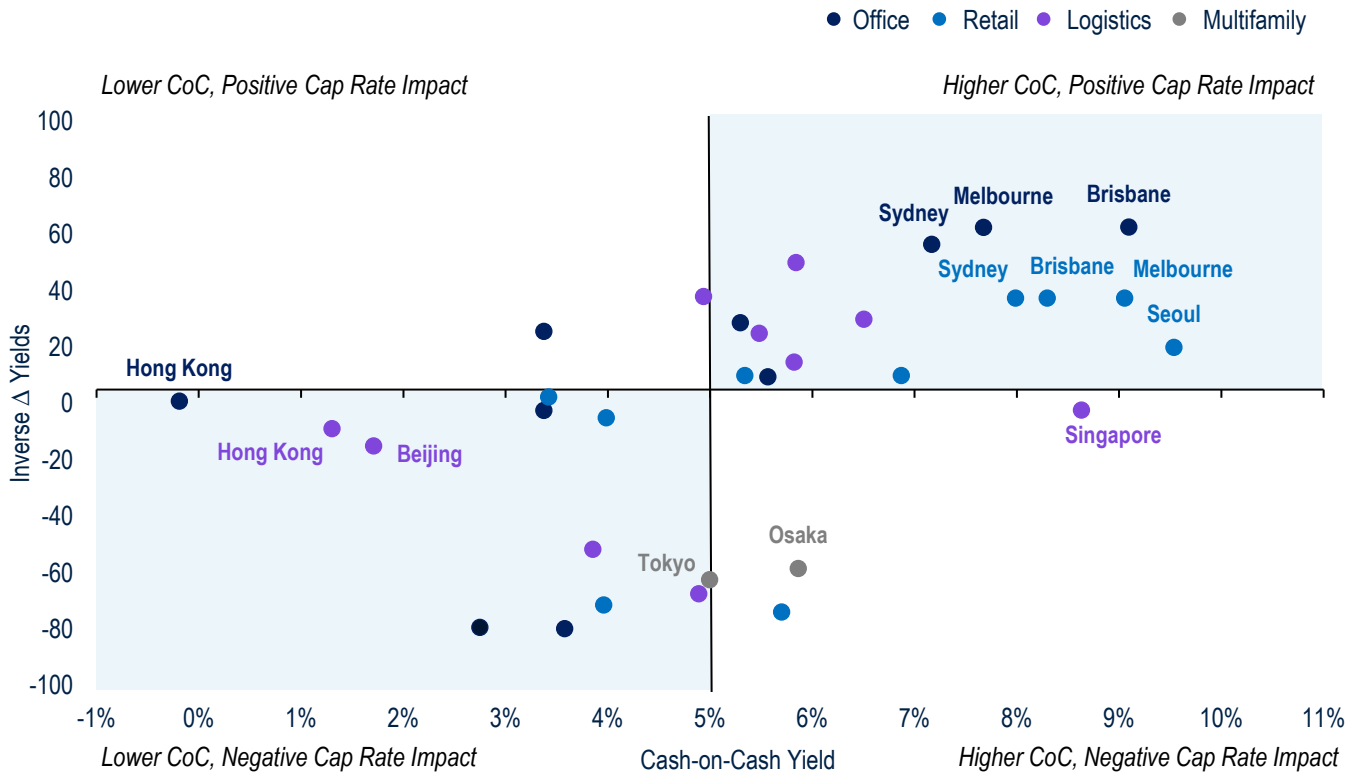
Retail stands out with the strongest CoC returns with marginal compression upside, underpinned by the higher entry capitalization rate and, consequently, the wider yield spread over borrowing cost. Additionally, the sector is expecting a stronger rental uplift driven

by improving consumer sentiment and spending in the coming years. However, the performance of office and logistics remains mixed, dependent on micro market fundamentals and structural trends such as return-to-office and e-commerce penetration.

Projections by JLL and PMA indicate that values are now under further pressure to fall in select markets like China and Japan, although China's outlook is stabilizing compared to Japan's upward yield shifts. Nevertheless, multifamily opportunities are still a viable strategy in Tokyo and Osaka, though asset selection remains key.

## Exhibit 6: Cash-on-Cash Yields Highlight Strategies Combining Higher Income Yields With Potential Capitalization Rate Compression

Cash-on-Cash Yield (5yr Hold Period) (%) vs. Capitalization Rate Movements (bps)



Sources: Oxford Economics, JLL, PMA, PGIM Real Estate. As of September 2025.

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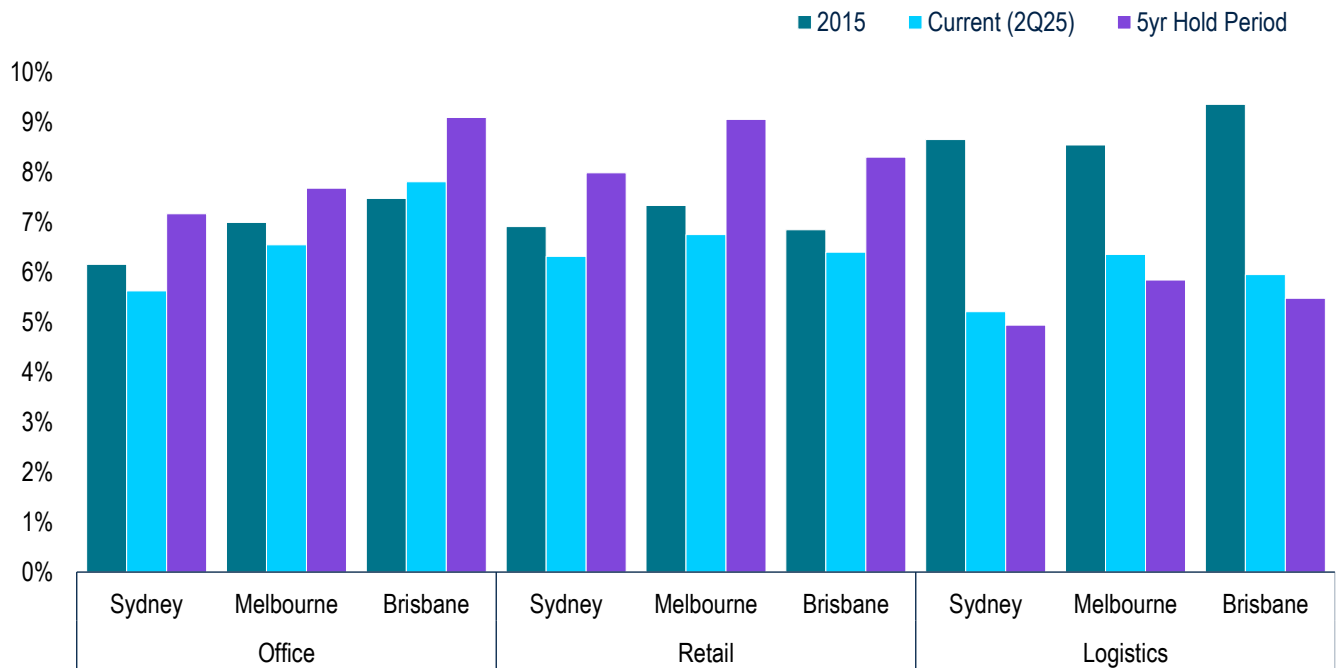
Looking ahead, CoC yields are expected to reaccelerate for the office and retail sectors amid the ongoing cyclical recovery to exceed decade-ago levels, though logistics CoC yields have materially compressed following its structural re-pricing over the past few years (**Exhibit 7**).

Using Brisbane’s office market as an illustration, expected CoC yields now sit in the high single digits – approximately 150 bps above levels a decade ago, highlighting the enhanced return profile from leverage amid a gradually easing funding environment.

Overall, the APAC real estate landscape continues to present itself as a nuanced but favorable environment for institutional investors. With global tariffs and protracted rate cuts keeping risk premiums wide, the current window for attractive entry pricing is still open, especially in markets where fundamentals and financing spreads align.

**Exhibit 7: In Australia, CoC Yields Are Expected to Accelerate for the Office and Retail Sectors**

Cash-on-Cash Yield (2015 vs Current 2Q25 vs. 5-yr Hold Period) (%)



Sources: Oxford Economics, JLL, PMA, PGIM Real Estate. As of September 2025.

## Contacts

### Natasha Lee

Vice President

Asia Pacific Investment Research

[natasha.lee@pgim.com](mailto:natasha.lee@pgim.com)

### Tiffany Tan

Associate

Asia Pacific Investment Research

[tiffany.tan@pgim.com](mailto:tiffany.tan@pgim.com)

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