JULY 2025 | INVESTMENT RESEARCH

Asia Pacific Value-Add Real Estate: Capitalizing on Opportunities in the Next Cycle

Executive Summary

Despite ongoing market uncertainty, the case for value-add in Asia Pacific today is supported by several factors.

- Asia Pacific real estate values have gone through a correction and, having stabilized in 2024, are set for a rebound in the coming years. Some parts of the market are set to rebound faster than others.
- The low liquidity market environment of today can offer an attractive entry point as investors can selectively acquire assets below valuation and capture immediate upside.
- After a relatively subdued investment and building cycle, there are supply shortages, even in parts of the market with resilient demand. In addition, there is a need for capital to modernize existing stock and meet the growing sustainability requirements of institutional investors.
- The value-add opportunity set is expanding to sectors not traditionally seen as part of the investment landscape, including operationally intensive sectors that offer higher potential returns but require more specialist expertise to execute on.

Five Key Themes Supporting Value-Add Investing in Asia Pacific Today

1	2	3	4	5
Value Rebound	**Attractive Entry Point**	**Need for Capital**	**Supply Shortages**	**Expanding Opportunity Set**
Rising values, falling borrowing rates set to boost returns	Illiquidity and stressed capital structures	Capex shortfalls and rising sustainability requirements	Constrained supply for most property types and locations	Operational platforms drive income growth potential

Part 1: Why Does Asia Pacific Value-Add Make Sense Now?

We identify five factors that are among the most important in determining the nature and scale of the opportunity in Asia Pacific value-add today.

1 Value Rebound

Falling interest rates to help drive the recovery in values

Across the major investment markets of Asia Pacific, prime real property values have been on a steady decline since 2019, despite a brief recovery in 2022.* This year, despite ongoing market uncertainty linked to U.S. trade policy, the region is expected to report the start of a persistent recovery in values driven in large part by the rental growth story and falling short-term rates. This is happening as long-term rates settle at above pre-COVID-19 averages (**Exhibit 1**).

This recovery paints a forward-looking picture of higher returns. It is set against a background in which Asian markets have been relatively resilient in this cycle, helped by a combination of values not being too stretched as interest rates rose and, outside of China and Hong Kong, ongoing strong employment growth. Nonetheless, details matter and this recovery will vary across the region – both in speed and timing – due to differential demand-supply and pricing dynamics.

In aggregate, we expect unlevered headline prime real value growth of just under 1% per year over the next five years, but by sector we have differences ranging from a -0.4% annual decline in retail to a 0.5% annual gain in offices, and by city we have differences ranging from a -0.3% value decline in Beijing to 3% p.a. growth in Sydney (**Exhibit 2**). Picking the right city-sector combination at the right time is critical to best capture the recovery in real estate returns.

Exhibit 1: Falling Short-Term Rates to Help Rental Growth

Six Country Aggregate 10-Year Bond Yields and Short-Term Policy Rates**

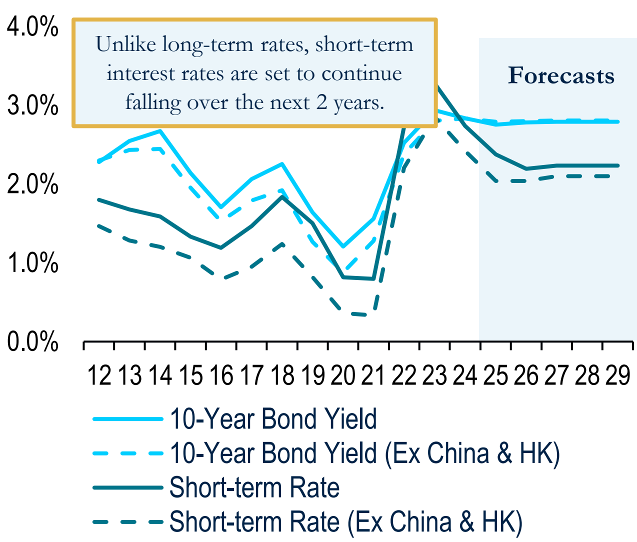
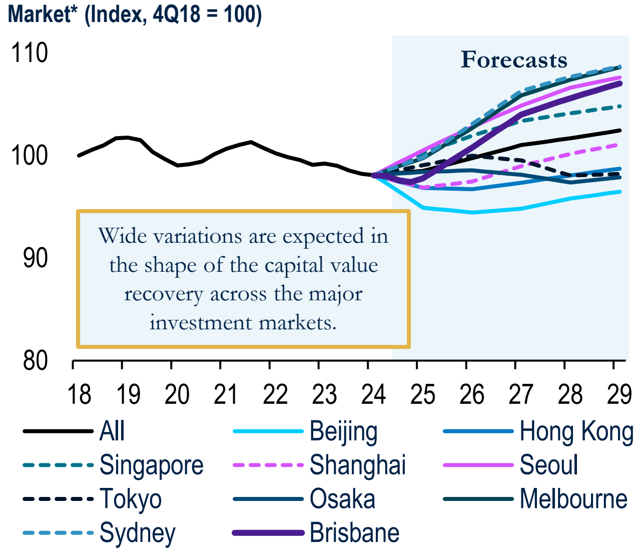


Exhibit 2: Recovery From 2025 Onwards – Some Parts of the Market Are Set to Rebound Faster

All Commercial Prime Real Capital Values by Major Investment Market* (Index, 4Q18 = 100)



* We define the major investment markets as Beijing, Brisbane, Hong Kong, Melbourne, Osaka, Seoul, Shanghai, Singapore, Sydney and Tokyo. Based off MSCI data, these cities average over 80% of all standing transactions activity in the region. See Appendix for details.

** Data includes Australia, China, Hong Kong, Japan, Singapore and South Korea, which collectively amount to more than 90% of transactions activity across the region. See Appendix for details.

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

Forecasts are not guaranteed and may not be a reliable indicator of future results.

For Professional and Institutional Investors only. All investments involve risk, including the possible loss of capital.

2 Attractive Entry Point

Illiquidity and stressed capital structures

With 2025 being the turning point for capital values, sentiment toward real estate has improved, but debt and equity liquidity remain low, compared to the last cycle (**Exhibit 3**). The combination of a drop in values and a shift to a higher interest rate environment compared to last cycle has given rise to a debt funding gap.

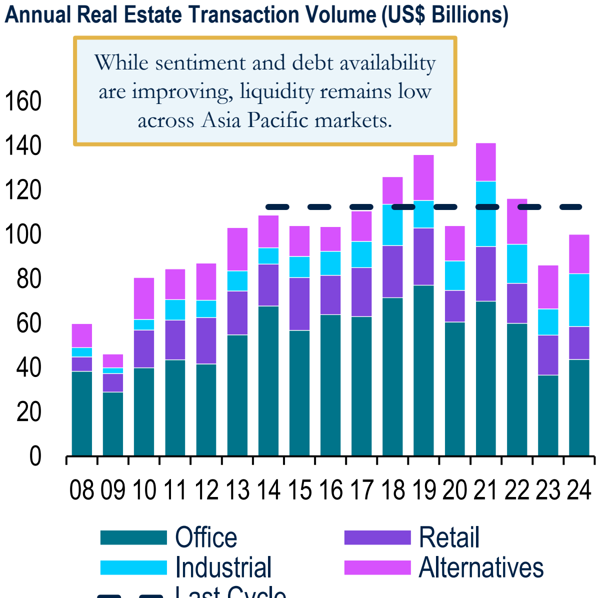
Low liquidity and funding pressures are creating stress around existing capital structures. Today's market may offer an attractive entry point in terms of being able to selectively acquire assets below valuation and capture immediate upside.

Such opportunities are most notable where there are cash flow challenges to overcome, such as a need for further capital investment or a relatively short lease expiry profile.

Moreover, such periods of low or fluctuating liquidity give rise to possible mispricing. In such instances, this can be seen through diverging patterns between yields and rental growth. One rule of thumb to spot mispricing is where the standard deviation of yields across markets does not match the standard deviation of rental growth. In **Exhibit 4**, there is evidence of mispricing more recently in both logistics and in retail. Taking advantage of such mispricing gives rise to possible enhanced returns.

Exhibit 3: Liquidity Is Low Across Asia Pacific

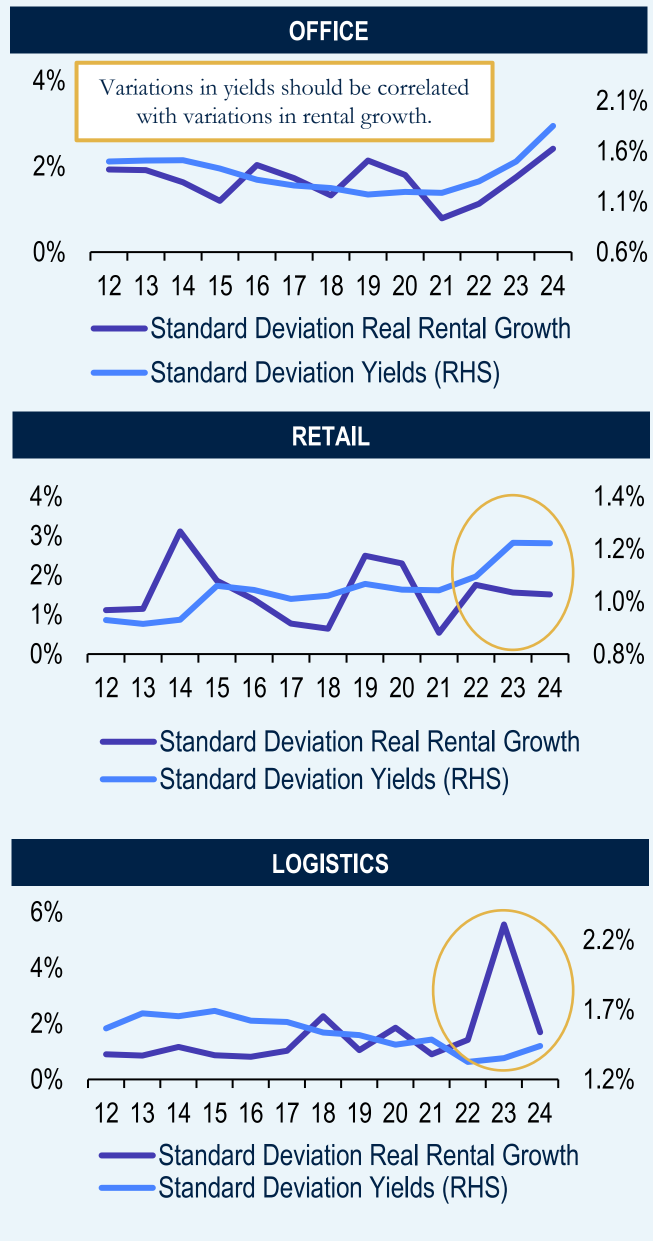
Annual Real Estate Transaction Volume (US$ Billions)



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

Exhibit 4: Examining Mispricing Across Sectors

Standard Deviation of Rental Growth and Standard Deviation of Yields, 10 Major Investment Markets (% p.a.)



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

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3 Need for Capital

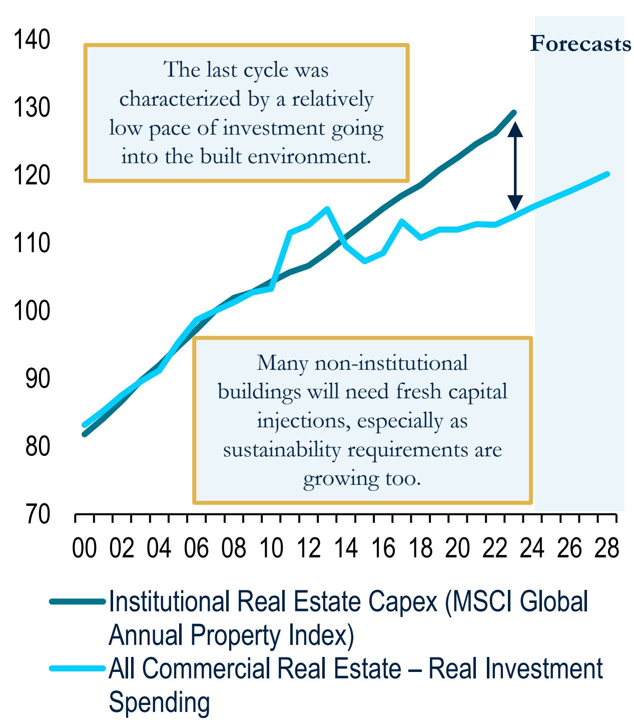
Capex shortfalls and rising sustainability requirements

Before the global financial crisis, non-institutional real estate capex spending had broadly kept pace with institutional capex spending, but it has fallen short over the past decade (**Exhibit 5**). At the same time, capex requirements for institutional-quality real estate has risen, most notably to meet tougher sustainability standards.

There is a vast quantity of real estate that is not currently institutionally held but that will need significant investment in the coming years. Financing such investment for smaller, existing owners is now much harder – given higher interest rates, lower credit availability and toughening sustainability requirements – favoring investors with significant expertise and high liquidity.

Exhibit 5: A Capex Shortfall Has Emerged

Index of Asia Pacific Capex Spending (2007 = 100)



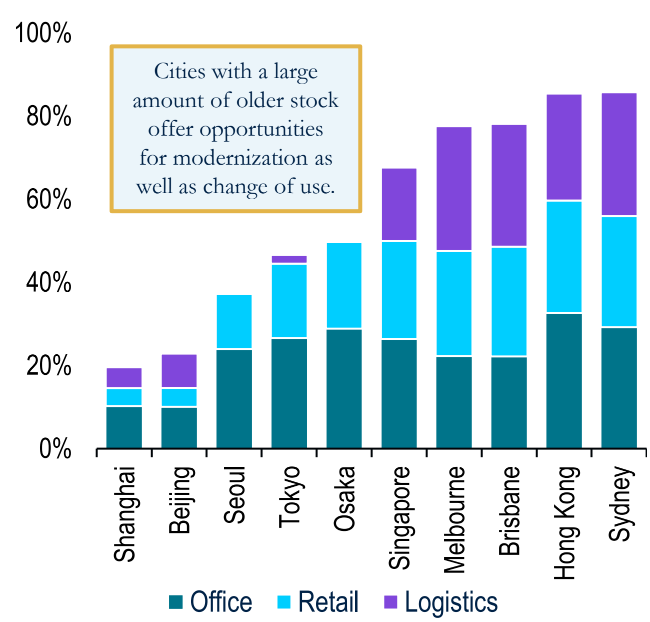
Sources: OECD, Oxford Economics, MSCI, PGIM Real Estate. As of July 2025.

Given the scale of the shortfall, the opportunity to modernize and institutionalize existing stock is expected to remain substantial throughout the next cycle. Moreover, there is scope for upside. Whilst the investment opportunity is one of seeking to achieve value gains through repositioning or redeveloping assets, the backdrop remains one of occupiers retreating to and/or searching for the highest quality stock.

Such opportunities vary significantly by city. Cities such as Hong Kong and Sydney have on average a greater share of commercial stock over 20 years of age than cities such as Beijing and Shanghai (**Exhibit 6**). At the same time cities such as Tokyo and Osaka offer opportunities, as reforms are giving rise to corporates divesting their often under-managed and/or under-invested real estate assets. But they also vary by sector where, unsurprisingly perhaps, the office market has the largest share of older stock followed by retail. The logistics boom explains its relatively modern stock.

Exhibit 6: Significant Variations in the Estimated Age of City Commercial Real Estate Stock

Estimated Percentage of Invested Commercial Real Estate Stock Over 20 Years of Age, by City



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

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4 Supply Shortages

Constrained supply for most property types and locations

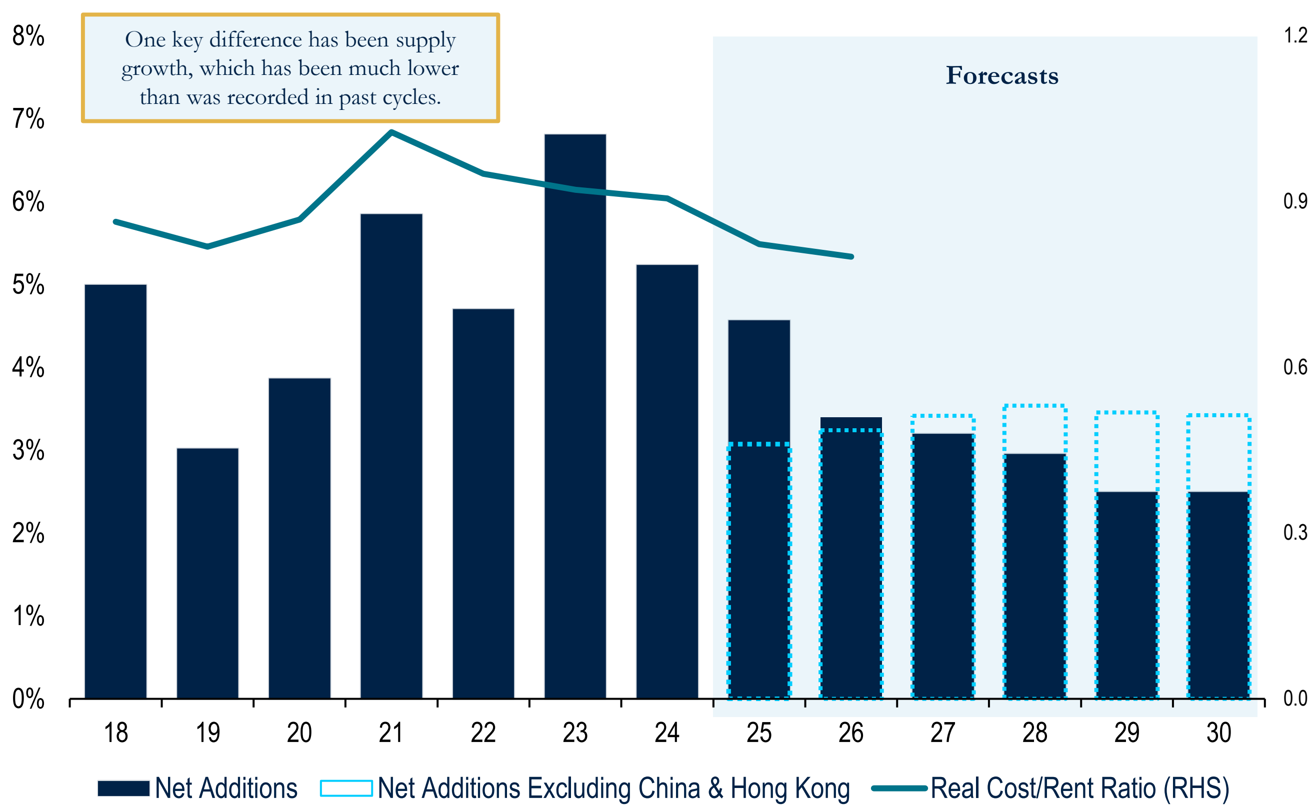
Trends in new supply mirror the broader investment picture – the pace of additions has been lower since the global financial crisis. Sentiment toward development among investors remains subdued, and new supply continues to be limited by factors such as higher build costs and constraints around access to development finance, effects that will weigh on supply deliveries for several years due to lags in the construction process. Unsurprisingly the supply story is only a bit stronger once we include China and Hong Kong (**Exhibit 7**).

Low supply makes sense in parts of the market facing demand headwinds, such as suburban office or retail, and where demand has eased on the back of short-term economic weakness but for which supply can adapt quickly, such as for big box logistics.

However, supply growth is also low in parts of the market where demand is resilient and/or rising – housing, data centers, senior living, CBD offices and hotels, for example – and we anticipate further supply shortages to arise, giving owners greater pricing power to drive rental growth.

Exhibit 7: Low Supply Growth Is Set to Persist

New Supply and Prime Commercial Property Rent to Construction Cost Ratio (% p.a.)



Average of net additions across office, retail and logistics sectors for the major city investment markets of Brisbane, Melbourne, Osaka, Seoul, Singapore, Sydney, Tokyo, China and Hong Kong. Sources: JLL, PMA, PGIM Real Estate. As of July 2025.

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5 Expanding Opportunity Set

Operational platforms drive income growth potential

There are two principal routes by which we see the value-add opportunity set expanding in response to changing patterns of investing across the board.

The first route is via a shift away from traditional sectors (office, retail, logistics) toward multifamily, which remains underdeveloped in the region outside Japan, but also those that are typically more operational in nature (including hotels, student accommodation, co-living, senior living, co-location data centers).

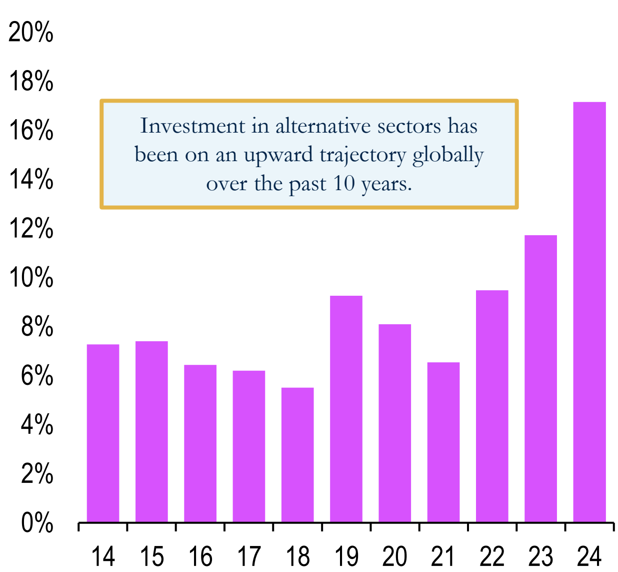
The shift toward a greater degree of operational exposure in the investment landscape is already underway. In 2024, the share of investment activity for operational sectors rose to 17% of all investment activity, up from 7% in 2014 (**Exhibit 8**). Whilst the opportunity to acquire assets in emerging sectors is one route, the opportunity in Asia Pacific is also to invest and build up these sectors.

The second route is by geography. The trend of institutionalization continues to play out in markets such as Australia and Japan. Over the past few years, transactions activity, a sign of improving liquidity, has trended up in second tier markets such as Nagoya, Fukuoka and Perth, making them interesting targets in what are already large, mature and stable investment markets.

Moreover, estimating the size of investable commercial real estate stock highlights countries such as South Korea and Japan as having larger shares of poor quality or non-investable stock (**Exhibit 9**). Differences across the region in part represent differences in the average age of real estate stock, but more importantly, it reflects differences in capital spending. High shares of non-investable stock speak to wider opportunities for driving value through improvements from capital spending.

Exhibit 8: Operational Sectors Growing as Part of the Investment Market

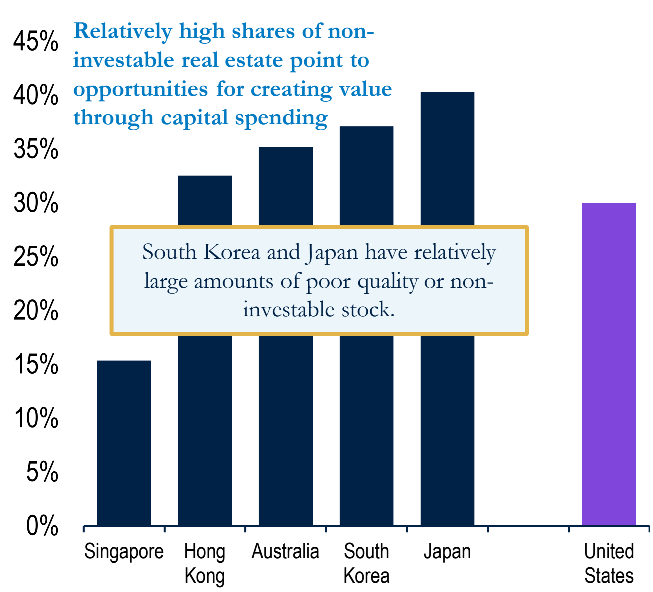
Transaction Volume for Alternative Real Estate as Percentage of Total Transaction (%)



Note: Operational sectors include multifamily, student housing, hotels, service apartments and senior housing
Sources: MSCI/Real Capital Analytics, PGIM Real Estate. As of July 2025.

Exhibit 9: Markets Like Japan and South Korea Have High Shares of Poor-Quality Stock

Estimated Value of Non-investable Stock as a Percentage of All Commercial Real Estate Stock



Sources: MSCI, Oxford Economics, PGIM Real Estate. As of July 2025.
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Part 2: Recognizing the Challenges

Aside from typical risks value-add investors face – such as interest rate cycles, pricing, fluctuations in occupier demand and exposure to external shocks – we identify challenges that are specific to today's investment environment.

Challenge #1

Interest rates have come down, but are still much higher than in the last cycle

In the major investment markets, short-term rates have started to fall, but, other than China, long-term interest rates remain elevated compared to where they were in the last cycle. Forecasts are for long-term interest rates to remain at current levels through the next cycle.

WHAT THIS MEANS

The potential boost from leverage and for value growth from yield compression is much lower than in the last cycle. Returns will predominantly be driven by factors relating to income growth and cash flow durability, rather than market yield shift.

Challenge #2

Returns on traditional real estate won't be enough to generate high value-add returns

Traditional core assets returns are set to grow at about 2% per year in the coming years, but based on history, this is consistent only with modest returns on non-core assets (**Exhibit 10**).

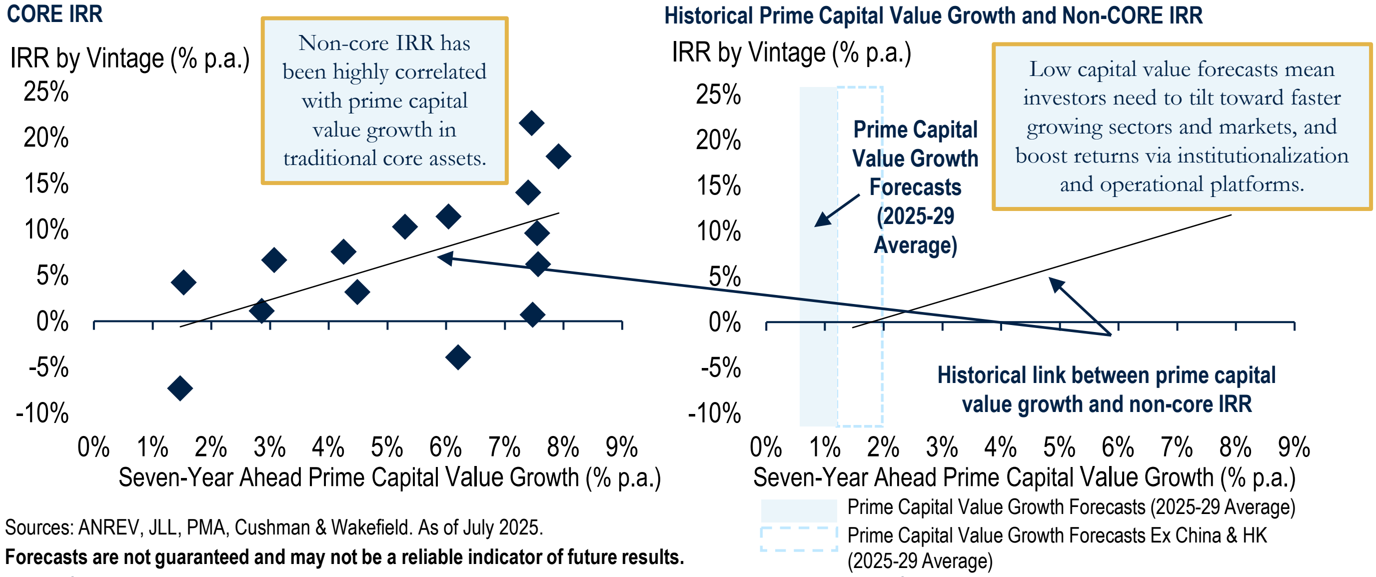
WHAT THIS MEANS

Investors will have to look beyond a portfolio focused on traditional assets and locations to drive growth to achieve higher returns. This will likely include investing in assets that need institutionalizing and in operational sectors, such as data centers, service apartments, senior and student living and hotels, which have a strong rental growth outlook and where investments into the operating platform can further boost potential returns.

Exhibit 10: Low Returns on Traditional Assets Mean Value-Add Investors Will Need to Broaden Their Horizons

Asia Pacific Headline Prime Capital Growth (2005-19) vs. Non-CORE IRR

Asia Pacific Headline Prime Capital Growth Forecasts vs. Historical Prime Capital Value Growth and Non-CORE IRR



Sources: ANREV, JLL, PMA, Cushman & Wakefield. As of July 2025.

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Part 3: Capitalizing on Opportunities

Defining Value-Add

While style definitions in real estate are not set in stone, in contrast to income-driven, buy-and-hold core investments, a value-add portfolio will typically seek to generate capital value growth-driven returns over a limited period of time, based on most or all of the following factors:

- Improving the level, quality and durability of cash flows by active asset management, capex and development activities.
- Achieving a positive valuation effect by growing the income stream on a portfolio, improving its quality and risk profile to capture favorable yield shift and upside from mispricing or market momentum.
- Taking on leasing risk and having an exposure to non-income producing assets, such as developments or refurbishment projects.
- Investing in a broad range of real estate asset types from traditional lease-based real estate, to secondary markets and locations, to operational platforms that have a business aspect on top of owning the underlying real estate.

Opportunities: Structural Versus Tactical Drivers

Broadly speaking, we split the opportunity set into structural and tactical groupings along sector lines, although geographical differences will play a role in portfolio allocation too. The following summarizes our views:

Structural Drivers

Investment conviction driven by basic needs and long-term structural themes that supports ongoing demand creation. Examples include:

- **Living and accommodation**: aging demographics, housing shortages and rising rental demand point toward a significant and ongoing opportunity set across Asia Pacific living markets, while hotels and service apartments are benefiting from rising tourism and business travel demand.
- **Digital infrastructure**: demand for data centers is being driven by digital transformation, a shift to cloud computing and the rise of AI.
- **Logistics and supply chain**: rising online spending, a need for facilities that can drive customer fulfillment in urban areas and supply chain optimization are among key drivers of logistics demand that are set to persist in the coming years.

Tactical Drivers

Opportunities arising from near-term growth, the anticipated cyclical value rebound and market dislocation that gives rise to potential mispricing. Examples include:

- **Traditional income-generating sectors**: Office has a lack of liquidity in the face of headwinds (including hybrid working) and potential mispricing in areas where strong demand persists, for example in low supply CBD markets. Retail opportunities are growing as in-store spending stabilizes at a time of stressed capital structures, discounted pricing and low liquidity.

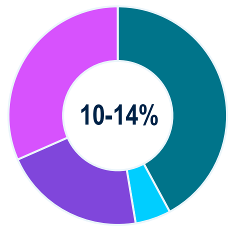
Sizing Up Different Approaches to Value-Add Investing

We identify five different value-add investment approaches in **Exhibit 11**, each with a different emphasis on how capital growth is generated and a different risk-return profile. Over the course of a cycle, a value-add portfolio would likely comprise elements of all of these.

Exhibit 11: Stylistic Target Return Range and Breakdown for Different Value-Add Investment Approaches

Mispricing

Opportunities linked to mispricing in the market, for example due to low liquidity or stressed capital structures.



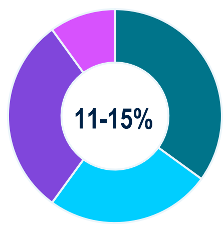
Key return driver(s): market performance plus yield shift

Indicative target sectors: hotels, logistics, office, retail

Risk Level: Low-Medium

Active Asset Management

Taking on risk in under-managed or under-performing assets likely with vacancy or a challenging lease expiry profile.



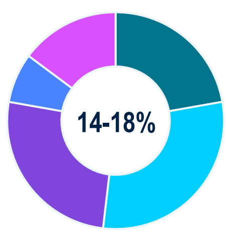
Key return driver(s): income growth via re-leasing and rental reversion

Indicative target sectors: multifamily, retail, office, student/co-living, urban logistics

Risk Level: Low-Medium

Institutionalize / Heavy Capex

Invest significant capex into outdated assets to institutional quality to drive modernization and meet latest sustainability standards.



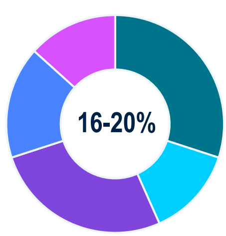
Key return driver(s): income growth and positive valuation effect

Indicative target sectors: hotels, multifamily, office

Risk Level: Medium

Operational Platforms

Investing in operational platforms alongside the real estate to allow greater control and enhance returns potential.



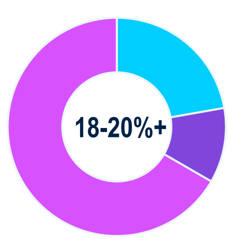
Key return driver(s): income growth, positive valuation effect and operational gain

Indicative target sectors: cold storage, data centers, flex office, hotels, senior housing, service apartments, student/co-living, urban logistics

Risk Level: Medium-High

Development

Ground-up development of assets in a low supply market environment.



Key return driver(s): valuation uplift and development profit

Indicative target sectors: cold storage, data centers, hotels, multifamily, senior housing, student/co-living, urban logistics

Risk Level: High

Income Return | Net Income Growth | ERV Growth | Operational Gain | Valuation Effect

Note: Net Income Growth reflects the gain from asset management activity while ERV Growth reflects the general boost to values from rising benchmark rents.
Source: PGIM Real Estate. As of July 2025.
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Building a Value-Add Portfolio for the Next Cycle

Here we assess how the different approaches to value-add investing affect portfolio allocation decisions relating to different sector and opportunity groups.

- One clear trend is that **operational platforms** are becoming key to achieving higher rental growth and returns (**Exhibit 12**). This can be in truly operational sectors, like senior living or hotels, urban logistics or co-location data centers, that require specialized expertise, or simply as a route to optimize performance, for example in office by including flex space in the offering to improve leasing outcomes.

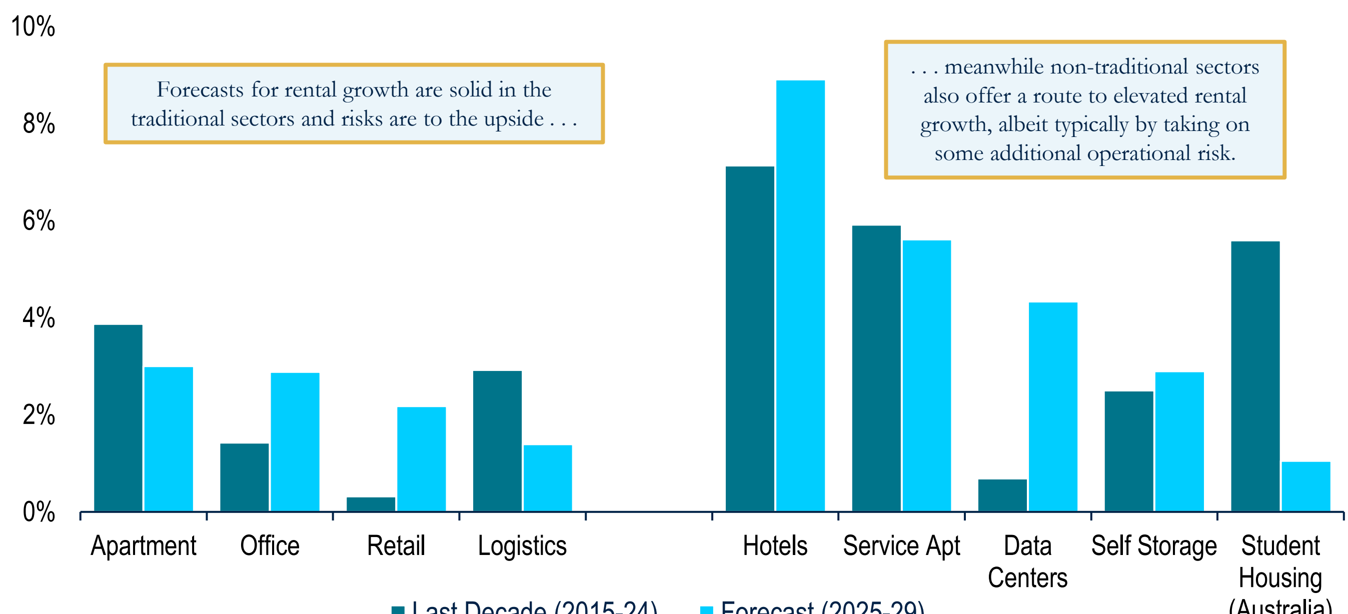
- **Development** strategies will likely focus on sectors with the strongest structural demand drivers including living, logistics and data centers, while **mispricing** is most likely to drive acquisitions in the traditional office, logistics and retail sectors, and in hotel markets that not only went through a significant adjustment during the COVID-19 pandemic but are gaining from structural growth in consumer demand.

- **Active asset management** is effectively a key feature of all value-add investing but is set to be a key returns driver in traditional office, retail and living sector assets, where operational platforms are not as heavily involved.

- Opportunities related to **institutionalization** are set to play out. For the living sector where many assets have been owned by small private landlords and are under-managed, it is modernizing rapidly in response to rising demand. The same is true for hospitality where also significant capex budgets are hard for smaller independent owners to finance.

Exhibit 12: Look to Operational Sectors for Higher Rental Growth Potential to Drive Returns

Prime Rental Growth by Sector – Major Asia Pacific Cities (% p.a.)



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

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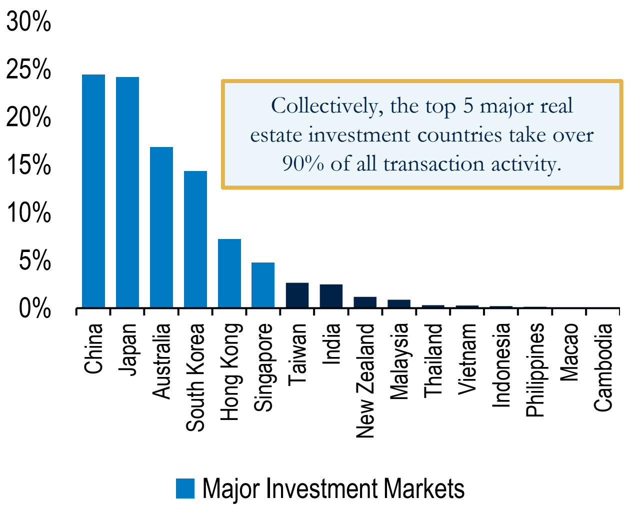
Appendix: Identifying the Target Markets

Here we examine what countries make up the target market set. In general, investment activity tells us what institutional investors are after. According to the MSCI database of transactions activity going back to 2008, the same five countries have continued to take almost 90% of all transactions activity in the region (**Exhibit A1**).

Exhibit A1: Transactions Activity Dominated by Six Countries

Share of Total Asia Pacific Standing Property Transaction Volume by Country %, (2015-24)



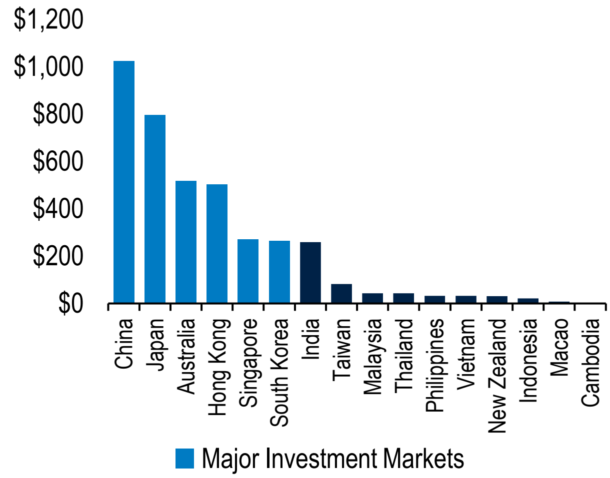
Sources: MSCI, PGIM Real Estate. As of July 2025.

If we rank countries based on the three most cited reasons for institutions to invest into a country's real estate – size of investment market, financial development and transparency – the top five investment countries come out on top (**Exhibits A2-A4**).

It is hard to see which other countries might take as significant a share of investment activity as these over the next few years. Whilst some score high on individual measures, they score poorly in one or more of others.

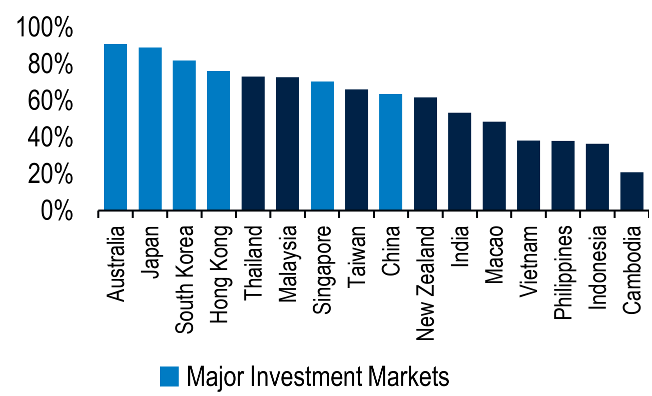
Even then, the country story only takes you so far – what also matters is the local market environment.

Exhibit A2: Size of the Real Estate Investment Market (US$ Billions)



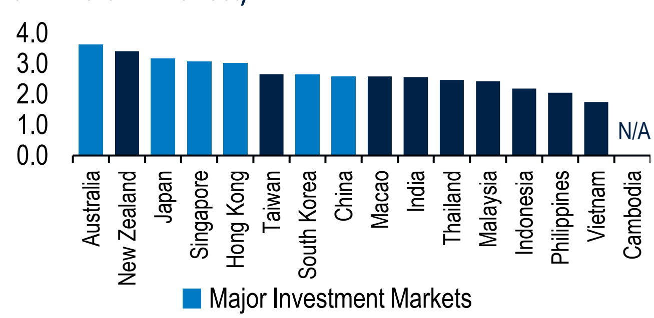
Sources: MSCI, PGIM Real Estate. As of July 2025.

Exhibit A3: Financial Development (100% = Perfect)



Sources: IMF, PGIM Real Estate. As of July 2025.

Exhibit A4: Transparency Index (2024, Values Inverted, 0-4 where 4 = Perfect)



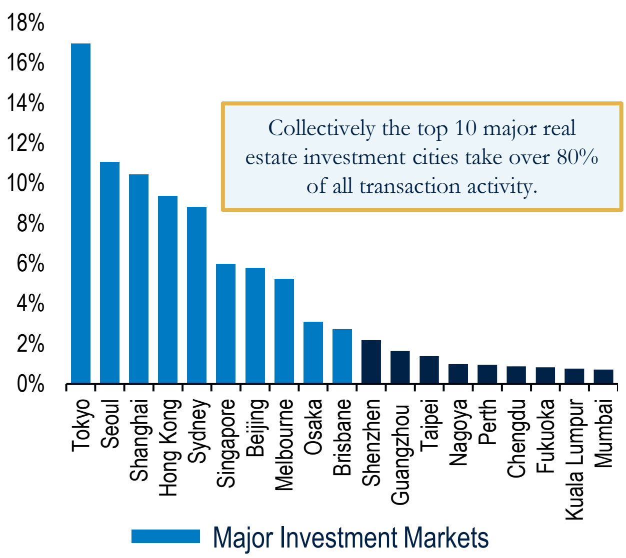
Sources: IMF, PGIM Real Estate. As of July 2025.

Appendix: Identifying the City Target Markets

Here we examine what cities make up the target market set. Within the major country investment markets, over the past 10 years just 10 cities consistently captured nearly 80% of all standing transactions volume. The next 10 cities only captured the next 11% of the market (**Exhibit A5**).

Exhibit A5: Transactions Activity Dominated by 10 Cities

Share of Total Asia Pacific Standing Property Transaction Volume by City %, (Top 20, 2015-24)

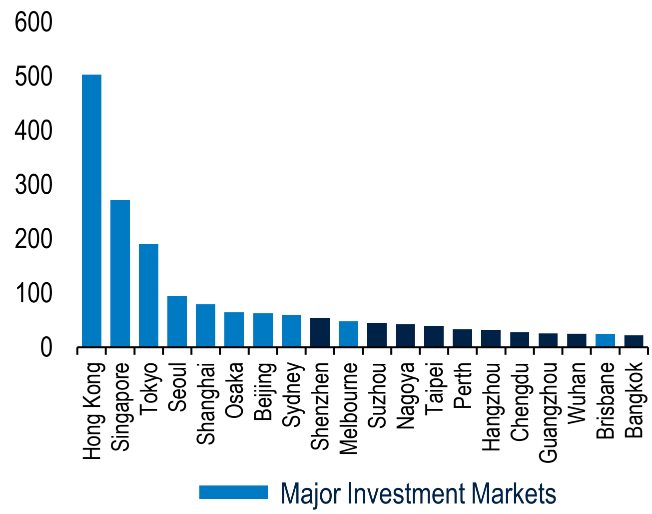


Sources: MSCI, PGIM Real Estate. As of July 2025.

That the top 10 cities are in the major five country investment markets is no surprise. When countries score well in terms of financial development and transparency, investors naturally look to indicators such as size of the city investment market and liquidity (number of deals done) (see **Exhibits A6** and **A7**). Together these two factors explain the persistence of the top 10 cities.

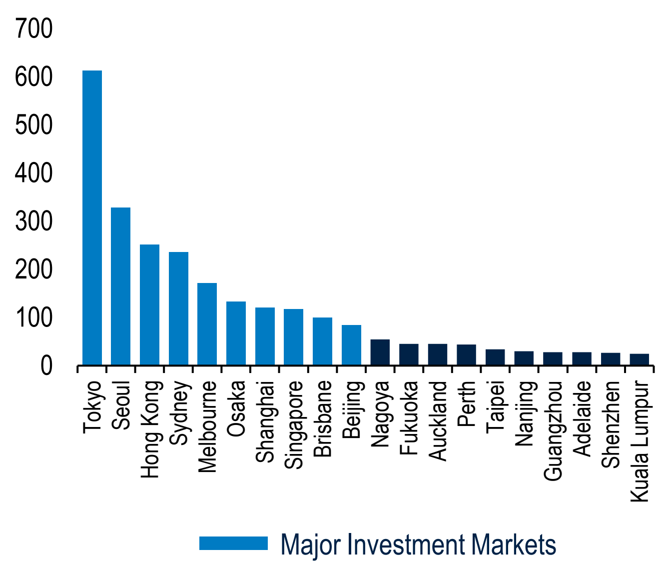
However, liquidity is improving outside of the major investment markets such as Nagoya and Fukuoka that are showing signs of becoming more institutionalized (**Exhibit A7**).

Exhibit A6: Size of the Real Estate Investment Market (US$ Billions)



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

Exhibit A7: Average Number of Property Deals per Year (2015-25)



Sources: RCA, PGIM Real Estate. As of July 2025.

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Important information

Risk Factors: Investments in commercial real estate and real estate-related entities are subject to various risks, including adverse changes in domestic or international economic conditions, local market conditions and the financial conditions of tenants; changes in the number of buyers and sellers of properties; increases in the availability of supply of property relative to demand; changes in availability of debt financing; increases in interest rates, exchange rate fluctuations, the incidence of taxation on real estate, energy prices and other operating expenses; changes in environmental laws and regulations, planning laws and other governmental rules and fiscal policies; changes in the relative popularity of properties risks due to the dependence on cash flow; risks and operating problems arising out of the presence of certain construction materials; and acts of God, uninsurable losses and other factors. As compared with other asset classes, real estate is a relatively illiquid investment. Therefore, investors' withdrawal requests may not be satisfied for significant periods of time. In addition, as recent experience has demonstrated, real estate is subject to long-term cyclical trends that give rise to significant volatility in real estate values. An investor could lose some or all of its investment. Real estate investment trusts (REITs) may invest in equity securities of issuers that are principally engaged in the real estate industry. Therefore, an investment in REITs is subject to certain risks associated with the real estate industry and, more generally, the public markets.

Important information *(continued)*

GENERAL/CONFLICTS OF INTEREST

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