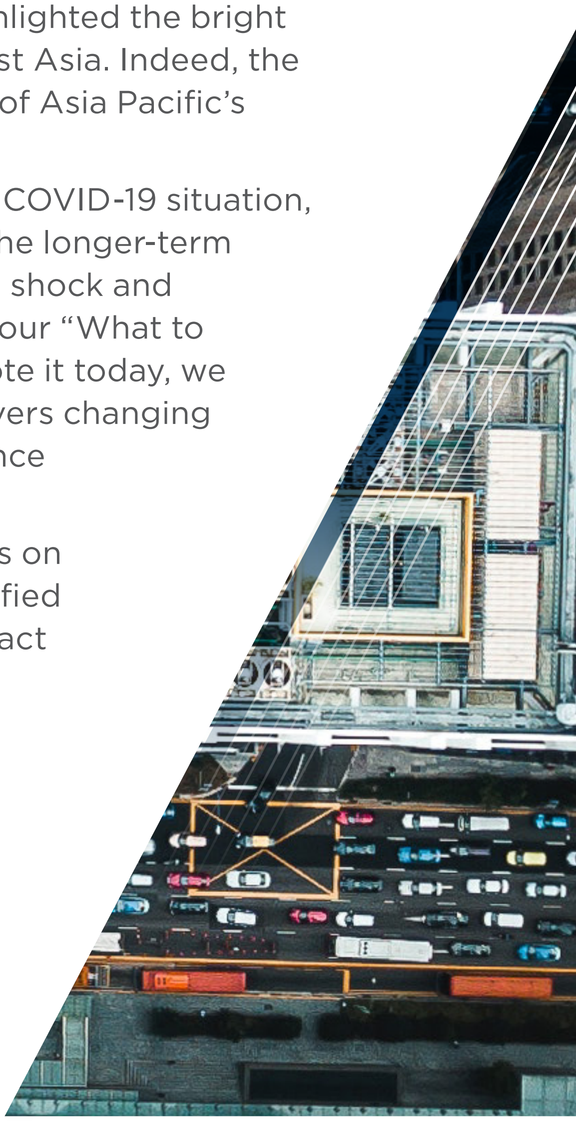
# THE RISE AND RISE OF ASEAN

CUSHMAN & WAKEFIELD

In both **Demographic Shifts: The World in 2030** and **What to Watch in 2020**, we highlighted the bright future that lies ahead for Southeast Asia. Indeed, the sub-region is a fundamental driver of Asia Pacific's Decade in the Sun.

As the markets navigate the unfolding COVID-19 situation, it can be tempting to take our eyes off the longer-term trends and focus solely on the short-term shock and immediate aftermath. Whilst undoubtedly our "What to Watch in 2020" would be different if we wrote it today, we can be fairly certain that the fundamental drivers changing the face of ASEAN will be of essential importance regardless of how far this crisis takes us.

Here we look at some of those drivers, with a focus on the growing number of companies adopting a modified China+ manufacturing strategy and its knock-on impact on commercial real estate.

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# ECONOMICS AND POPULATION

The ASEAN bloc is a significant economic powerhouse. It has the sixth largest global economy in 2019 at around USD3.0 trillion, which equates to about 11% of the Asia Pacific total. China contributes 49%, Japan around 16% and India at 9.5%. Over the next decade, ASEAN is forecast to grow at an average annual rate of 4.9% per annum to reach USD4.9 trillion (in 2015 fixed prices and USD exchange rates – forecasts as at Q1 2020).

From a demographic perspective, the region's credentials are equally impressive. ASEAN is currently home to over 660 million people – equivalent to a little under half the population of China – of whom 450 million are of working age (15 – 64 years). Over this decade to 2030 these numbers will swell to 725 million and 488 million respectively. It is this demographic windfall, combined with economic expansion that will power the region forward in the decade ahead.

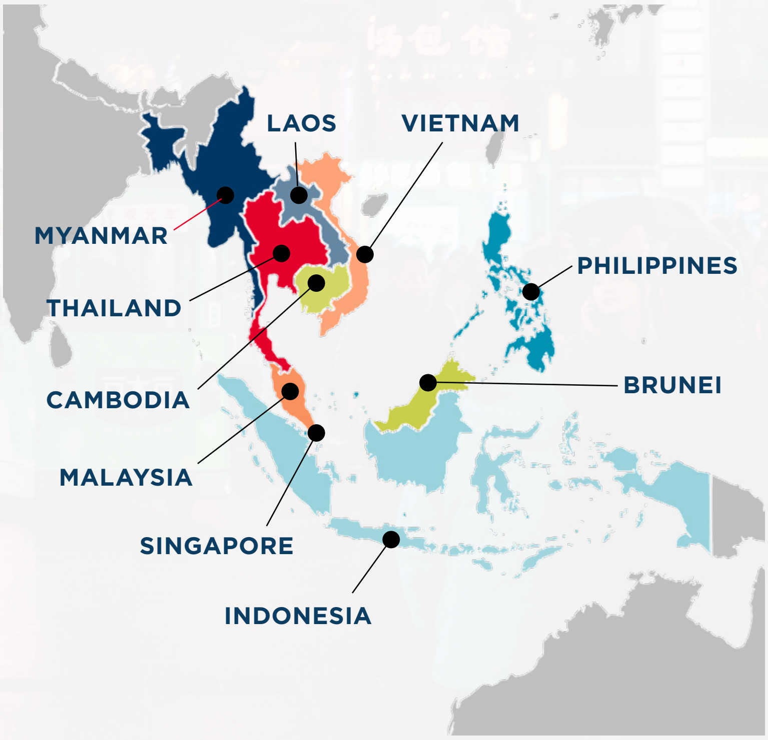



**Figure 1:** Countries comprising the ASEAN bloc

# CHINA+ STRATEGIES

"China plus one", or more commonly "China+" strategies are nothing new. They started off over two decades ago with western manufacturing companies wanting to expand into China but also diversify their risk. This approach saw companies open Chinese operations, but also hedge their bets with additional premises located elsewhere in the region.

Over time, this approach has led to a great deal of diversification across the ASEAN region, with countries displaying strengths in different sectors:

- **Singapore** clearly stands out as the region's leading financial and hi-tech hub.
- **Malaysia** is a key exporter of electronics.
- **Vietnam** has specialised in textiles.
- **Thailand** is a leading automotive parts exporter.
- **The Philippines** has established itself as a major business-process outsourcing hub, alongside being a production hub.
- **Indonesia** overtook Singapore to take top-spot in terms of gross value added (GVA) by the financial services sector in 2016 (Asia Development Bank).
- In recent years, China+ strategies have taken a twist. Rather than western companies seeking an additional base outside of China, it is now Chinese companies that are seeking to expand beyond their own domestic borders.
- There are several compelling reasons for this, not least the geographical centrality of ASEAN within the Asia Pacific region. According to the McKinsey Global Institute Global Connectedness Index, ASEAN countries rank highly for connectedness on the inflow/outflow of goods with Singapore topping the global list, Malaysia 9th; Thailand 10th; and Vietnam 19th.

### CHINESE RISK DIVERSIFICATION

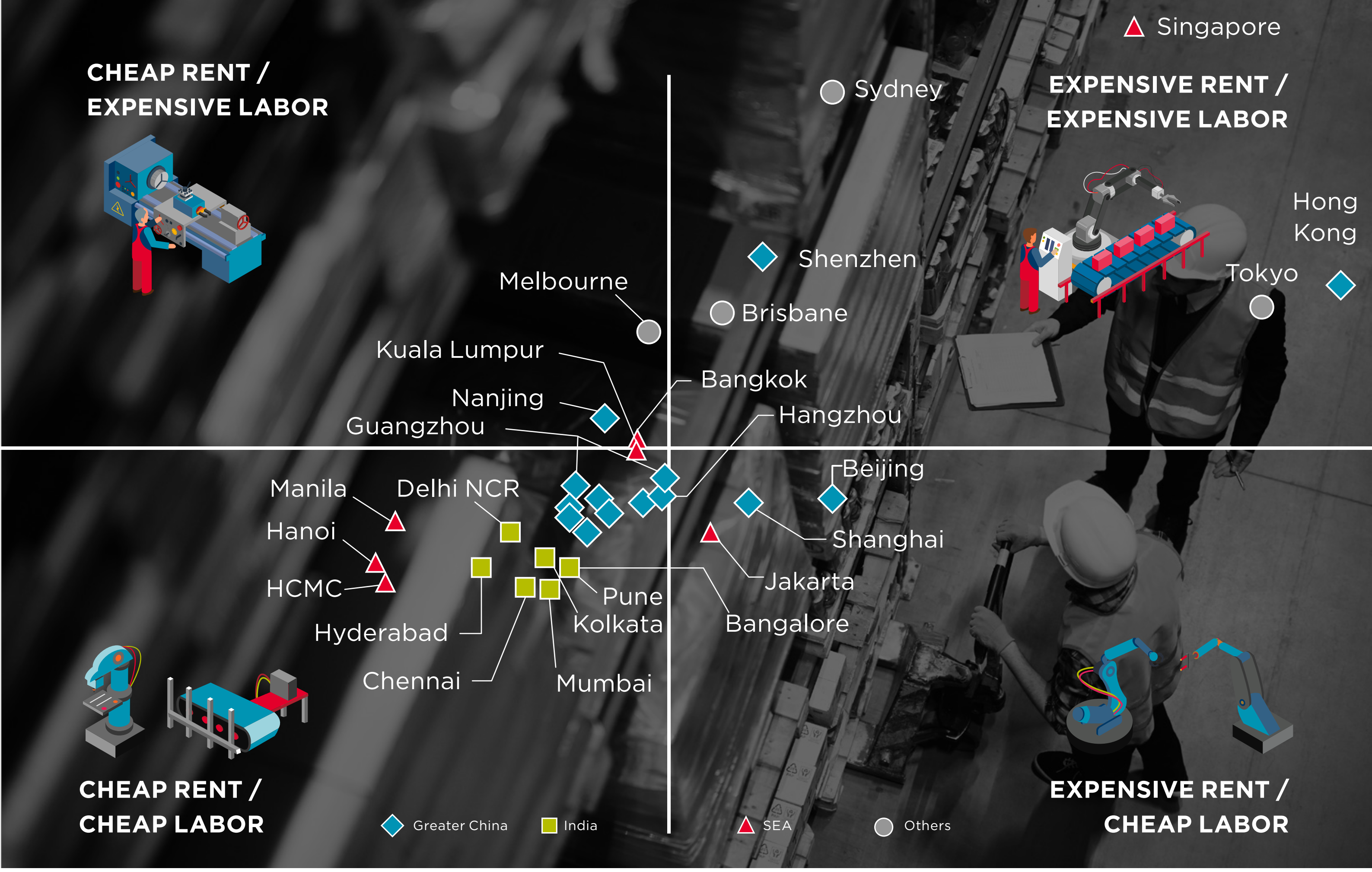
Beyond this geographic centrality, the need to diversify risk permeates through Chinese companies' expansion in the region, just as it did for many western companies, though now it takes different forms such as cloud computing. It should be noted that this expansion goes beyond the current China-US trade war and more recently the COVID-19 outbreak, which may act as a catalyst for change, but they are not the underlying drivers. Rather there is a structural element for expansion into ASEAN driven by the increasing costs of operating within China.

Looking at the manufacturing sector, the impact of rising costs is clear. Costs for industrial land rent and labour in Shenzhen have increased in recent years to such an extent that they both are among the top echelon in the region (Figure 2). For Tier 1 Chinese cities such as Beijing and Shanghai, increasing rents have pushed them to be amongst the most expensive in the region, notwithstanding lower labour costs.

In contrast, Suzhou and Guangzhou are relatively cheap on industrial rent but more expensive for labour. Turning to South East Asia, Ho Chi Minh City, Hanoi and Manila enjoy a cost differential over all Chinese markets – offering cheaper land and labour. It is noted that many Indian cities also sit in this quadrant. Beyond this, Jakarta and Bangkok act as alternative locations for higher order manufacturing due to higher costs in rent and labour respectively.

While the focus here is on manufacturing, similar differences are also likely for office-based sectors. Tencent and Alibaba are two companies that have already enjoyed first mover privileges with expansion into the region.

**Figure 2:** Comparison of industrial land and industrial labour costs by city in Asia Pacific.




Source: Hickey & Associates, Cushman & Wakefield Research

# THE COMMERCIAL REAL ESTATE IMPACT AND OUTLOOK

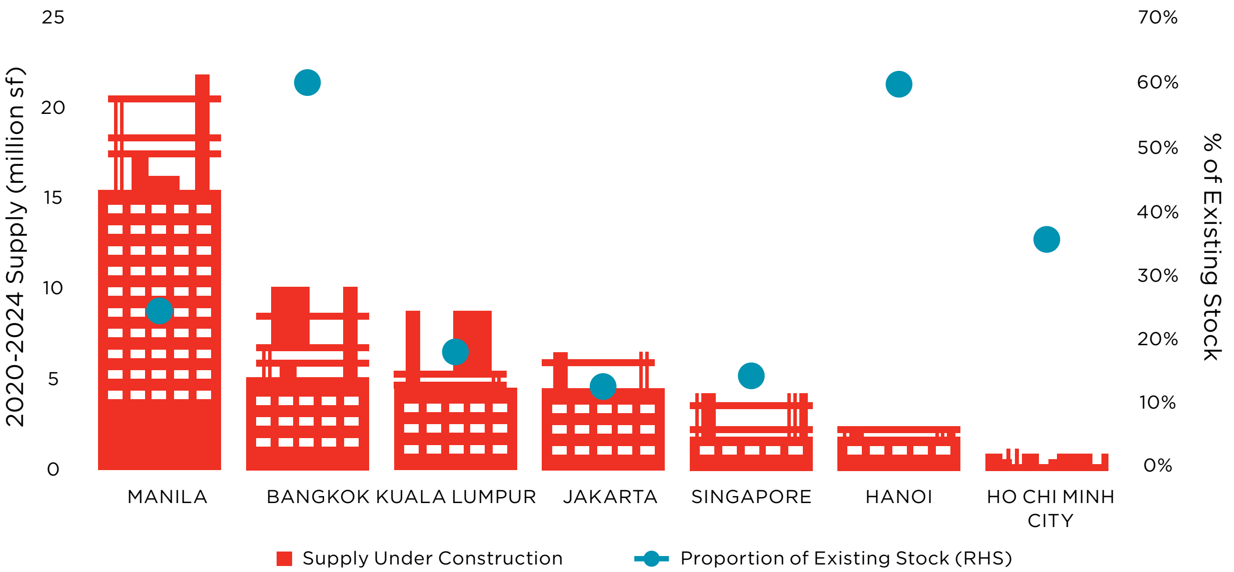
This all bodes well for the ASEAN region going forward, not least the commercial real estate sector. As more occupiers move operations, or expand into countries in the ASEAN region, there will be an inevitable increase in demand for space.

## OFFICE

The growth opportunities are already being seen through expansion of the commercial real estate sector in many ASEAN countries. For example, Grade A stock across Jakarta, Kuala Lumpur and Manila has nearly doubled over the past five years. The rate of expansion is especially impressive in Manila where 40 million square feet of stock has been delivered to market since 2015. There is still plenty more to come with extensive office development underway across the region (Figure 3).

As a result of this rapid market expansion, tenant demand has equally increased. While it is agreed that market conditions as at the end of 2019 were somewhat more buoyant than in 2016, it is still remarkable to see the extent that tenant demand has increased across the region. In Manila annual net absorption increased from 4 million square feet in 2016 to almost 10 million square feet in 2019. Even more impressive are the corresponding figures for Kuala Lumpur which increased from a low of 417,000 square feet in 2016 to almost 2 million square feet in 2019.

**Figure 3:** Office new supply under construction across Southeast Asia (million square feet) and % of existing stock




Source: Cushman & Wakefield Research

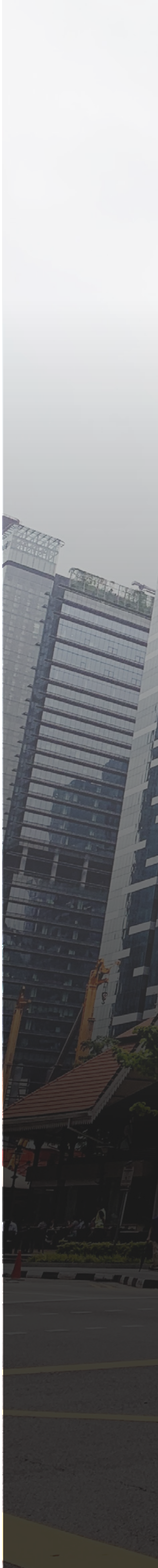
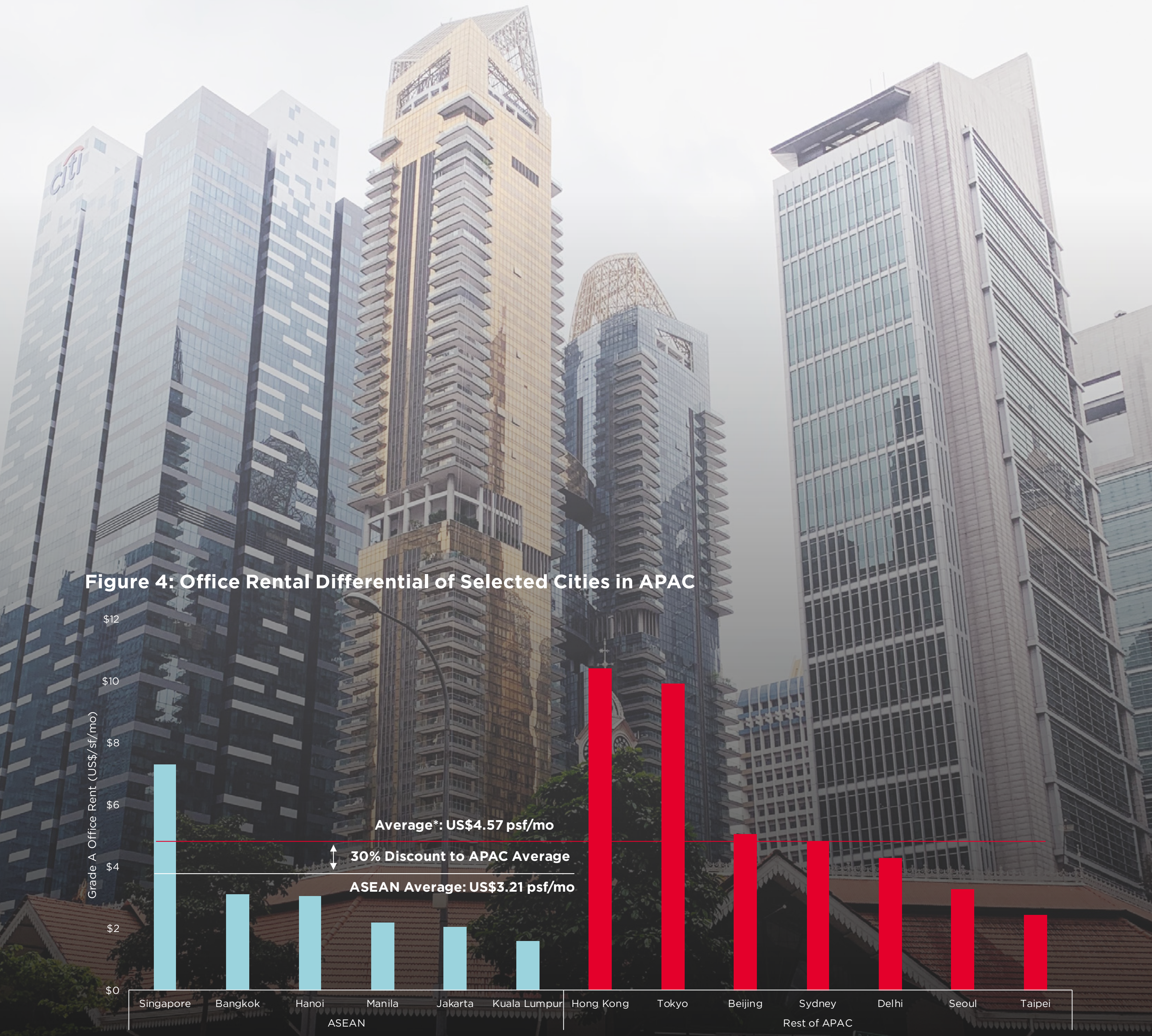


**Figure 4: Office Rental Differential of Selected Cities in APAC**




*Average of major national capital cities in APAC (Sydney is used for Australia instead of Canberra)

Source: Cushman & Wakefield Research

It is noted that with such rapid growth, rents have been under upward pressure. Notwithstanding the fact that these rents are amongst the cheapest in the region, they have in many cases experienced rapid growth. Over the same 2016-2019 period, rents in local currency have increased by 23% in Manila and 32% in Ho Chi Minh City. However, gains have been more modest in Hanoi at 11%, while they have retreated by 6% and 10% in Kuala Lumpur and Jakarta respectively. The disparity in rental and price movements has offered discerning investors a strong value proposition at a time when prices of real estate assets in mature economies are going through the roof. Given a slightly longer investment horizon, these assets would eventually emerge as investment grade, if they remain in good quality and scarcity in their respective ASEAN countries.

# INDUSTRIAL

It's clear that there are strong prospects for in the industrial sector for both owners and occupiers alike. For example, Jakarta now boasts nearly 150 million square metres of industrial land. Furthermore, industrial stock continues to increase across the region. While current inventory levels in Ho Chi Minh City and Hanoi are significantly lower, at 25 million square metres and 13 million square metres respectively, nationally, Vietnam is experiencing a rapid increase in industrial parks.

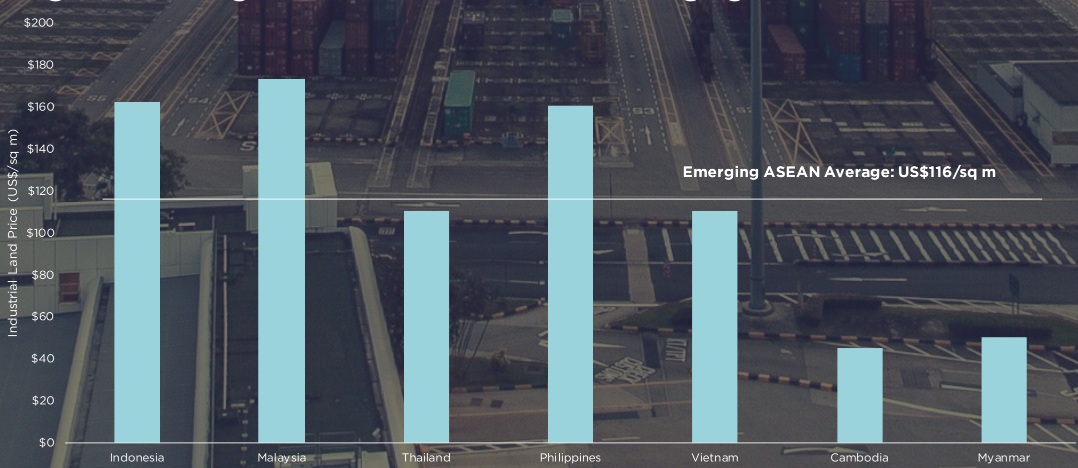
Currently there are 260 operating industrial parks across Vietnam, with a further 75 under planning. In total these 335 industrial parks cover almost 97,800 hectares, or over 10.5 billion square feet of land. Clearly this highlights the level of development happening in both the southern and northern economic key regions, presenting opportunities for occupiers to take-up space at competitive land rates. Dong Nai and Binh Duong especially have significant upcoming supply in the southern corridor, while the tech and automotive industries are also undertaking substantial development in the north of the country.

Since the COVID-19 pandemic, the global supply chain disruption story has served as a wake-up call for Chinese manufacturers and business owners. The current events highlight the ongoing need to diversify risk, which creates opportunities for investors and developers to take advantage of such movements in the occupier space.

**Figure 5: Minimum Wages in Emerging ASEAN**


Source: Various sources, Cushman & Wakefield Research

**Figure 6: Average Industrial Land Prices in Emerging ASEAN**




Source: Cushman & Wakefield Research

# CONCLUSIONS

There are real opportunities on offer in the emerging economies of the ASEAN bloc. However, there are challenges that must also be overcome. ASEAN is a microcosm of Asia Pacific as a whole, epitomised on one end by the market leading economy of Singapore and the other by the emerging economies of Brunei Darussalam and Cambodia. As a result, the timeline for opportunities for investors and occupiers alike will vary between countries in the ASEAN region as they mature, improve their regulatory framework and become more transparent.

Once the region emerges from the ongoing COVID-19 crisis, it appears that Vietnam, Thailand, Philippines and Indonesia are set for a bright future through the rest of the 2020s. Developers active in these markets need to identify the stream of new corporate occupiers scoping out their markets. At the same time those corporate occupiers need to be aware of the opportunities and challenges on offer, and therefore what should be and equally as important, what shouldn't be, outsourced to those markets.

Nevertheless, the rapid economic and demographic growth of the region, combined with the forecast rapid expansion of the commercial real estate sector across ASEAN markets herald a very exciting time ahead for the ASEAN region.

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