Keppel Capital

watch

Real Estate Disruptions

Boon or Bane?

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Executive Summary

The juxtaposition of technology innovations with the growth of the sharing economy is disrupting the traditional real estate market across the office, residential, retail and hospitality sectors.

Jobs automation, financial technology (FinTech), property technology (PropTech), exponential growth in co-working spaces and an increasing trend towards activity-based workspaces will all have an impact on office demand. This impact may however not all be negative. The growth of the start-up and technology economy generates new demand for office space, while co-working spaces can be complementary to traditional office space and cater to workers who were previously working from home or out of cafes. Modern buildings with more efficient floor plates will be more resilient as they provide more options for occupiers to configure their space.

Living spaces can also be shared, but the impact on the traditional residential market is limited for now. Co-living is targeted at a transient demand pool of young professionals, whose needs will change as they start a family, become wealthier or move to a new city. Shared accommodation services have also affected to some extent the hospitality industry but its appeal is more limited to the leisure and budget travel segments, and there are restrictions against rampant sharing in many cities. Nevertheless, there will be some disruption to the residential and hospitality sectors which will compel operators to provide better service and niche products. Sharing has also extended into the warehouse space, and this could have some impact on logistics demand in future though it may be mitigated by e-commerce growth.

In the retail sector, the growth of e-commerce has led to a decline in traditional retail demand. Nevertheless, e-commerce will not completely replace physical retail as there will still be services that cannot be had online. Instead, we expect the retail sector to continue to be transformed, with retailers going omni-channel, integrating both online and offline sales channels. Retailers and landlords who are able to adapt and transform and provide a stronger lifestyle and entertainment offering will be more resilient.

We cannot stop these disruptions, but we can turn them into new opportunities. We can leverage appropriate technology to enhance user experiences and integrate multiple uses in buildings to ensure they stay relevant to modern needs such as sharing, convenience and accessibility to services. Co-working and co-living operators can be new tenants or partners. In addition, the age-old adage of "location, location, location" will become even more important with the lower level of new demand compared to the traditional level of demand that we are used to in the past.

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Introduction

We are at the cusp of another technological revolution. Technology has seeped into every aspect of our lives and aided the flourish of the sharing economy. The sharing economy is projected to grow by more than 20 times between 2013 and 2025, while the corresponding growth rate for traditional economy sectors is slower at about 40% over the same time period[1].

The idea of sharing is not new but with the coming of age of the millennial generation, who are usually early adopters of technology and more open to sharing, the juxtaposition of technology innovations with the growth of the sharing economy is disrupting the traditional real estate market. In this paper, we summarise the major disruptors, their impact on traditional real estate and the mitigating factors against the fall in traditional demand.

Disruptions in office demand

The traditional office market is being disrupted in various ways. The growth of the sharing economy, automation and digitization of work processes will lead to a loss in traditional jobs and impact office demand. The impact may not be significant currently, but is certain to increase with technological advances, with a disproportional impact across different countries, industries and job functions. Within Asia Pacific, PwC estimated that 22-26% of existing jobs could potentially be automated by the 2030s in Singapore, Japan and South Korea[2].

Financial technology (FinTech)

Workers in the financial services industry spend a disproportionate amount of time engaged in simple computational tasks, which are more automatable in the short term. The financial services industry, typically one of the larger occupiers of office space especially in key cities, is therefore facing some challenges from the rapid expansion of FinTech. Mobile payments, digital money transfers, credit and lending services for consumers and small firms, along with robo financial advisors, disrupt the traditional banking sector, reducing the need for traditional banking services and staff and hence office space. PwC estimated that about 30% of existing jobs in the financial and insurance sector are at high risk of automation by the early 2030s[3]. In emerging countries such as China where the financial industry is less developed, there is less disruption to office demand as FinTech has already leapfrogged the traditional financial infrastructure.

One mitigating factor for office demand is that some traditional financial institutions are building up their FinTech capabilities in response, setting up innovation labs and increasing employment of IT professionals. In Singapore, financial institutions see FinTech as an opportunity to expand their products and services and local banks have set up in-house FinTech labs.

At the same time, the growth of the start-up and technology economy generates new demand for office space. Technology firms are now among the

[1] PwC, The Sharing Economy, Aug 2014
[2] PwC, Will Robots Really Steal our Jobs?, Feb 2018
[3] PwC, Will Robots Really Steal our Jobs? Feb 2018

largest occupier categories in many markets and further growth is expected. According to CBRE, technology firms accounted for more than 50% of new office leases in Asia Pacific in 1H2017[4]. Although they do not occupy as much space as traditional financial firms, we have noticed rapid space expansion as these firms grow. Contrary to common notion that these firms will occupy cheaper premises, larger technology firms have been relocating into Grade A office space to attract and retain top talent. For instance, Grab and Facebook are amongst the tenants at Marina One in Singapore, a newly-completed Grade A office building.

Co-working

Driven by demand from the growth of start-ups and technology companies, the number of co-working spaces globally has grown about 74% in three years from 8,900 in 2015 to 15,500 in 2017. The number of co-working spaces globally is projected to increase further to 18,900 by 2018, according to Deskmag[5].

Besides freelancers, start-ups and small firms, co-working spaces are also catching on amongst traditional office occupiers including multinational companies (MNCs). Unlike other disruptors, we think that co-working space can complement traditional office space and may not necessarily take away office demand. For instance, traditional office occupiers can leverage on the flexibility offered by such co-working spaces to house temporary project teams or visiting overseas staff. When start-ups and small firms become more established and grow their businesses, there will be requirements for larger and traditional office spaces. Co-working spaces can also generate new demand by catering to needs that were not catered to by traditional offices previously, such as those working from home or cafes.

Co-working spaces are a new source of office demand – co-working space operators have leased 2.5 million sq ft of office space in Asia Pacific tier-1 cities between 2016 and 1H2017[6]. This is equivalent to about 5% of the total net absorption of office space in Asia Pacific in 2017[7]. Like technology firms, demand by co-working operators is not limited to cheaper premises at the fringe of the Central Business District (CBD) or decentralised areas. As more traditional firms take to co-working space, there is increasing demand for co-working space in CBD Grade A office buildings.

While co-working is likely to continue to expand to cater to demand in the new economy, we think there could be some consolidation within the industry given the rapid growth over the last few years. The larger co-working operators with a wider global network of offices are likely to do better.

[4] CBRE, APAC Real Estate Economic Overview, Beyond Disruption in Real Estate, 3Q2017
[5] Deskmag, 2018 Global Coworking Survey
[6] CBRE, The Evolution of Co-Working: Supporting the Emergence of the New Business Eco-system, July 2017
[7] CBRE, Asia Pacific Marketview, 4Q2017

Activity-based workspaces

We think office demand will be more disrupted by the trend towards activity-based workspaces as companies endeavour to foster an entrepreneurial and innovative culture. Analysing responses from mainly MNC respondents, CBRE found that more than 50% of the occupiers surveyed intended to implement activity-based workspaces in the next three years[8]. Activity-based workspaces include desk sharing amongst employees and more common areas for collaboration. Technology facilitates the shift towards these activity-based workspaces. For instance, cloud computing allows employees to access their personal workstation from anywhere and so reduces the need for physical or a fixed office desk. Office space per employee will fall which will reduce office demand. Modern buildings with more efficient floor plates are more resilient against this trend as they provide more options for occupiers to configure their space, as opposed to older buildings or buildings with more inefficient layouts.

Property technology (PropTech)

The real estate industry is not immune to technological disruptions. PropTech is basically the use of technology in the real estate sector. Early versions of PropTech include online marketplaces usually focused on residential properties, linking brokers, property owners and purchasers, such as PropertyGuru in Singapore.

Going forward, technological advancements in the form of artificial intelligence (AI), virtual/augmented reality (VR/AR), blockchain and Internet of Things (IoT), will reshape the real estate industry. For instance, VR can be used for marketing and concept visualising purposes while blockchain could potentially replace physical contracts. IoT allows for data to be collected from user activity and preferences which enables building owners and managers to understand the behaviour of their tenants as well as their customers. PropTech could reduce the need for intermediaries such as real estate brokers, property managers, lawyers and finance professionals, hence reducing related office demand from these occupiers.

However, the impact on office demand could be limited as technology cannot completely replace the interpersonal relationships and experience in real estate transactions. PropTech growth could be constrained by security and privacy concerns. Collected data could fall into the wrong hands or users could worry about their activities being tracked. Smart buildings could also face cyber threats, with the inter-connectedness between landlords' and tenants' IT systems a potential cyber risk for both parties. These could explain the results of a recent survey by Altus Group, which found that commercial property companies in Asia were less optimistic than their global peers about the potential of PropTech.

[8] CBRE, 2017 Asia Pacific Occupier Survey

Shared living spaces disrupt residential and hospitality demand

Co-living

Just as offices can be shared, living spaces can also be shared. Co-living disrupts the traditional private residential and serviced apartment markets. Co-living incorporates a mix of private and community space and combines convenience, a sense of community and cost saving through sharing space and resources. Shared activities can include anything from exercise classes to cooking classes or free drinks. Mobile applications enable instant communication with the property manager and social networking with other tenants. Co-living is gaining popularity in cities where it is becoming more unaffordable to own or rent a private apartment and where there is a large young migrant population who would appreciate the flexible lease terms, convenience and community of friends that co-living provides.

Co-living is targeted at a transient and niche demand pool of young mobile professionals and will have more demand in cities where housing is more unaffordable. They will not replace much of the traditional private residential demand. The demand for co-living is transitory and renters are likely to move out when they start a family, become wealthier, or when they move to a new city. Meanwhile, government efforts to provide or encourage more rental or subsidised housing to tackle the unaffordability issue could also reduce the need for such co-living developments. For instance, in China, the government has launched pilot programmes in 13 cities to build rental housing in rural areas, and Chinese developers have also entered the market to build and invest in rental housing projects.

Shared accommodation services

Technological advances and the sharing economy have facilitated an industry that allows hosts to offer rooms or apartments for short-term rental via online platforms. Airbnb is the market leader, with 4.5 million listings worldwide currently, without owning a single hotel room. This is similar to the number of hotel rooms owned or managed by the top five hotel groups (Marriott International, Hilton Worldwide Holdings, Intercontinental Hotels Group, Wyndham Hotel Group and AccorHotels Group) combined. In many Asian markets, such shared accommodation services are still relatively new with room to grow, with some countries restricting such services while others are regulated.

The regulation of shared accommodation services could prompt the entry of more providers, exacerbating the challenges to the traditional hotel industry. For instance, in Japan, the government passed a new law in June 2017 allowing short-term private housing rentals ("minpaku") up to 180 days per year. In response, other operators are readying for entry into the minpaku market. China's largest vacation rental site Tujia, is partnering Japanese e-commerce firm Rakuten and aims to increase the number of properties available for holiday rental in Japan by 10 times from 10,000 now to about 100,000 by 2019[9]. The entry of alternative accommodation providers could

[9] Bloomberg, China's Answer to Airbnb Sets Sights on Japan, 6 Oct 2017

be one of the reasons why average daily room rates and RevPAR in Japan have not increased as fast as the double-digit growth in visitor arrivals.

The impact on the traditional hotel industry is likely felt more in the leisure and budget hotel segments. The competitive advantage for shared accommodation services is the lower cost, and typically for longer and leisure stays by families and groups of friends. However, shared accommodation services have started to target business travellers, so the negative impact on traditional hospitality demand could worsen going forward.

Nonetheless, traditional hoteliers are actively responding to the challenge and coming up with strategies to appeal to travellers by targeting specific traveller groups and providing niche experiences. Some hoteliers have created brands to branch into the home-sharing arena, or hotels that specifically target younger travellers, such as providing mobile check-in services and more communal areas, like in co-living and co-working, for hotel guests to hang out. Lower costs will however continue to attract more budget-conscious travellers to shared accommodation services.

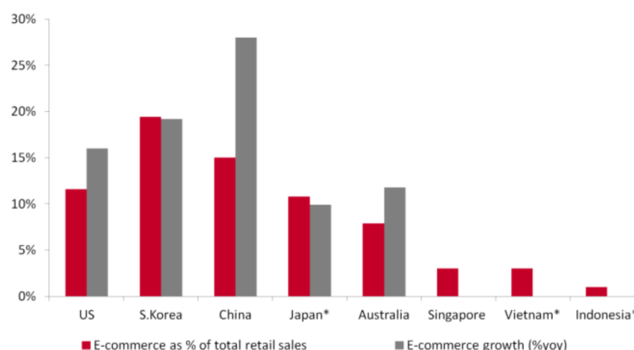
Warehouse space can be shared too

The idea of "what's mine is yours" can also be applied to warehouse space. In a similar concept to Airbnb, UK start-up Stowga has built a platform for renting out empty space in warehouses. This allows owners of warehouse space to sell their space during periods when the warehouses are under-utilised. It currently has more than 4,000 warehouses listed in the UK and connects companies and logistics and delivery firms that need the space. All things equal, this could eventually reduce the need for companies to acquire or lease their own warehouse space. However, this is likely to be mitigated by the growing logistics needs of e-commerce.

Retail demand disrupted by e-commerce

E-commerce is growing rapidly in Asia, with double-digit growth last year in China, South Korea and Japan (Figure 1). Further growth is expected, driven by increasing consumerism, widespread smartphone adoption with easy e-payment methods, improved delivery systems and social media. Shoppers no longer have to make a trip to a mall to purchase goods and services, leading to a decline in traditional retail demand. This has implications on occupancies and rents for landlords as per capita demand for physical retail space has reduced and will continue to fall.

Figure 1: E-commerce growth and share of total retail sales (2017)



Source: US Census Bureau, Statistics Korea, NBS, Japan METI, NAB, Singapore MTI, Vietnam E-commerce Association, McKinsey, KepCap Research
**2016 data (latest available)*
Note: Data on e-commerce growth rates not available for Singapore, Vietnam and Indonesia

Transformation of retail sector

As highlighted in our publication in May 2017 "*Rethinking Retail: Lessons from China*", e-commerce will not totally replace physical retail. There will still be a need to meet, eat and socialise, to touch and feel, and to enjoy convenience and store services that cannot be had online. Tourists will still continue to enjoy shopping. More online stores have also set up physical stores to capture a wider market, pointing to the need for both online and offline sale channels. Food delivery services such as Foodpanda in Singapore are also opening central kitchens with dine-in options.

Retailers and landlords who rise to the challenge and adapt will thus be able to do well while the traditional ones will fade into obsolescence. Besides integrating online and offline sales channels, retailers are also venturing into other sectors so as to provide a stronger entertainment and lifestyle offering to consumers. For instance, French beauty brand Chanel opened Coco Café, a travelling pop-up café showcasing their latest beauty products in Hong Kong, Tokyo, Seoul, Singapore and Shanghai. Japanese retailer Muji is opening a Muji Hotel in Tokyo's Ginza area in 1H2019, in a commercial complex together with a new Muji flagship store.

Landlords are also adapting by changing the tenant mix, focusing more on place-making, and using technology to data-mine and push marketing promotions. Well-located malls that have transport connectivity and large residential or tourist catchment will also be more resilient.

Turning disruptions into opportunities

We cannot stop the disruptions, but we can turn them into new opportunities. We can leverage appropriate technology to enhance user experiences to ensure our properties stay relevant to modern needs such as sharing, convenience and accessibility to services. There should also be flexibility in having multiple uses in an integrated development. Co-working and co-living operators can be new tenants or partners. In addition, the age-old adage of "location, location, location" will become even more important with the lower level of new demand compared to the traditional level of demand that we are used to in the past.

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