APAC REAL ESTATE MARKETS: WHEN WILL THEY REBOUND?

Recovery in Investment Activity from COVID-19 Delayed

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Insights & Recommendations

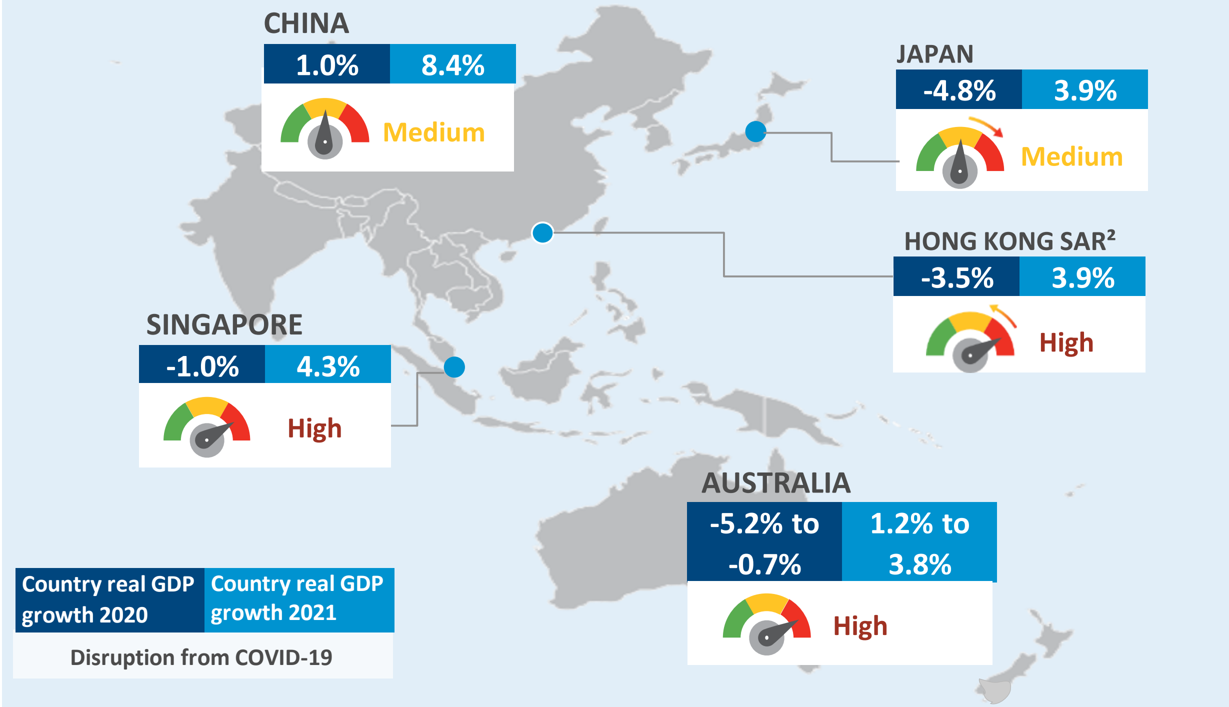
This note updates our Flash Report of 3 March. Following the lessons of SARS in 2003, we assumed activity in APAC real estate capital markets would rebound from the impact of COVID-19 from late Q2 or early H2 2020. However, the global spread of COVID-19 implies this rebound will be pushed back three to six months.

Initial Q1 2020 investment volumes are predictably weak: the APAC total fell 62% YOY to USD17.0 billion[1]. However, we see bright spots in the region such as major investments in China, and strength in Singapore and in second-ranked centres like Yokohama. This gives us confidence that price corrections for APAC markets will stay within a reasonable range.

Economic growth forecasts for 2020 have fallen fast since early March. However, historical examples suggest growth may recover rapidly in late 2020 and 2021. Quicker economic recovery should help drive a pick-up in property deal volumes.

Among top investment markets in APAC, the COVID-19 outbreak has peaked in China, which is slowly returning to normal. Conversely, disruption has risen since early March in Australia, Singapore, and most recently Japan. Against this background, our preferred asset classes are detailed overleaf.

Real GDP growth forecasts and disruption from COVID-19 to investment property markets



Source: Oxford Economics (most recent forecasts), plus Deloittes Access Economics for Australia, Colliers International for degree of disruption by COVID-19.

Given COVID-19's global spread since early March, we think activity in the region by international investment institutions will be muted in the near term. Moreover, while the Chinese economy has started to pick up, Australia has largely shut down, with policy curbs acting as an extra potential brake on real estate investment. A rebound in investment activity across the region will probably therefore be delayed three to six months, although in some cases (notably Singapore) a pick-up in H2 still looks likely. The likelihood of a sharp recovery in GDP growth in the major APAC investment markets in late 2020 and 2021 should give further impetus to a rebound in investment property transactions. Our preferred asset classes are unchanged from our report of 3 March.

[1] Source: Real Capital Analytics (preliminary figures for Q1 2020, excluding land development sites). These figures are likely to be revised upwards gradually. Total APAC investment sales including land sites fell 58%, to USD78.8 billion. [2] Special Administrative Region [of the People's Republic of China]

SUMMARY OF MARKET DEVELOPMENTS, INVESTMENT SALES VALUE AND RECOMMENDATIONS

Preliminary investment sales in Q1 2020[1] / update on economic and investment activity in light of COVID-19 | **Preferred asset classes**

> COVID-19 has clearly peaked in China; staff are returning to work in major cities; official March manufacturing index showed expansion.

> Investment sales in Shanghai fell 78% YOY in Q1, to USD0.95 billion. However, total investment sales including land sites fell only 21%, to USD9.73 billion, supported by Hongkong Land's USD4.4 billion purchase of a large development site in the West Bund.

> Blackstone's bid for developer SOHO China[2] (not completed), with a combined debt and equity value of USD8.7 billion, is another vote of confidence in long-run prospects for China.

> Enforced online shopping and surging data use over Q1 point to strong demand for logistics space and data centres.

Preferred asset classes: Logistics, e-commerce; Data centres

> The Hong Kong SAR government has imposed strict controls on movement and assembly, but has not imposed a full lockdown.

> Q1 investment sales fell over 80% YOY to USD0.90 billion. A gap between bid and ask prices of 20-25% for some office and hotel assets implies that parts of the market have yet to stabilise. Conversely, prices of industrial assets have only fallen 5-10%.

> We believe en-bloc office prices have fallen 10-15% from recent peaks, whereas strata-title office prices have fallen 25-30%. For example, one recent strata-title deal in the Kwun Tong fringe area suggests a value of about HKD11,000 per sq foot, versus HKD16,000 at the peak in 2018.

> Asking prices of hotels for sale have fallen about 30% from recent peaks. In our view, this decline fully reflects operating pressures.

Preferred asset classes: Office; Hotels (for rebound); Industrial (stable, for conversion)

> The government has imposed an almost full lockdown for one month from 7 April. However, Singapore's strong policy response to COVID-19 has won praise; and disruption to the office leasing market in Q1 was limited.

> Based on Colliers' definition, Q1 investment sales fell 37% QOQ and 17% YOY to SGD3.9 billion (USD2.7 billion). Colliers' figures include M&A in the REITs sector and public land sales.

> investment volume eased in Q1 across all sectors except residential, which took the lead due to strong public land sales. Industrial transactions moderated QOQ but doubled YOY, led by high-specification and business park deals. Conversely, commercial and hospitality deals were weak.

> Non-REIT activity should pick up in H2. We now predict a 24% drop in full-year investment deals, from SGD29.6 billion to SGD22.6 (USD15.8) billion.

Preferred asset classes: Office; Hotels

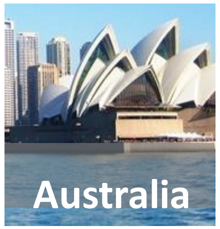
> COVID-19 has driven a steep downturn and has delayed the Olympics by a year. A state of emergency was declared in Tokyo and six other regions on 7 April. However, this does not entail full lockdowns; and 52% of the national economy is functioning normally outside restricted areas.

> Total Q1 investment value fell 66%, to USD3.9 billion. Tokyo and Osaka were weak, Yokohama and Kyoto were strong.

> Tokyo office market still favours landlords. End-Q1 vacancy was a record low of 1.0%; rent growth is positive (0.3% QOQ); pre-commitments stand at 83% for 2020 and 39% for 2021. Recession may threaten rent income from weaker tenants, but this should not affect most prime office areas.

> We still favour Tokyo Grade A offices due to high yield (3.4%), as well as logistics assets in greater Tokyo due to shortage of quality modern stock.

Preferred asset classes: Office; Logistics



> An expected downturn in 2020 will break Australia's 28+ year record of unbroken growth, with recovery heavily reliant on the length of the economic shutdown and on how quickly Australia can reopen its borders.

> Investment value fell 47% YOY in Q1, to USD2.2 billion, with the drop amplified by the weak Australian dollar. While transaction evidence is limited, a recent major office deal suggests yields have started to soften. However, with deal activity likely to stay muted, deal evidence may stay scarce.

> Low Australian dollar should support offshore investment once markets reopen. That said, the FIRB[3] will now assess all potential sales to foreign firms. This could lead to sales campaigns being postponed until the assessment programme is lifted.

Preferred asset classes: Biomedical precincts; Logistics

[1] Source: Real Capital Analytics (RCA), except for Singapore where we use Colliers data. [2] See reports from Reuters, SCMP, other sources on 9-10 March. [3] Foreign Investment Review Board

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