Asia Pacific - March 2020

SPOTLIGHT

Savills Research

COVID-19 and Regional Property Markets

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COVID-19 and its Impact on Asia Pacific Property Markets

The rapid economic growth of Asia-Pacific has had wide ranging consequences; supply chains have grown to exploit comparative advantages, particularly land and labour costs; investment capital has become better able and more willing to cross borders in search of higher returns and the benefits of diversification; and intra-regional travel and tourism has hit all time highs as more leisure time, higher incomes and substantial improvements in transport infrastructure have encouraged greater regional mobility.

This higher level of integration means that a relatively small disruption can have far reaching consequences, as any student of chaos theory will tell you.

Disease in human populations is a very old disruptor and despite advances in medical science, a very unpredictable one. It is unfortunate that this particular virus originated and developed fastest in Asia's largest economy with implications not just for the region's economic wellbeing, but also the global economy. China is one of the world's biggest importers of commodities and a powerhouse exporter of manufactures as well as being a significant destination for overseas capital and an increasingly important source of outbound investment funds. According to the IMF, China accounted for 39% of global economic expansion in 2019. At its peak in 2016, mainland investors invested US$35 billion in overseas real estate markets.

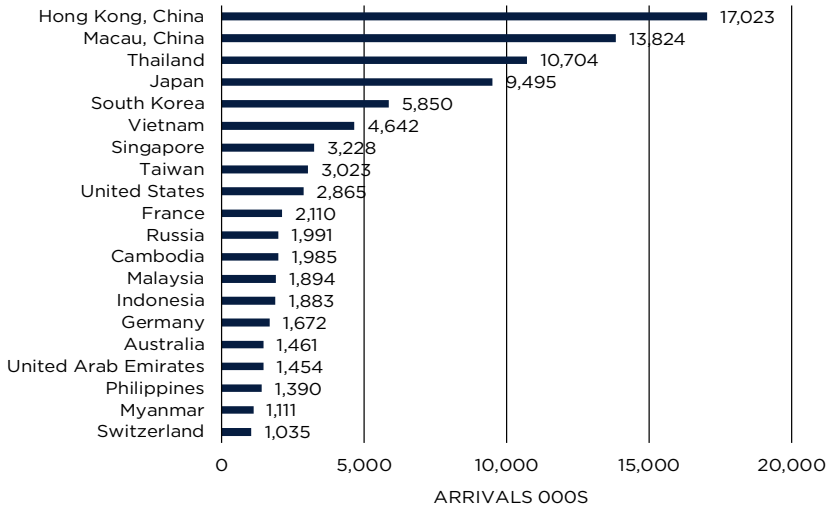
So what is the current consensus regarding the timing and geographical spread of COVID-19? We know that this novel coronavirus is very similar (80%) to Severe Acute Respiratory Syndrome (SARS) which occurred in 2003 and also originated in a Chinese wet market. SARS was mostly confined to Southern China and Hong Kong and lasted from around November 2002 to June 2003 as the warmer summer months weakened and finally eradicated the virus. It is likely that COVID-19 will behave in a similar manner but with some important differences. As a much more infectious disease, and given much closer levels of regional integration, it has already spread much further and much faster than its predecessor.

As COVID-19 is now a threat at both a regional and global level, economic and social disruption is expected to be far more widespread. Conditions conducive to the virus vary in particular between the Northern and Southern Hemispheres where the flu season is dictated by seasonal changes in the weather so, for example, in the US the season runs from October to May, peaking in February and in Australia from May to October, peaking in August. In the tropics and subtropics the period is less well defined but in, for example, Hong Kong, typically lasts from December to March[1]. We can speculate that as the virus dies out in one hemisphere, it could just be starting in the other. The spread of the virus will also depend on the effectiveness of health protocols as well as levels of social compliance. It should be noted that in the event that the outbreak is prolonged, the chances of developing a vaccine and/or finding an effective treatment increase.

What does this mean for regional real estate markets? There are two aspects to this question: one concerns the evolving uses to which real estate is put; and the other is the relative value put on those uses by investors and end users.

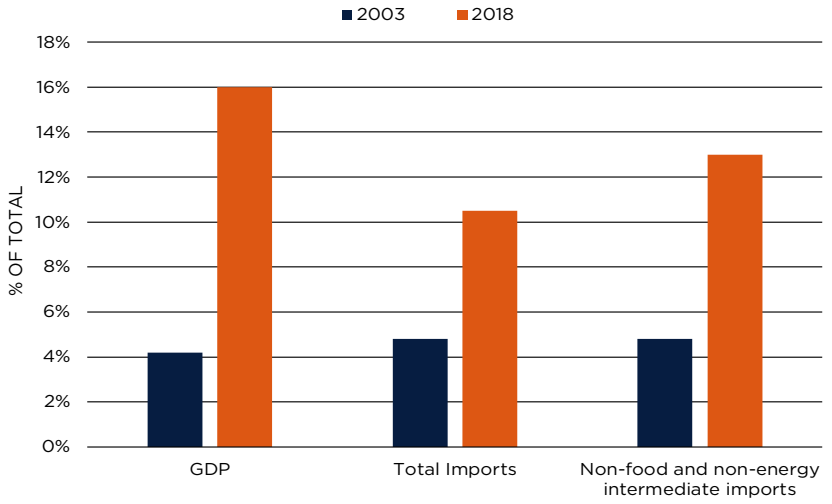
Over recent decades, technology has been the biggest disruptor of real estate, in particular the movement of activity which

GRAPH 1: Top 20 Destinations for China's Outbound Travel, 2019



Source Tourism Economic

GRAPH 2: China's Importance to the World Economy



Source Oxford Economics/Haver Analytics

1 The WHO makes two vaccine formulations every year, one for the Northern and one for the Southern Hemisphere.

previously took place in built environments to online environments where cost and convenience are enhanced. This has had the biggest implications for retailing and logistics but other asset classes have not been immune. While disrupting the Old Economy, the New Economy has made its own demands on real estate, especially for data storage, which has created its own asset class. Technology has also enabled flexible or remote working and the portability and connectivity of technology via laptops and smartphones has encouraged the emergence of shared space in the form of co-working and co-living.

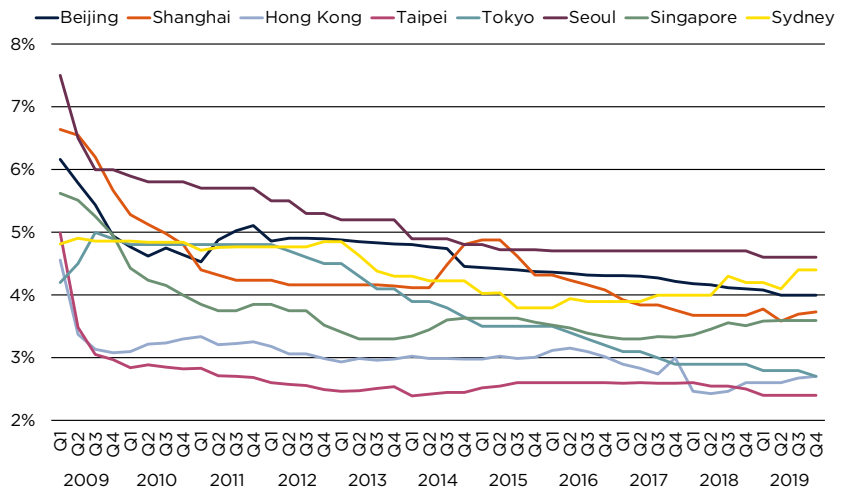
The COVID-19 health emergency has become a fast evolving global event with both short and long term implications for real estate as both an accelerator and a disruptor of market trends.

TABLE 1: Numbers of SARS and COVID-19 infections in Asia Pacific, as of 3 March 2020

COUNTRY	NOVEL CORONAVIRUS	SARS	NOVEL CORONAVIRUS	SARS
	CUMULATIVE NUMBER OF CASES*		CUMULATIVE NUMBER OF DEATHS#	
China	80,152	5,327	2,944	349
South Korea	4,812	3	28	-
Diamond Princess	706	-	7	-
Japan (excluding Diamond Princess)	274	-	6	-
Singapore	108	238	-	33
Hong Kong	100	1,755	2	299
Thailand	43	9	-	2
Taiwan	41	346	1	37
Australia	34	6	1	-
Malaysia	29	5	-	2
Vietnam	16	63	-	5
Macau	10	1	-	-
India	6	3	-	-
Philippines	3	14	1	2
Indonesia	2	2	-	-
Cambodia	1	-	-	-
New Zealand	1	1	-	-
Others	4,595	324	2,898	15
Total cases	**90,933**	**8,096**	**3,119**	**744**

Source World Health Organisation
* Based on data as of the 3 March 2020
# Based on data as of the 31 December 2003

GRAPH 3: Regional Grade A Office Cap Rates, 2009 to 2019



Source Savills Research & Consultancy

In many respects we expect the recent epidemic to accelerate the changes which technology has already initiated as the danger of infection has forced people and businesses to function more online as a means of avoiding human contact. A great many office-based businesses will have had to downsize or close altogether; some may also have realised the longer-term benefits of remote or flexible working on their need for expensive floorspace. Expect cost saving relocations and the faster adoption of new workplace practices. Demand from tenants exposed to retail, tourism and trade will be most affected but financial services can also expect to be widely disrupted. A pandemic resulting in a severe market sell-off at a time when economies are still vulnerable and debt burdened post-GFC could result in far reaching financial sector distress not dissimilar to previous major crises.

For retailers and retail landlords, the outbreak has been an unmitigated disaster and we anticipate widespread bankruptcies and a substantial rise in vacancy. Once shoppers return to bricks and mortar stores, however, we can expect a sharp rise in take-up as empty units are leased at competitive rents. Online is expected to make permanent inroads however, especially in areas such as necessity shopping and routine services such as banking. Tourism will eventually return but before it does, levels of distress in the hotel industry can also be expected to rise as the sector is reporting historically low occupancy rates; less than 10% in the worse affected areas. Widespread unemployment will also weaken demand for travel and discretionary spending, especially on luxury goods.

In terms of capital markets, levels of distress will yield opportunities as volumes can be expected to recover quite quickly in the second half of the year if the outbreak ends in Spring/Summer and a pandemic is successfully contained. In the case of a full-blown global health emergency, however, travel restrictions would be commonplace while Governments with little room to lower interest rates further will resort to emergency fiscal stimulus to offset the negative impact. We would expect a downturn and a correction in real estate markets from values which in many instances are at historical highs. Just as cheap credit and abundant liquidity has inflated asset values to record levels, a decline in aggregate demand and banks willingness to lend would see them fall back. At present, however, this scenario seems unlikely.

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