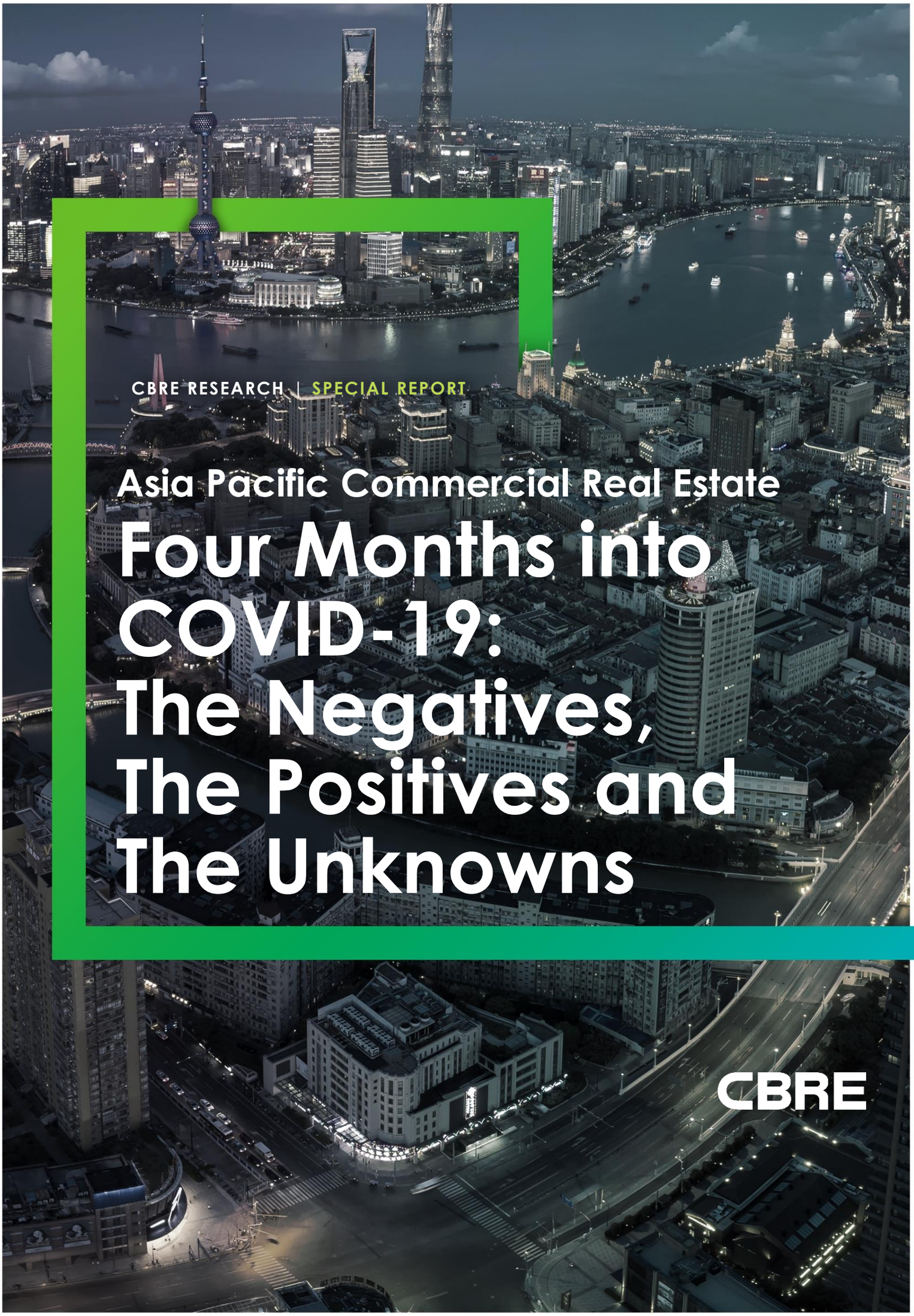


CBRE RESEARCH | SPECIAL REPORT

Asia Pacific Commercial Real Estate

Four Months into COVID-19: The Negatives, The Positives and The Unknowns

CBRE

CONTENTS

INTRODUCTION

More than four months since the Chinese economy was shut down to contain the spread of COVID-19, most restrictions have now been lifted and business activity is resuming. However, many other countries in Asia Pacific and elsewhere around the world remain subject to lockdown measures, the impact of which appears likely to trigger a severe global recession.

CBRE Asia Pacific Research's first assessment published in February identified the short-and long-term impacts of COVID-19 on the office, retail, industrial and investment sectors[1]. With COVID-19 since escalating into a major global pandemic, this Special Report by CBRE provides an updated appraisal of how Asia Pacific commercial real estate markets have responded so far; evaluates which markets and sectors have performed better – or worse – than expected; and identifies the challenges and opportunities that lie ahead.

Figure 1: COVID-19 & APAC Real Estate - The Negatives, the Positives and the Unknowns

[1] Why the Coronavirus Outbreak Could Have A Lasting Impact on Asia Pacific Real Estate, CBRE Research, February 2020.

ECONOMY

ECONOMY

THE NEGATIVES

Recession Imminent as Lockdown Measures Curtail Economic Activity

CBRE expects most Asia Pacific economies to fall into recession this year - the first in 40 years - due to the sharp decline in economic activity resulting from the imposition of lockdown measures and other restrictions. While several markets such as Korea, Taiwan and Hong Kong SAR managed to contain the spread of the virus without having to implement a full-scale lockdown, they have still felt the impact of reduced business activity.

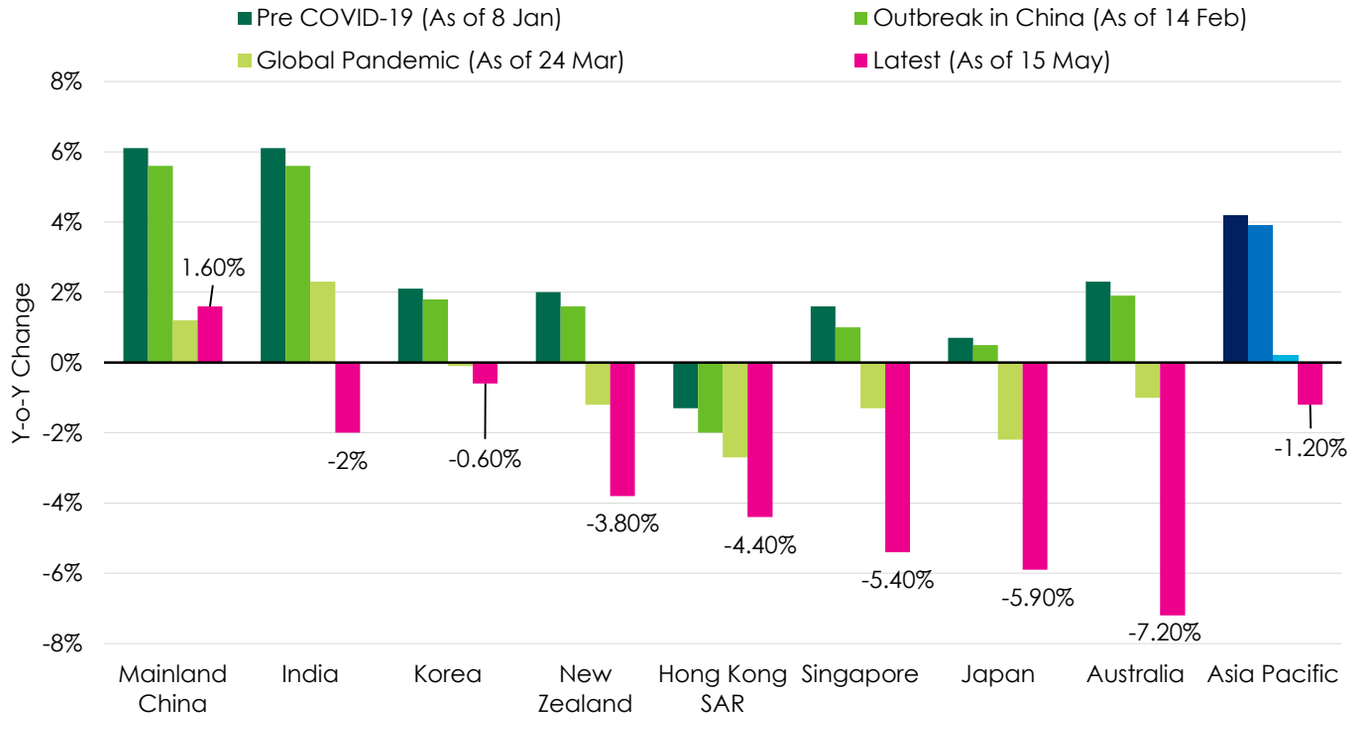
Markets that continue to report high case numbers, such as India, Singapore and Indonesia, may have to extend lockdown measures should the situation not improve.

Several major Asia Pacific economies contracted in Q1 2020. Mainland China's GDP shrank by -6.8% y-o-y, while Hong Kong SAR's GDP declined by -8.9% y-o-y. Japan's GDP slipped by -2.0% y-o-y, the lowest since 2009, confirming the onset of a recession.

With business activity and various forms of manufacturing now returning to normal, economic indicators in Mainland China are expected to improve in Q2 2020. However, the rest of the region will see the release of some downcast data in the coming months.

Mainland China will likely be the only major economy in Asia Pacific to register full-year GDP growth in 2020. Developed economies including Hong Kong SAR, Singapore, Japan and Australia are expected to record a GDP contraction in excess of -4% - a scenario that would lead to Asia Pacific full-year GDP growth falling to -1.2%.

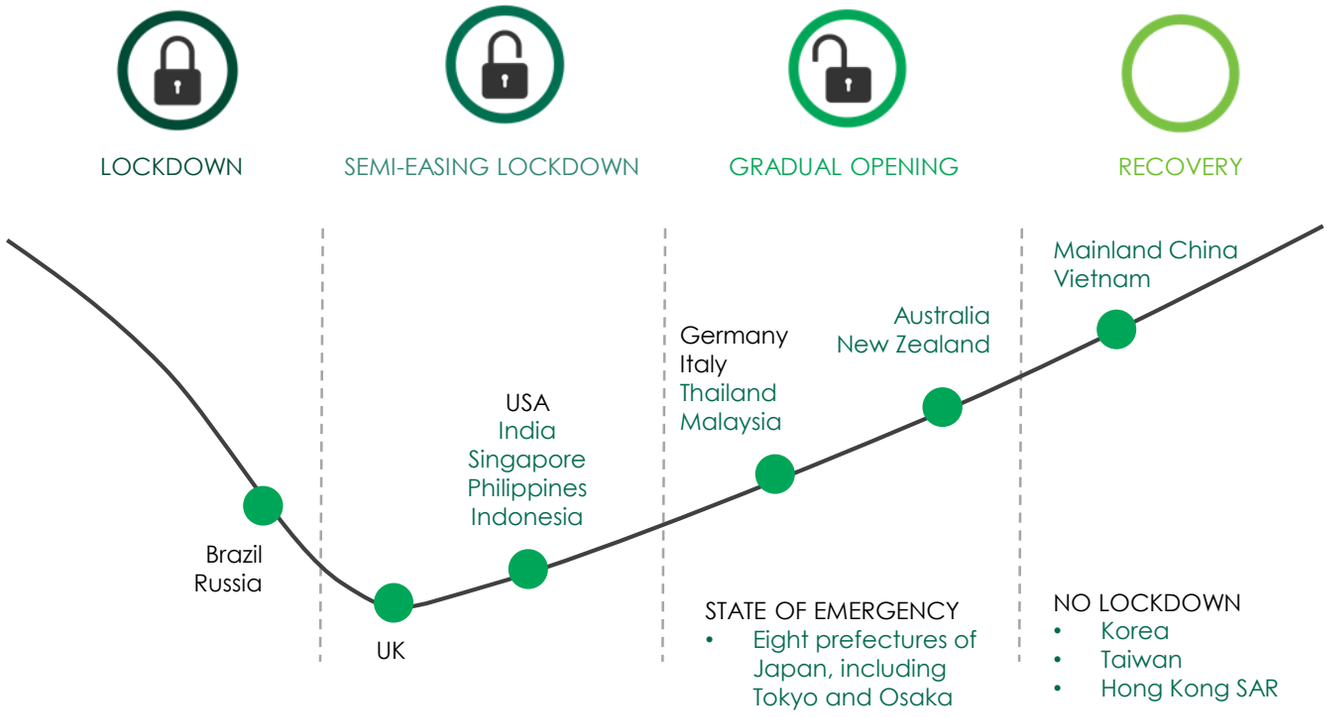
Figure 2: CBRE House View –GDP Growth Forecast 2020



Source: CBRE Research, Oxford Economics, 15 May 2020.

ECONOMY (CONT'D)

Figure 3: The Pace of Economic Resumption in Major Markets



Source: CBRE Research, May 2020.

ECONOMY (CONT'D)

THE POSITIVES

Supportive Measures Provide a Cushion

The U.S. Federal Reserve cut interest rates twice in March to a target range of 0% to 0.25% and announced an unlimited bond-buying plan. In Asia Pacific, all major economies (except Japan) cut interest rates in Q1 2020, with rates in most markets now at historical lows.

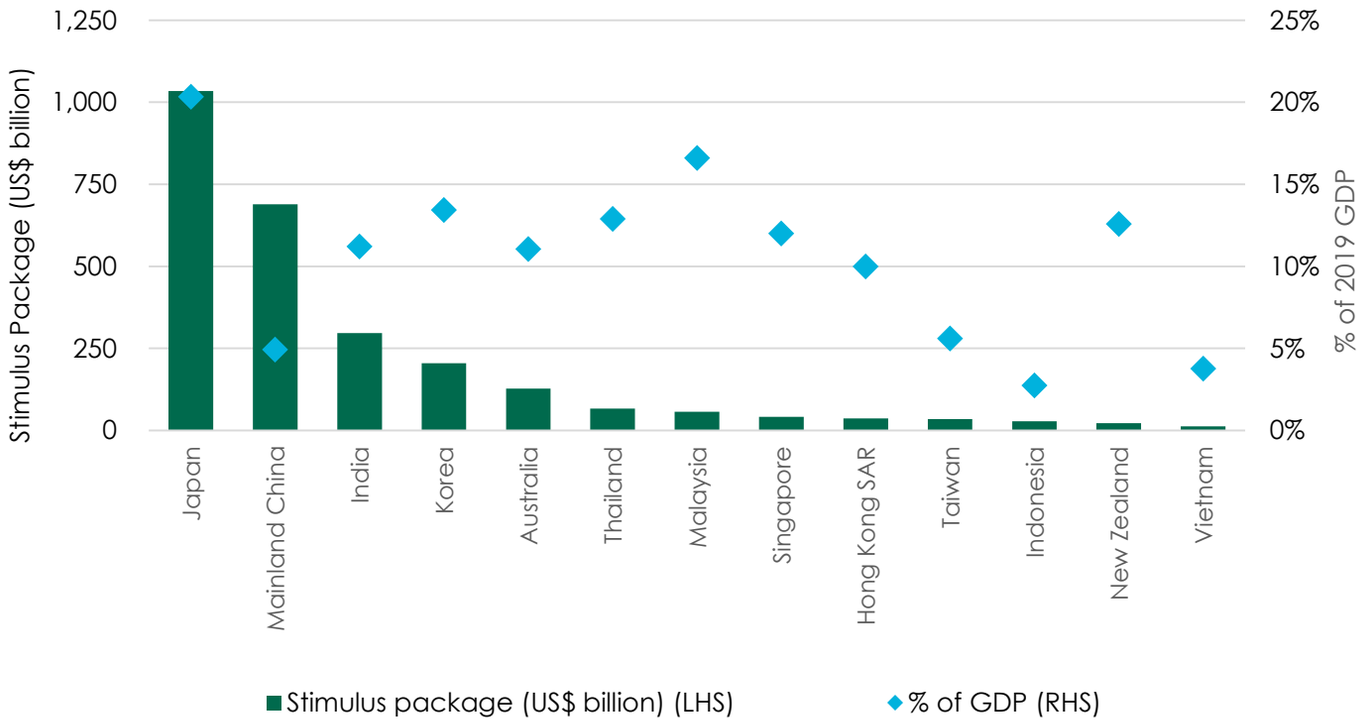
As of May 15, 2020, regional fiscal stimulus totalled more than US$2.6 trillion, equivalent to 9% of 2019 regional GDP. Measures including direct subsidies to businesses and individuals, loan guarantees and tax cuts have also been introduced to support corporate and consumer confidence.

India recently announced a special US$266 billion (circa 10% of 2019 GDP) package which includes structural policy reforms and privatisation measures in key sectors.

China's package has been relatively small (circa 4.9% of 2019 GDP) as it focuses on loosening monetary policy and improving funding to small and medium-sized businesses. There are other supportive measures not included in the package such as consumption coupons offered to citizens by local authorities. CBRE expects more supportive measures to be introduced in the future, including special treasury bonds. There may also be further monetary easing, including cuts to both the loan prime rate and the required reserve ratio.

Most Asia Pacific markets began relaxing lockdown restrictions in May. CBRE is therefore optimistic about the prospects for a gradual resumption of business in the coming months, which would support an economic recovery in H2 2020.

Figure 4: Stimulus Packages Introduced by Major Asia Pacific Markets



Source: Oxford Economics, CBRE Research, 15 May 2020.

ECONOMY (CONT'D)

THE UNKNOWNS

The Pace and Path of Recovery

Although more countries are gradually lifting lockdown restrictions to prepare for the gradual resumption of economic activity, there is significant uncertainty around the pace and path of the recovery. The risk of a second wave of infections poses an additional challenge for markets seeking to restart their economies.

Regional economic indicators are likely to deteriorate further in Q2 2020 owing to the impact of the worsening labour market, with many countries seeing widespread lay-offs, furloughs and hiring freezes. Global trade flows and supply chains will require time to regain momentum interrupted by lockdown measures and a sudden shrinkage in new orders. Cross-border travel restrictions are likely to remain in force for some time, meaning that tourism and related consumption will lag the broader recovery.

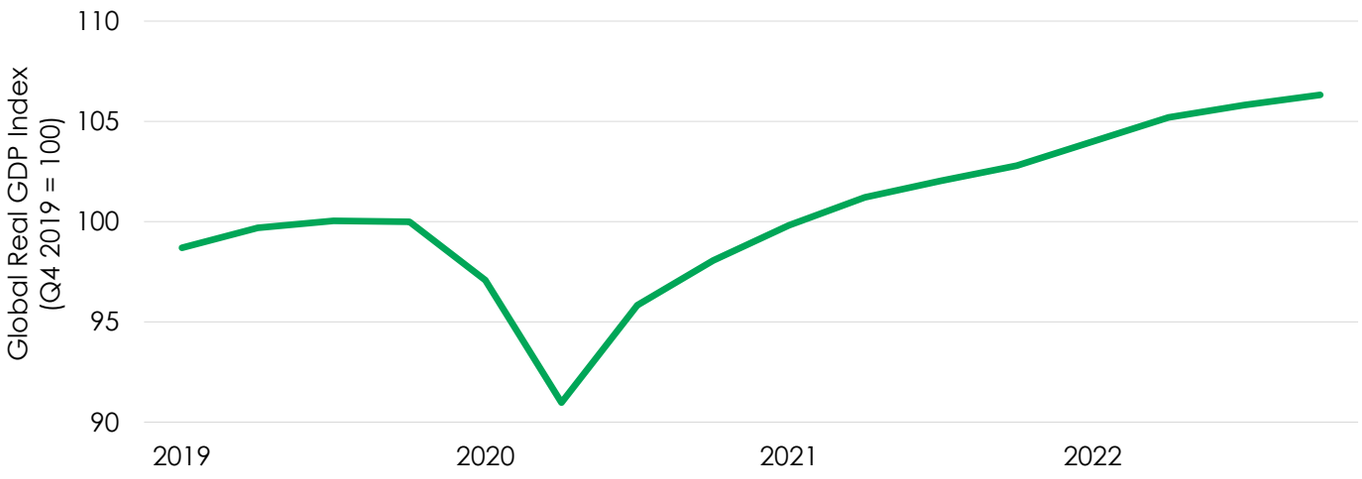
CBRE expects the global economic recovery to take the form of a "wide V shape" consisting of a sharp decline in Q1 2020 and Q2 2020, followed by stabilisation in Q3 2020, and then a recovery in Q4 2020. There will be a strong rebound in 2021, with the global economy forecasted to expand by 6.3%.

Economies with more scalable domestic demand, including Mainland China and Japan, will be more resilient and among the first to rebound. To support the economic recovery, CBRE expects to see the introduction of additional stimulus related to longer term investment in areas such as infrastructure. However, growth momentum in export-oriented markets such as Hong Kong SAR, Singapore, Taiwan, Korea and Southeast Asia is likely to be weaker as they are more reliant on demand from western economies.

While CBRE is cautiously optimistic about an economic rebound in Asia, reheating trade tensions between the U.S. and Mainland China, as well as a potential debt crisis in emerging Asia, could weigh on business sentiment and delay the recovery.

The real estate recovery will lag the economic revival by six to 24 months. CBRE retains its original expectation that logistics will be the first sector to recover, followed by office, and finally retail.

Figure 5: The "Wide V Shape" Global Economic Recovery



Source: Oxford Economics, CBRE Research, 15 May 2020.

OFFICE

OFFICE

THE NEGATIVES

Sharp Decline in Office Demand

Office demand in Asia Pacific has weakened significantly owing to the double impact of fading economic growth prior to the onset of COVID-19 and the abrupt slowdown in economic activity resulting from lockdown measures imposed to contain the pandemic.

Demand in Greater China and Singapore was first to be affected, with net absorption in Mainland China turning negative in Q1 2020 for the first time since CBRE began tracking national office data. Other markets saw a slowdown in leasing activity towards the end of the quarter as lockdown and social distancing measures came into force. The full extent of the decline in demand will become more visible in Q2 2020.

Although outright leasing cancellations remain limited, CBRE's April Asia Pacific Occupier Flash Survey found that at least two-thirds of respondents had experienced delays to the leasing process, including the postponement of site visits and suspension of expansionary plans.

Activity in Mainland China has begun to pick up but the extension of lockdown measures in key markets such as India, Japan and Singapore until at least the end of May makes a significant rebound in regional office leasing enquiries unlikely until midway through H2 2020.

Cost-saving will remain top of the occupier agenda. Even if COVID-19 is brought under control relatively quickly, leasing demand will take some time to recover to pre-outbreak levels owing to rigorous approvals for capital expenditure. Operational resilience will be a top priority in the coming months.

Regional net absorption fell by 40% to 50% in 2009 and 2010. A similar decline is likely in 2020, followed by a recovery to pre-pandemic levels in 2021.

Short term downside risks to office demand include more headcount reduction, along with faster consolidation in the flexible space industry, which could trigger more merger and acquisition activity and lead to consolidation as well as the closure of centres.

Figure 6: Asia Pacific Office Net Absorption

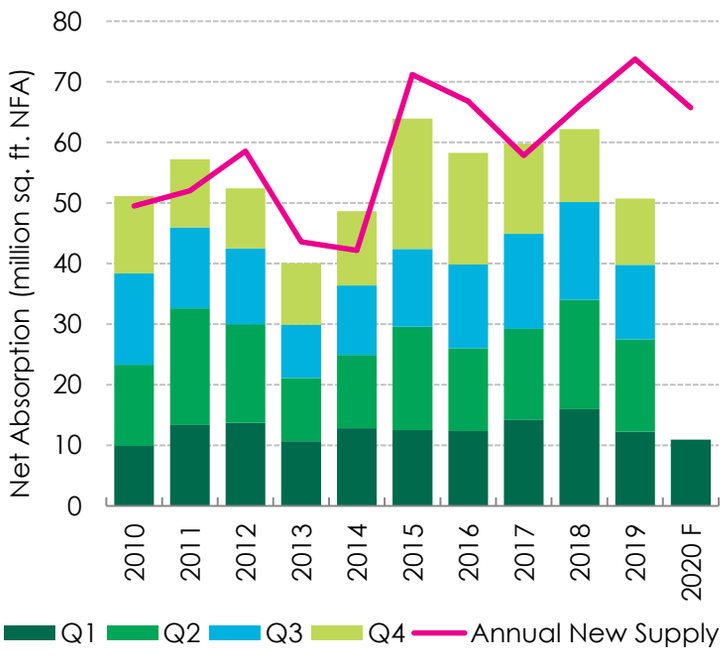
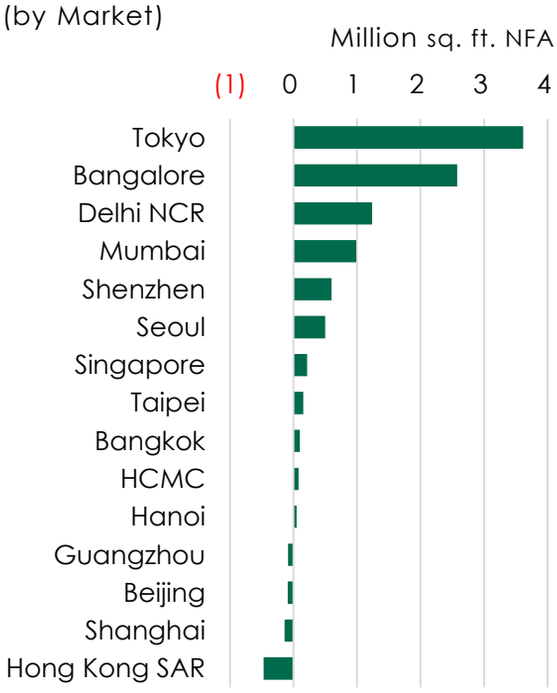


Figure 7: Office Net Absorption in Q1 2020 (by Market)



Source: CBRE Research, May 2020.

OFFICE (CONT'D)

Over the past five years, the tech sector has emerged as the major driver of office leasing demand in Asia Pacific, a trend expected to continue in the current cycle. In particular, the prominent and invaluable role technology has played in supporting remote working during lockdown restrictions is likely to generate additional office demand from firms providing these applications.

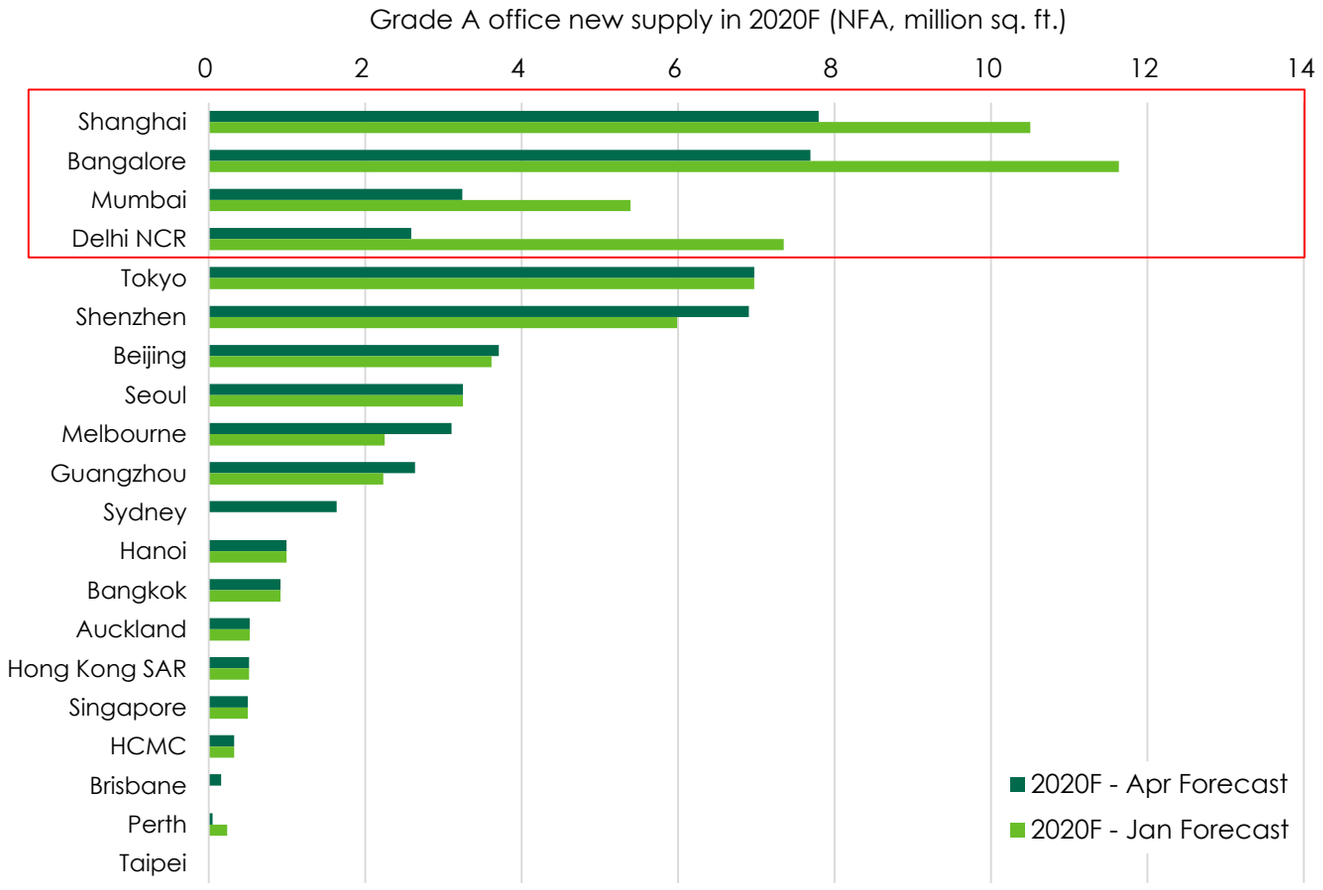
Although large occupiers are likely to accept higher levels of remote working in future, demand for flexible space is unlikely to diminish, ensuring it remains a key component of corporate real estate portfolios. However, with companies set to explore rebalancing options in the coming years, there is still some uncertainty around the composition of portfolios in future.

Disruption to New Supply Requires Contingency Planning

Although most new supply due in Q1 2020 was delivered according to schedule, the remainder of the year's pipeline is likely to experience delays resulting from disruption to global supply chains – which has led to a shortage of construction materials – and restrictions on labour mobility. This trend will be especially prevalent in India and China, both of which typically see a slippage ratio of 20% every year. Construction delays in Singapore will also be prominent and are set to affect new supply in 2021/22.

Although the slippage of new supply may alleviate oversupply pressure in these markets, occupiers who have pre-committed to these new projects or have an upcoming lease expiry will need to make contingency plans.

Figure 8: New Supply Pipeline Revision by Market



Source: CBRE Research, May 2020.

OFFICE (CONT'D)

Abatement and Concessions to Drag on Rental Growth

The sharp decline in business activity has prompted many occupiers to request rent abatement – a trend first witnessed in Greater China and subsequently in other markets.

Rental relief measures have initially been led by state-owned landlords in Mainland China. Rent reductions have been the most direct concessions, while other arrangements include extended rent-free periods, rent holidays and fitout subsidies.

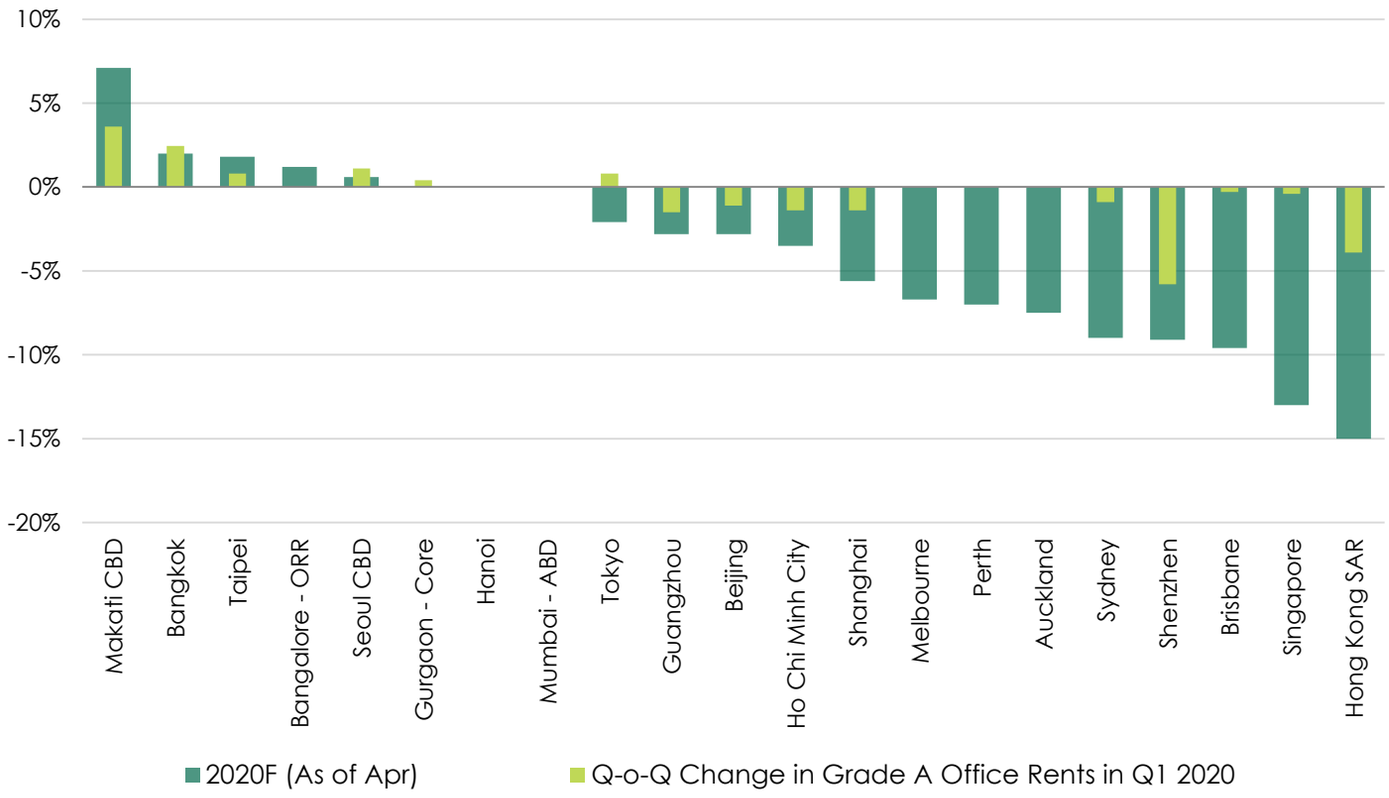
71% of respondents to CBRE's Asia Pacific Occupier Flash Survey said they had not been offered any relief measures by their landlord. However, selected private landlords have demonstrated a willingness to review rents.

Governments in New Zealand and Australia have encouraged landlords and tenants to engage in 'constructive' dialogue, with authorities in the latter advising parties to refer to the leasing principles outlined in the Commercial Code of Conduct.

Landlords and investors are increasingly concerned about rising vacancy risk resulting from weak demand owing to the impact this will have on cashflow and valuations. This will likely lead to a more accommodative stance toward rent abatement in the coming months.

Rent abatement is adding to downward pressure on Asia Pacific Grade A office rents, which fell by 0.6% q-o-q in Q1 2020. The full-year rental forecast has therefore been revised downward for almost all major regional office markets tracked by CBRE.

Figure 9: 2020 Office Rental Outlook



Note: Rental growth in each market represents the CBD unless specified.
Source: CBRE Research, May 2020.

OFFICE (CONT'D)

THE POSITIVES

Gradual Resumption of Office-based Activity

Office-based employees in Greater China markets, Korea and Vietnam have now largely returned to work, while those in other markets gradually moving out of lockdown and relaxing restrictions expect to do so in the coming weeks.

The process of re-opening workplaces is occurring in phases, with some employees returning on a split shift basis and others continuing to work from home in order to maintain low workplace density and ensure adequate social distancing. Some occupiers have temporarily ceased desk sharing or installed plastic screens between desks to reduce the likelihood of disease transmission.

The enhanced focus on health and safety will require facilities management teams to conduct general health screening at access points; ensure a reliable supply of cleaning and personal protective equipment; conduct frequent sanitisation of workplace areas; and communicate these and other best practices on a regular basis.

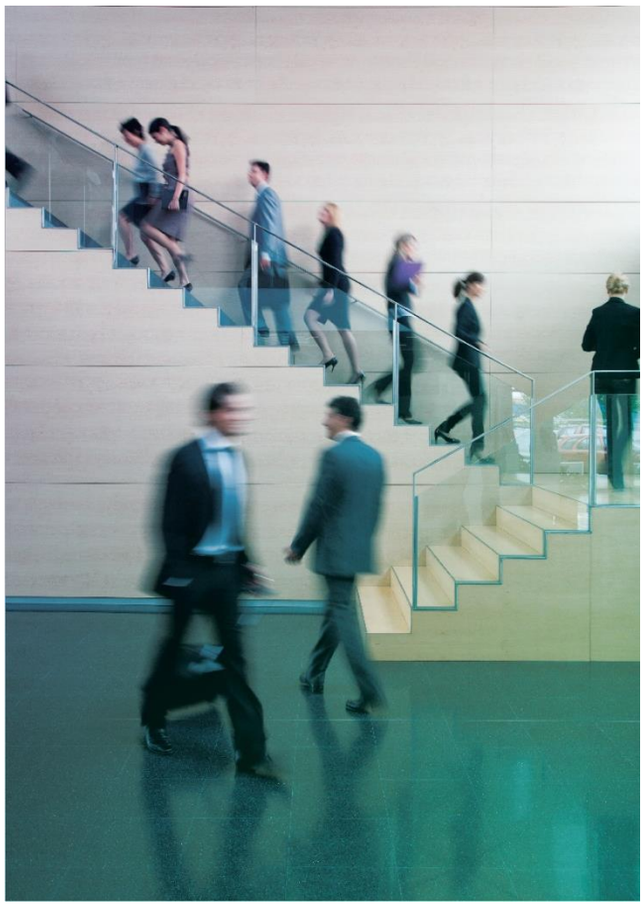
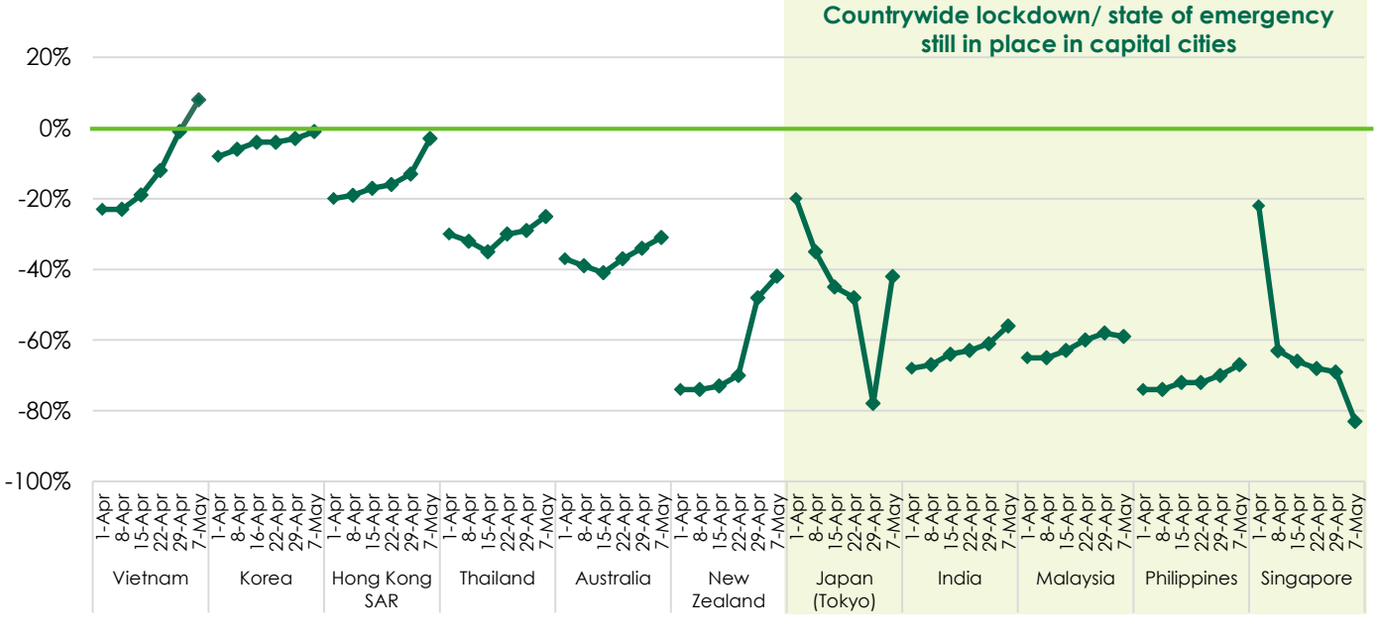


Figure 10: Mobility to workplaces compared to pre-pandemic levels
(based on Google Mobility Index, 0% = mobility back to pre-COVID-19 levels)



Note: Google's mobility index extracted from Google's COVID-19 Community Mobility Reports, as of 1, 8, 15, 16 (for Korea due to national holiday in 15th), 22, 29 April & 7 May 2020, the baseline for prior outbreak is the median value for the corresponding day of the week during the 5 week period Jan 3–Feb 6, 2020
Source: Google Mobility Index.

OFFICE (CONT'D)

THE UNKNOWNS

The Long-term Impact of Home-Working

The imposition of country lockdown measures and social distancing protocols has led to the widespread adoption of home-working. Although there remain some challenges around home-working – such as the absence of in-person interaction, distraction from family members, poor connectivity and a lack of home space – the trend is expected to become a permanent feature of the Asia Pacific office landscape.

Several multinational technology and financial companies have already announced the extension of work-from-home policies to the end of 2020. India-based Tata Consulting Services recently stated that 75% of its employees will work from home by 2025, while Twitter has told its staff that they can keep working from home "forever" if they wish.

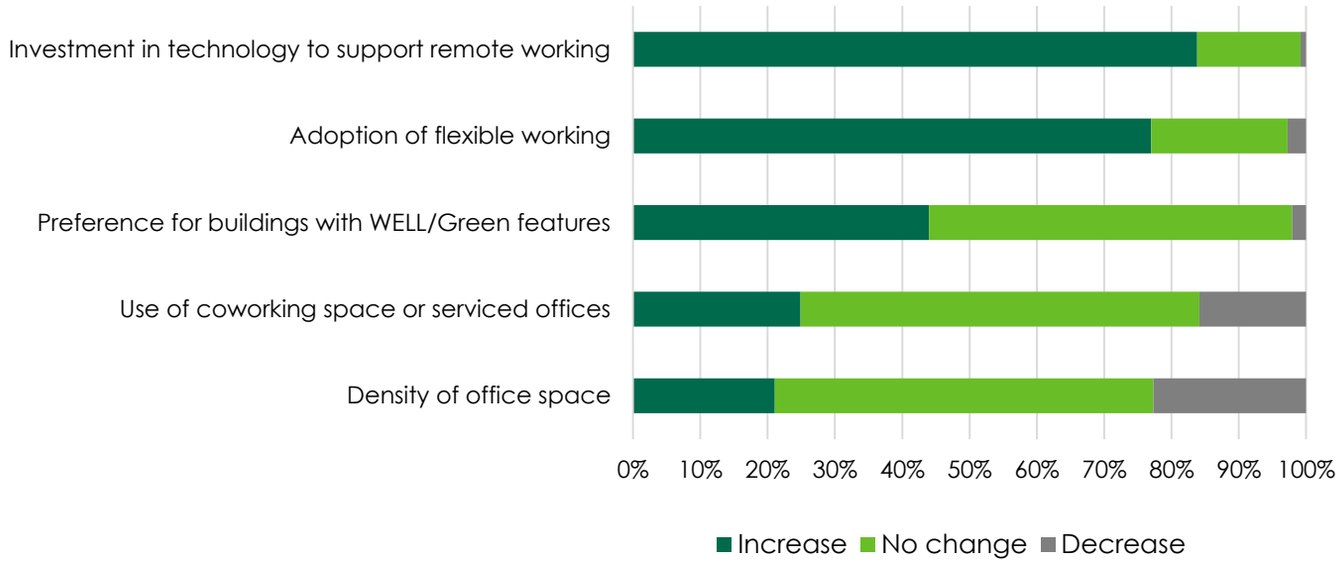
Combined with increased vigilance around health and safety, a more fluid office-based workforce will require occupiers to re-think their workplace requirements, particularly workstation size, desk spacing and meeting room and social area capacity. This will necessitate a reassessment of occupancy levels and revision of allocations to open and enclosed space.

Business Continuity Planning (BCP) requirements - especially for critical business functions and essential employees – must also be accounted for. This may lead to occupiers adopting a strategy of maintaining a high-quality main office in a prime location supported by a network of smaller offices in decentralised areas or closer to employees' homes – a trend that will reinforce existing "Core + Flex" models.

Ascertaining space requirements will become more complex. Although occupiers will reduce space when they implement remote working, they will need more space to maintain physical distancing, lower workplace density and manage BCP.

CBRE believes it is too early to ascertain how office space demand will evolve in individual markets. The process of portfolio rebalancing will take at least two to three years before occupiers achieve an equilibrium that satisfies all these requirements.

Figure 11: Shift in Long-Term Occupier Strategy



Source: Asia Pacific Occupier Flash Survey, CBRE Research, April 2020.

RETAIL

RETAIL

THE NEGATIVES

Lockdowns and Travel Restrictions Bring Retail Sector to Near Standstill

With a few exceptions, most Asia Pacific markets have either been under lockdown or seen the temporary closure of non-essential retail businesses since March. Aside from Australia, which saw a surge in demand for food prior to the imposition of lockdown measures, the negative impact on retail sales figures in the region became more visible in March.

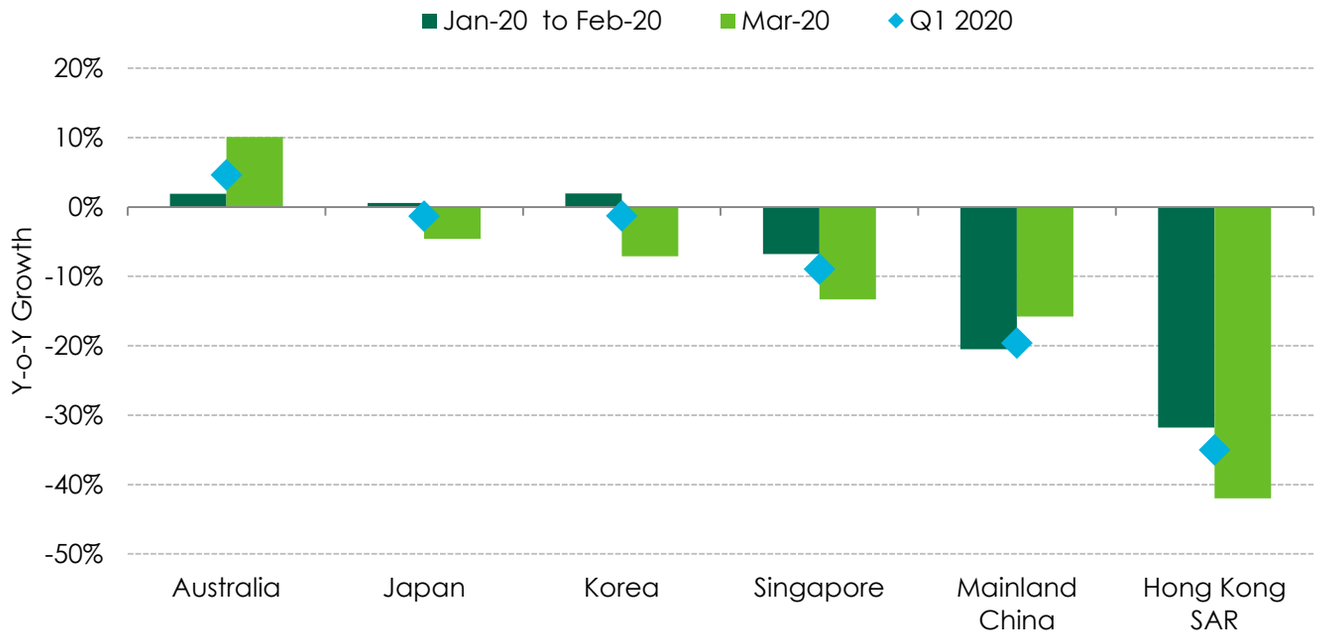
However, retail activity in Mainland China is already showing gradual improvement, with the retail sales contraction narrowing from -20.5% y-o-y in the first two months of the year to -7.5% in April. Nevertheless, sales in Hong Kong SAR continue to struggle due to the lack of inbound tourists, which account for about one-third of the city's retail sales. Retail assets targeting domestic consumption in these properties are therefore more resilient. Shopper footfall also recovers more quickly than in prime locations.

The regional F&B industry has been hit hard by lockdowns, mobility constraints and social distancing regulations. Many restaurants have switched to takeout and delivery, leading to strong business growth for on-demand delivery apps.

Although some markets have reported a gradual increase in footfall in recent weeks, in-store shopping activity remains limited as social distancing measures are still in place and shoppers opt to purchase goods online. With the exception of Greater China, retail sales figures are expected to worsen in Q2 2020. Retailers must also prepare for further shifts in consumer behaviour once lockdown measures are eased.

Duty-free stores and airport retail have been hit hard by widespread travel restrictions. Some duty-free stores have turned to their domestic market, with Taiwanese operators offering discounts to locals and Korean authorities approving the local sale of some duty-free goods.

Figure 12: Q1 2020 Retail Sales Performance of Major Markets in Asia Pacific



Source: CEIC, May 2020.

RETAIL

Widespread Rent Concessions and Lease Restructures

Most retailers previously considering expansion or other activity involving major capital expenditure have suspended such plans indefinitely. Some groups are under severe liquidity pressure and have been warned for deferring rental payments. A recent survey by CBRE Property Management found that just 63% of this year's retail rents in Australia and New Zealand had been paid as of 21 April [2]. Other retailers with existing leases have approached landlords for rent abatements.

While some landlords have provided temporary rent holidays, such offers have mainly been extended to smaller retailers or those whose business has been significantly impacted by the pandemic. Governmental support to retailers has involved rent and/or wage subsidies, loan guarantees and the temporary suspension of forced evictions.

Apart from direct rental discounts, retailers have been exploring other relief measures, such as lease restructures. Preliminary findings from CBRE's May 2020 Retail Occupier Survey found that around 40% of retailers have requested landlords to convert lease payment terms to pure gross turnover rents. Other popular strategies include requesting fit-out subsidies and tenant allowances and using deposits to pay rents.

Figure 13: The Retailer Response

MONETARY RELIEF MEASURES

Fit-out subsidies/ tenant allowance

Shift to pure gross turnover rents

REVIEW OF LEASE STRUCTURE

Longer rent free periods/ rent holidays

Burn down deposits to pay rents

Replace cash deposits with other instruments such as insurance/company indemnity

PROMOTIONS

More pop-up stores

Joint sales campaigns

Purchase coupons/ goods from retailers and distribute to consumers

Source: CBRE Research, May 2020.

[2] CBRE Property Management - COVID-19 - Impacts on rental income receipts and occupancy, 27 April 2020.

RETAIL (CONT'D)

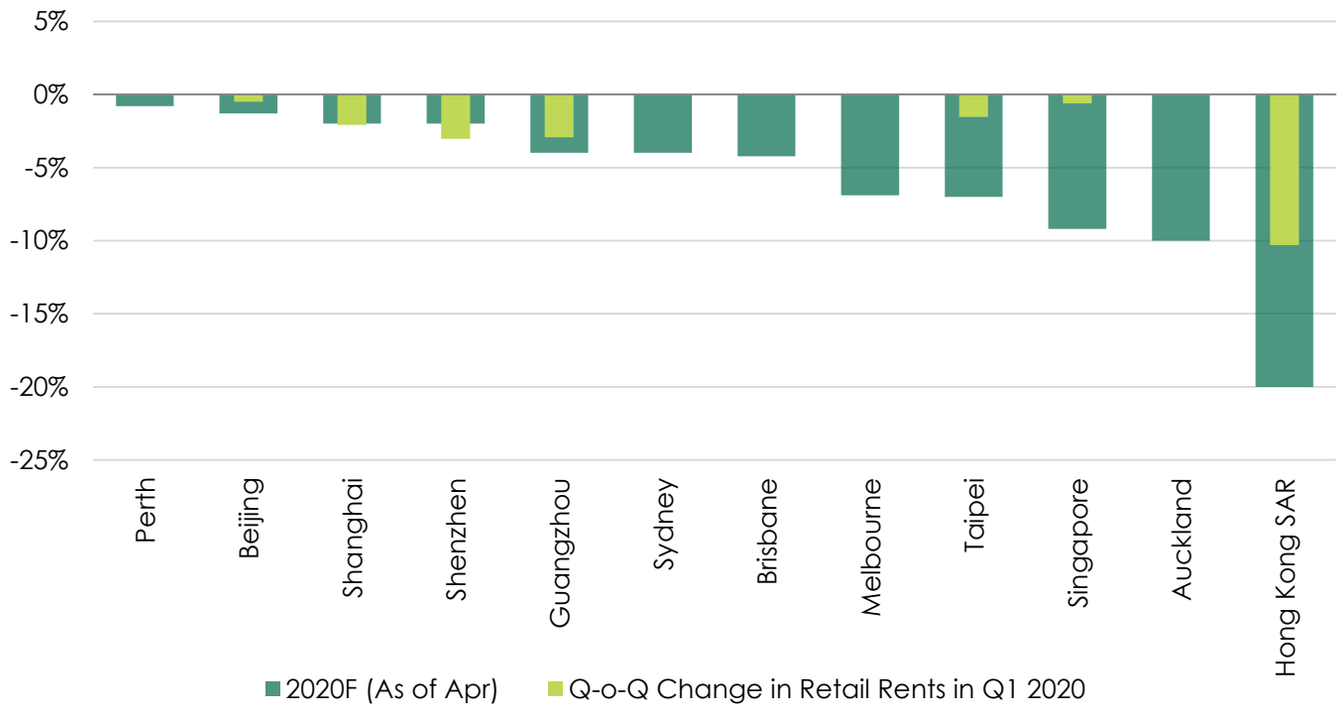
Rental Weakness Across the Region

Despite widespread discussions about relief measures, most new retail leases signed in Q1 2020 did not involve significant rental reductions. Although Asia Pacific retail rents fell by -2.4% q-o-q - the sharpest fall on record - this was largely due to an especially steep decline in Hong Kong SAR. Other markets can expect to see rental declines in Q2 2020, albeit in the low single digits.

In addition to postponing expansions and delaying new openings, retailers have adopted a far more stringent approach to evaluating new stores. In view of muted new demand, CBRE Research has once again revised down its full-year regional rental forecast to a record low of around -6%. This would mark a sharper decline than that recorded after the Global Financial Crisis, when regional rents fell by -5.2% in the 12 months after June 2008.

Recent financial results published by leading Hong Kong SAR landlords including Swire Properties and Hysan Development suggest the sales performance of daily necessity-driven neighbourhood malls has been more resilient. Prime retail malls reliant upon discretionary spending have suffered considerable sales declines – a trend that will suppress income from turnover rents.

Figure 14: 2020 Retail Rental Outlook



Remarks: All markets track the performance of prime high streets except China, Singapore and Auckland. China tier I cities track the performance of G/F prime shopping centres, Singapore tracks prime floor units while Auckland tracks regional shopping centres.
Source: CBRE Research, May 2020.

RETAIL (CONT'D)

THE POSITIVES

Consumers are Spending Again

International brands - including several luxury retailers - reported a strong rebound in sales at stores in Mainland China and Korea that reopened during "Golden Week" in early May. However, this is partly due to the re-shoring of tourist demand owing to travel restrictions.

Although most shopping malls in Mainland China have re-opened, mid-April footfall was just 50% of 2019 levels, while sales turnover lagged even further [3]. To combat the downturn, authorities in 170 cities have distributed a combined total of more than RMB 19 billion-worth of consumption coupons to boost consumer spending [4].

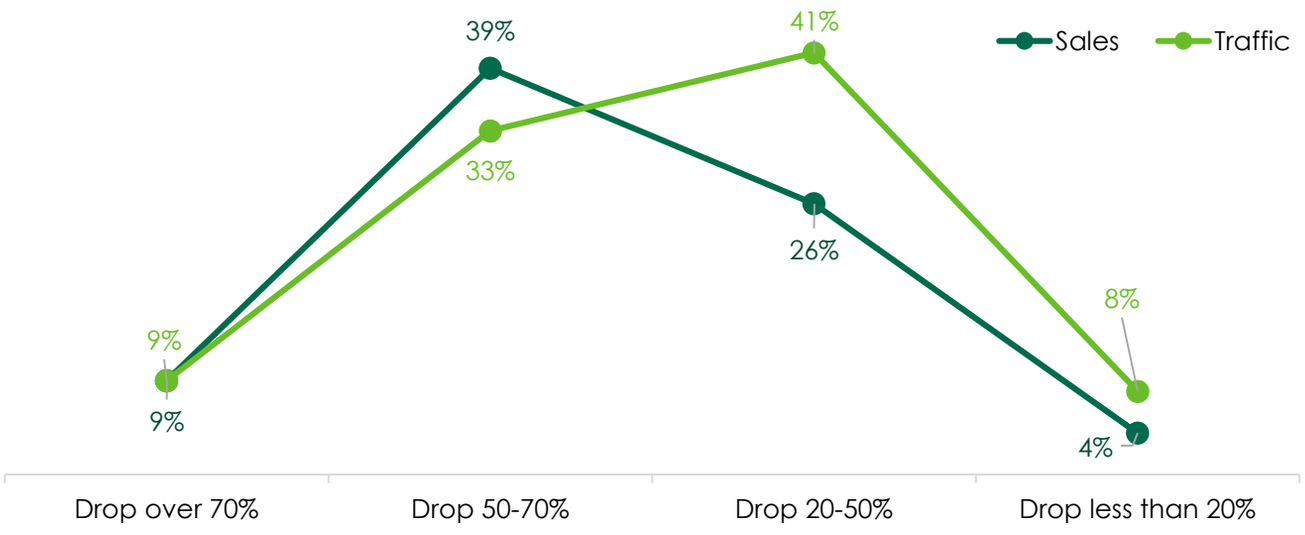
Although most markets in Asia Pacific have provided cash subsidies and tax breaks to individuals, the strong likelihood of a global recession and surge in unemployment will have a prolonged impact on consumer confidence and spending.

Discretionary spending on apparel and big-ticket items is expected to be most affected. Bain & Company expects the global personal luxury market to contract by 20% to 35% this year.

While the enforcement of country lockdowns and social distancing protocols for several months will likely create solid pent-up demand for dining-in and entertainment, the possible extension of such measures will weigh on the recovery, with retailtainment occupiers hit especially hard.

While domestic demand will support the retail recovery, retailers and landlords of properties catering to tourists will take longer to recover as restrictions on international travel are expected to remain in place until later in the year.

Figure 15: Y-o-Y Change in Consumer Traffic and Sales Turnover in China's Shopping Malls (as of week ending April 12)



Source: Survey by CCAGM (中国百货商业协会), April 2020.

[3] Survey by CCAGM (中国百货商业协会), 13 April 2020 (link).
[4] Ministry of Commerce of the People's Republic of China, 8 May 2020 (link).

RETAIL (CONT'D)

THE UNKNOWNS

Omnichannel Retail in a Post-Pandemic World

The resumption of retail activity involves both reopening brick-and-mortar stores and restarting production. With the pandemic forcing retailers to adjust purchasing levels, production capacity and sales activity to handle unsold stock and avoid excess inventory, these will take some time to return to normal.

The pandemic has accelerated the shift online, with shoppers now more willing to purchase a range of goods – including fresh food and groceries – via e-commerce. In March, online retail accounted for 44% of total sales in Korea, up from 35% a year ago. The more frequent usage of online sales channels will prompt retailers to engage more actively with consumers in the digital realm. E-commerce livestreaming continues to gain traction in Mainland China, with over four million sessions held in Q1 2020.

CBRE expects the retail leasing recovery to be slowest among all sectors as store networks are rationalised across the region. Almost half of the respondents to a recent CBRE Retail Occupier Pulse Survey stated they expect to open fewer stores and have a smaller footprint in H2 2020. However, this may create opportunities for more financially sound brands to secure prime space at discounted rents.

Although brick-and-mortar stores will undoubtedly remain part of retailers' core business, more capital expenditure will be allocated to enhancing digital sales channels and logistics capacity. There will also be a shift in how retail properties are priced, with metrics such as omnichannel sales, micro fulfillment and media influence carrying more weight [5].

[5] Global Outlook 2030: The Age of Responsive Real Estate, CBRE Research, April 2020.

INDUSTRIAL & LOGISTICS

INDUSTRIAL & LOGISTICS

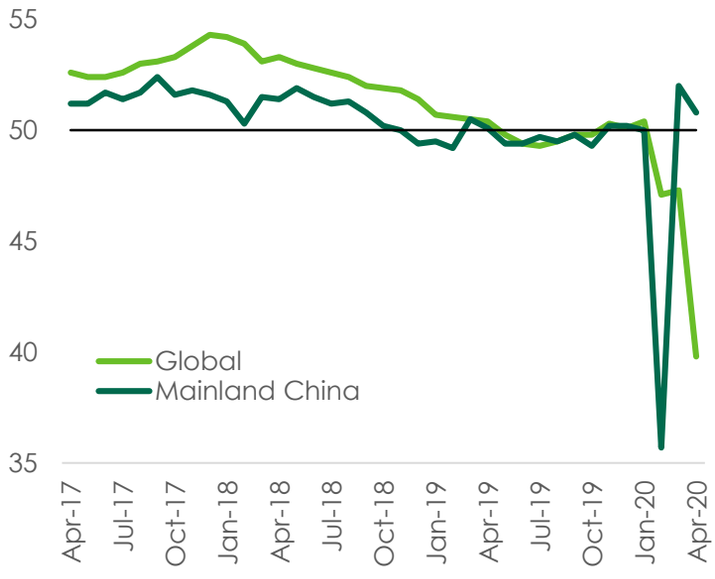
THE NEGATIVES

Global Industrial Activity Suffers Significant Disruption

As of mid-May, regional industrial production and logistics activity remain well below pre-pandemic levels. Manufacturing activity in several markets came to a complete halt due to lockdown measures, while some capacity was prioritised to ensure the adequate production of medical equipment. Cross-border traffic has been further constrained by travel restrictions and border closures. All these disruptions have affected the operations of exporters, third-party logistics companies and non-essential manufacturers.

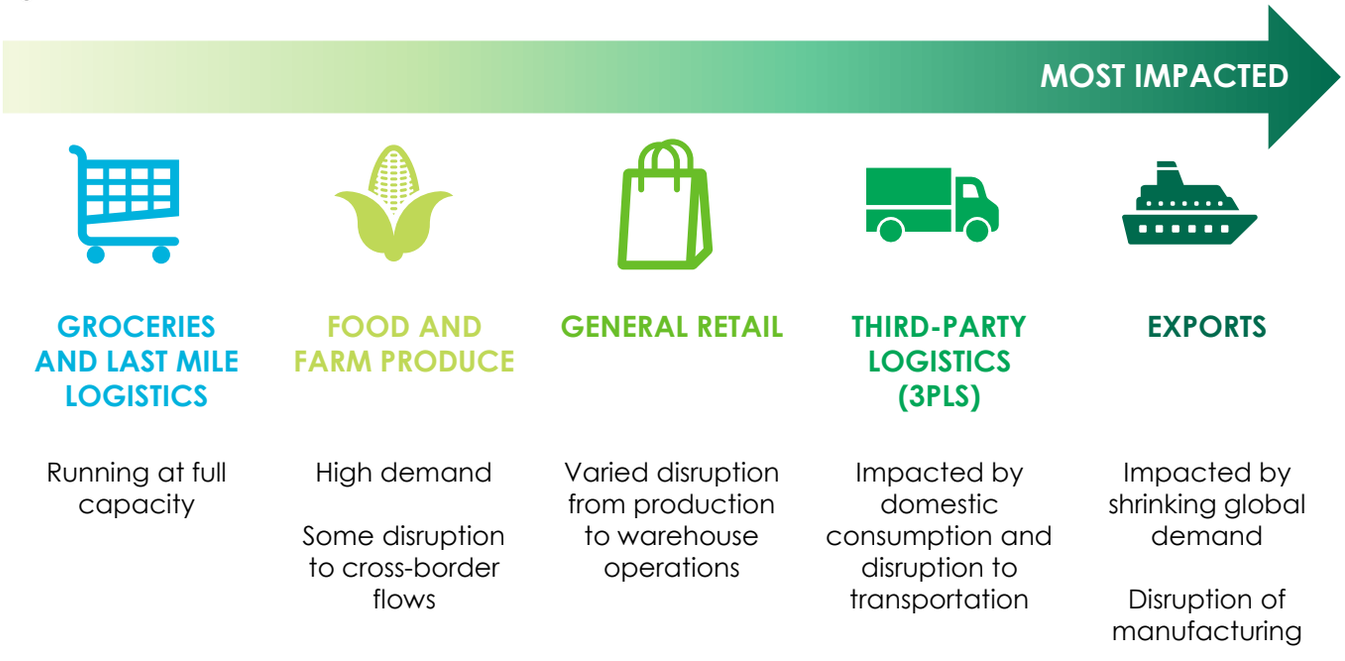
Regional air cargo and container throughput reported double-digit declines in February. Although there was a slight uptick in activity after factories in Mainland China resumed production in March, regional manufacturers continue to experience the knock-on effects of global supply chain disruption, rising logistics costs and a decline in liquidity and new orders. In India, manufacturing is suffering from a labour crunch, which will take several weeks to return to normal after the lockdown is eased.

Figure 16: Global vs Mainland China Manufacturing PMI (>50 = expansion)



Source: IHS Markit, National Statistics Bureau of China, May 2020.

Figure 17: Industrial Sector Demand Drivers



Source: CBRE Research, May 2020.

INDUSTRIAL & LOGISTICS (CONT'D)

THE POSITIVES

E-commerce is Thriving

Lockdown and mobility restrictions have had a diverse impact on the retail trade. While general retail has suffered a sharp decline, retailers have required additional space to store unsold goods. Consumer stockpiling of food, groceries and other necessities – much of it ordered online - has also led to a spike in demand for temporary warehousing. Several online platforms were forced to temporarily suspend taking new orders and deliveries of non-essential items due to capacity constraints.

E-commerce adoption is expected to continue after the pandemic has been contained, leading to stronger demand for last mile logistics and warehousing space. Last mile delivery will also be fulfilled via brick-and-mortar store networks, with a number of retailers in Hong Kong SAR and Australia now allocating click-and-collect points in stores or designating certain areas to sorting online orders.

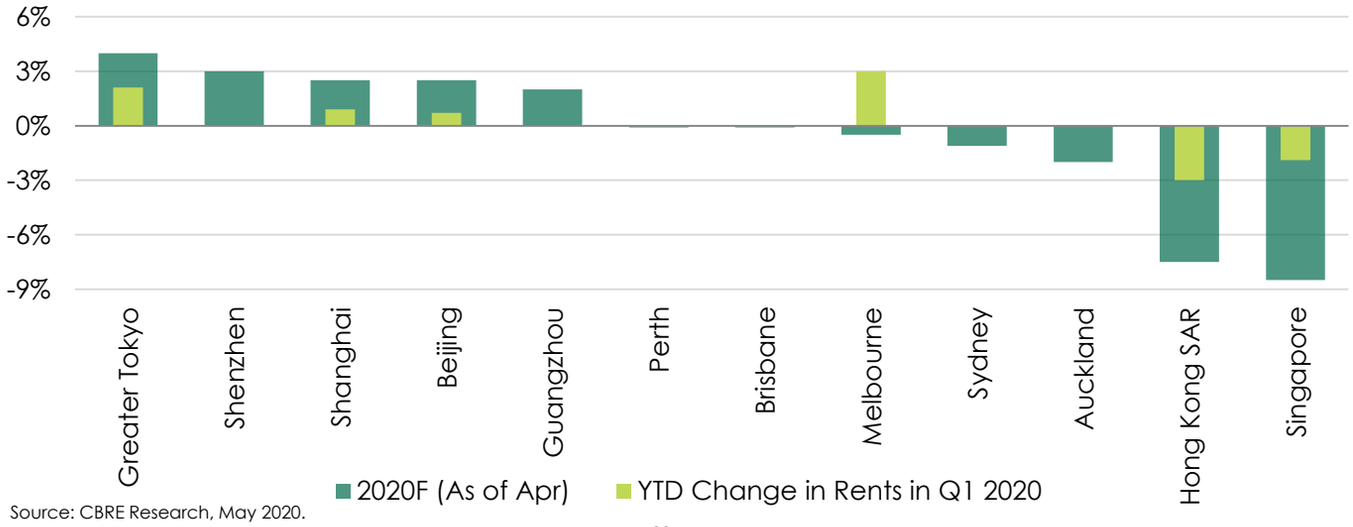
Logistics Rents are Relatively Resilient

The surge in e-commerce demand will ensure logistics is the first sector to recover. Logistics rents have performed resiliently since the onset of the pandemic, supported by rising requirements for last mile and cold storage space. Rental growth will be led by Greater Tokyo due to continued tight availability.

Rental performance in Mainland China will diverge, with tier I cities registering solid performance amid a limited development pipeline, but tier II markets coming under pressure from double digit vacancy, an ample development pipeline and the relocation of e-commerce retailers to self-built warehouses.

Australia has seen a spike in warehouse demand as inventory piled up amid temporary store closures. However, this demand will eventually fade, while the deteriorating economy will also weigh on rents. Singapore has seen a similar trend, with warehouse availability contracting amid government stockpiling, which prevented rents from freefalling in Q1 2020. However, the full year rental forecast has been revised downward due to the lack of new demand. In Hong Kong SAR, rents are declining amid worsening economic conditions and weakening trading activity. Vacancy will continue to edge upwards as most occupiers focus on cost-saving measures such as downsizing or lease termination.

Figure 18: 2020 Logistics Rental Outlook



Source: CBRE Research, May 2020.

INDUSTRIAL & LOGISTICS (CONT'D)

THE UNKNOWNS

Supply Chain Resiliency and Relocations

Although cost efficiency remains a key priority, CBRE expects to see a far stronger emphasis on strengthening supply chain resiliency and continuity after the severe disruption caused by COVID-19 exposed the danger of overreliance on a single base of production.

With U.S.-China trade conflict and rising labour costs already prompting many companies to conduct sourcing outside China in what has come to be known as a 'China Plus One" strategy, CBRE expects the pandemic to add impetus to plans to reduce supply chain dependency on this (and potentially any other) single market.

India and Vietnam are likely to emerge as destinations for smartphone production, while high-tech manufacturing may relocate to more advanced economies such as Japan, Korea and Taiwan.

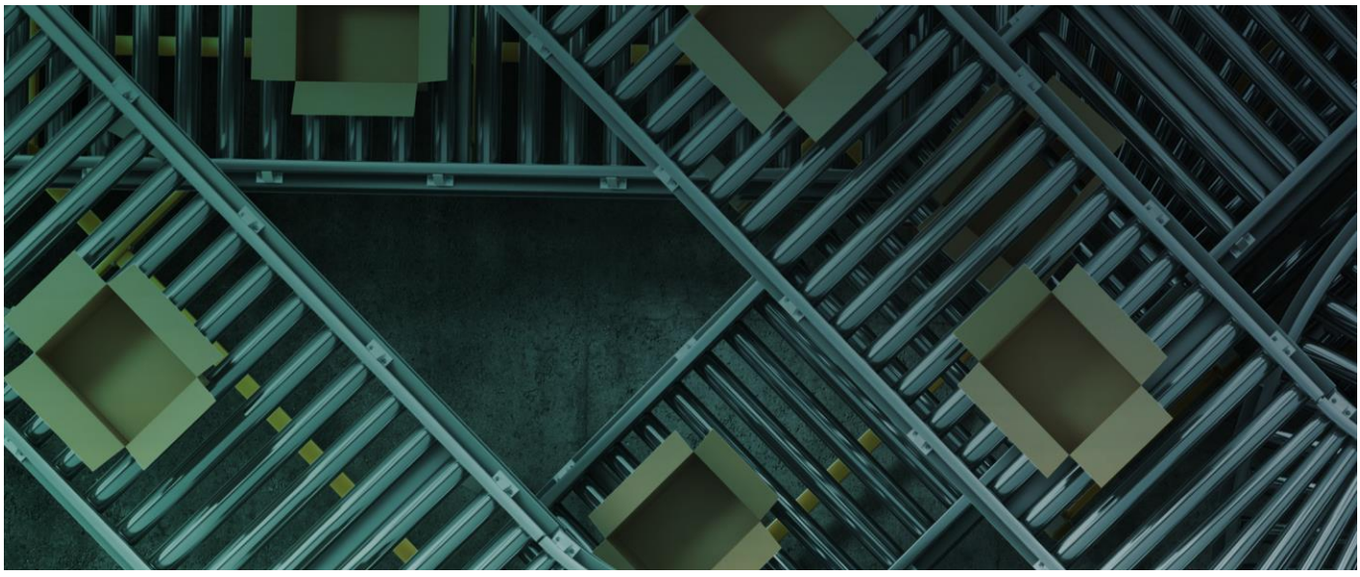
CBRE nevertheless retains its view that a sudden and massive outflow of manufacturing capacity is unlikely. Mainland China's status as an important consumer market will ensure it remains a key player in the global supply chain, while the lack of infrastructure in India and Southeast Asia remains a bottleneck.

Inventory Adjustment

In order to maintain sales as supply chains are reset, CBRE believes brands and manufacturers, especially those engaged in the production of necessities, may tend to store more stock and keep inventory closer to consumption points and service locations. Maintaining higher stock levels in-country is set to generate more warehousing demand and will transform how companies store goods, plan infrastructure and serve their local customers [6].

The future may also see governments identify certain foodstuffs and medical supplies as strategic commodities and keep large quantities of these items in stock to ensure sustainable supply. In Singapore, state-owned industrial property developer and manager JTC Corporation has withdrawn vacant logistics space from the leasing market to serve the government's strategic needs. This may become the new normal and accelerate demand for temperature controlled storage facilities.

With food production set to become a strategic priority for cities, occupier demand for food processing facilities and vertical farms may also increase.



[6] COVID-19 and the Asian Supply Chain: Refocusing Priorities in a Post-Pandemic World, CBRE Research, May 2020.

CAPITAL MARKETS

CAPITAL MARKETS

THE NEGATIVES

Sharp Decline in Investment Activity

Asia Pacific commercial real estate investment volume fell to US$22 billion in Q1 2020, a decline of -25% y-o-y and the lowest quarterly total in almost three years. Despite an abrupt halt in deal-making towards quarter-end, transaction volume was underpinned by the completion of several major deals that had been under negotiation since the end of 2019.

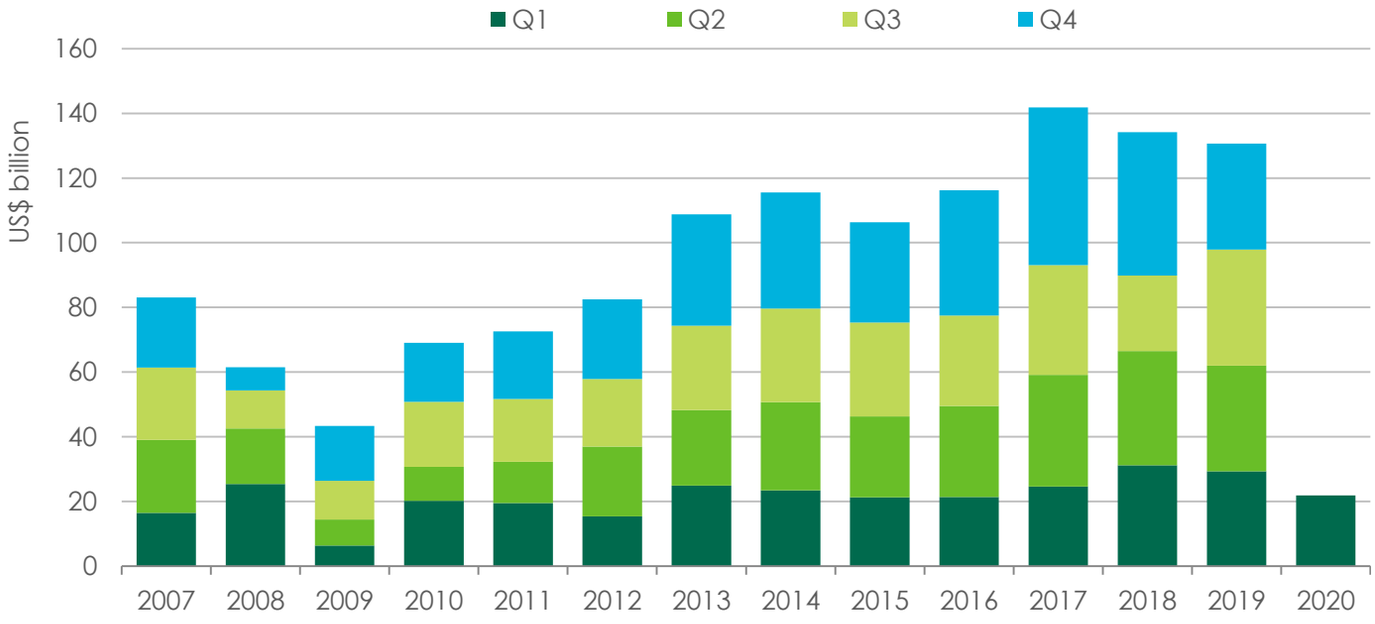
Turnover in the office and industrial sectors was firm but a sharp decline in retail deals combined with a fall in hotel investment pulled down overall transaction volume.

Investment in Japan remained upbeat, with several major acquisitions conducted by domestic buyers supporting a 30% y-o-y increase in transaction volume to US$8.5 billion. However, most deals were signed relatively early in the quarter.

Real estate investment in Mainland China faded from the end of January as the spread of COVID-19 led to a nationwide shutdown. However, sentiment improved in in April as business activity resumed, with domestic investors returning to the market to seek opportunities.

With many countries still subject to lockdowns and travel restrictions, Q2 2020 data will serve as a more accurate gauge of post-outbreak real estate investment activity.

Figure 19: Asia Pacific Commercial Real Estate Transaction Volume



Note: transactions include deals above US$10 million in the Office, Retail, Mixed, Industrial, Hotel and Other commercial sectors. Residential and development site are excluded.
Source: RCA, CBRE Research, May 2020.

CAPITAL MARKETS (CONT'D)

Policy Interest Rates Fall but Banks Turn More Cautious

Most central banks in the region cut policy rates in Q1 2020, with further rate cuts expected in the coming quarters. However, the cost of borrowing in several markets including Australia and Korea has not fallen significantly as banks have increased premiums over benchmark rates to reflect elevated risk.

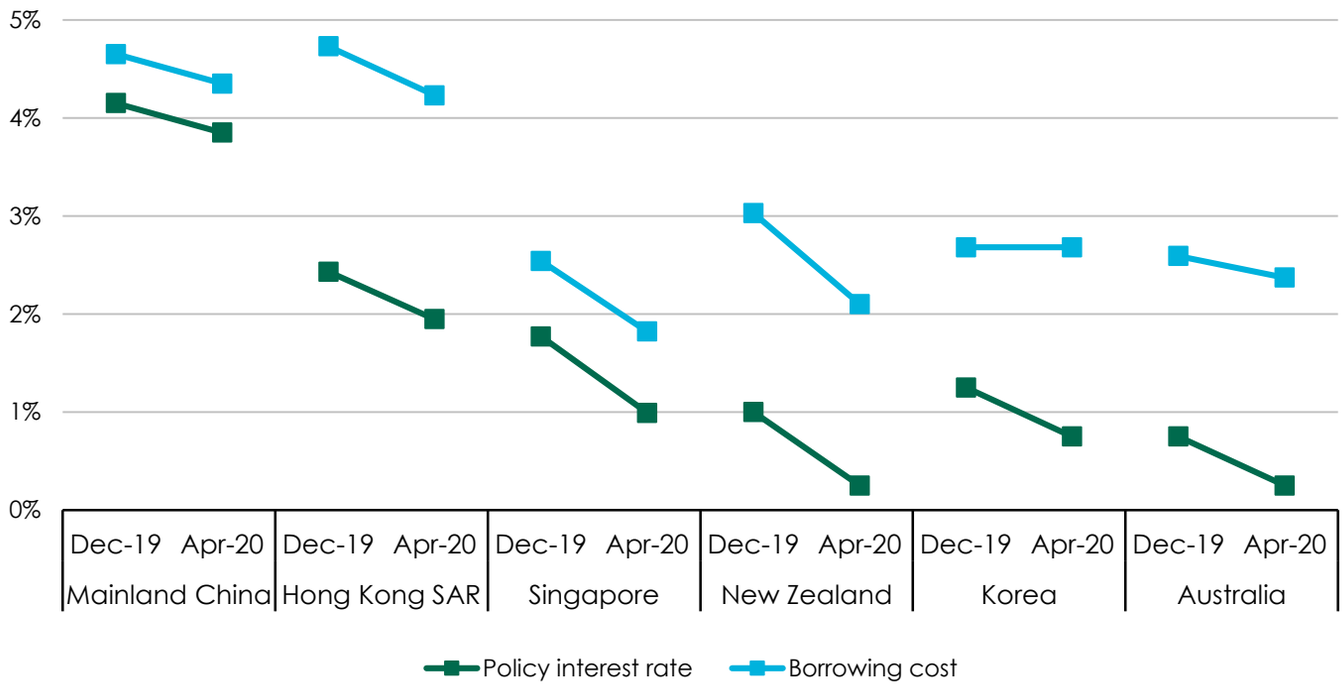
Monetary easing has also not prompted banks to relax Loan-to-Value (LTV) ratios for commercial real estate lending. Banks in Greater China and Japan are seen to have left LTV ratios unchanged, while those in the Pacific and Singapore have turned more cautious, according to CBRE's latest Cap Rate Flash Survey. Loans for retail and hotel acquisitions and developments have tightened significantly.

The Price Gap Remains Significant

Many buyers are already seeking distressed opportunities but these have yet to become available. Prices have corrected, albeit only slightly, with the CBRE Asia Pacific Office Capital Value Index falling 1.4% q-o-q in Q1 2020. A mild price correction was recorded in Greater China and New Zealand.

Most vendors are holding prices firm on the back of the low interest rate environment. At the same time, buyers are seeking discounts due to the weaker rental outlook. This mismatch in pricing expectations will inhibit negotiations in the coming months.

Figure 20: Comparison of Borrowing Cost and Interest Rate



Note: Policy rates represent Australia (Cash Rate), New Zealand (Cash Rate), Mainland China (1-Year Loan Prime Rate), Hong Kong SAR (3M HIBOR), Singapore (3M HIBOR), Korea (Base Rate).
Cost of borrowing represents the reference rate plus interest rate spread (lower bound). Reference interest rate for Australia (3M Bank Bill Swap Rate); New Zealand (5-year swap rate); Mainland China (1-Year Loan Prime Rate), Hong Kong SAR (3M HIBOR); Singapore (3M Swap Offer Rate); Korea (3M CD Rate)
Source: Capital IQ, CBRE Research, May 2020.

CAPITAL MARKETS (CONT'D)

THE POSITIVES

Large Volume of Capital Waiting on the Sidelines

Despite the weak short-term outlook, there is still ample liquidity in the market. Asia Pacific-focused close-ended private equity real estate funds possess an estimated US$60 billion of capital to be deployed in the next two to three years. Institutional investors will also be active as they seek to generate steady income by increasing allocations to real estate and infrastructure. Several Korean insurance companies recently made public their intention to invest in real estate this year.

CBRE has observed that investors are delaying decisions rather than shifting away from real estate entirely. Major transactions, such as Alibaba's recent US$1.2 billion purchase of a 50% stake in AXA Tower in Singapore – a property that will be redeveloped into a mixed-use project under the government's CBD Incentive Scheme - continue to be completed.

Potential Increase in Asset Availability

CBRE expects to see an increase in willing sellers in H2 2020, driven by fund expiration and redemption pressure. With the next wave of fund expiry in Asia Pacific expected to commence in 2021, fund managers will already be planning exit strategies. Fund redemption pressure may prompt open-ended funds and Australian superannuation funds to market their assets for sale.

Smaller sized developers and hotel operators will display a greater willingness to dispose of assets to boost liquidity. Investors may also capitalise on Southeast Asian developers' liquidity needs to form partnerships.

Resilient Industrial & Logistics Facilities and Business Parks

Modern logistics facilities have performed resiliently compared to other asset types as the pandemic accelerates e-commerce adoption. Recent months have also seen a surge in requirements for temperature-controlled storage facilities for fresh food and medical product use.

With the technology and life sciences sectors displaying solid business performance in Q1 2020, business parks will continue to benefit from strong leasing demand from these industries.

THE UNKNOWNS

The Pace of Recovery

Asia Pacific real estate investment activity fell significantly after the onset of the Global Financial Crisis in 2008. This was followed by a strong rebound in H2 2009, which saw investment turnover double compared to the first six months of the year.

However, the COVID-19 pandemic has severely impacted real estate market fundamentals while accelerating the structural shift in the way people work and shop. This will prompt investors to revisit the valuations and sector allocations of their real estate portfolios. Investment is therefore unlikely to return to pre-pandemic levels until late H1 2021.

INVESTMENT OPPORTUNITIES IN 2020

CBRE believes that in the post-pandemic market, investors must not only identify what type of asset to buy, they must carefully consider how to buy it. Potential strategies include the following:

Public to Private

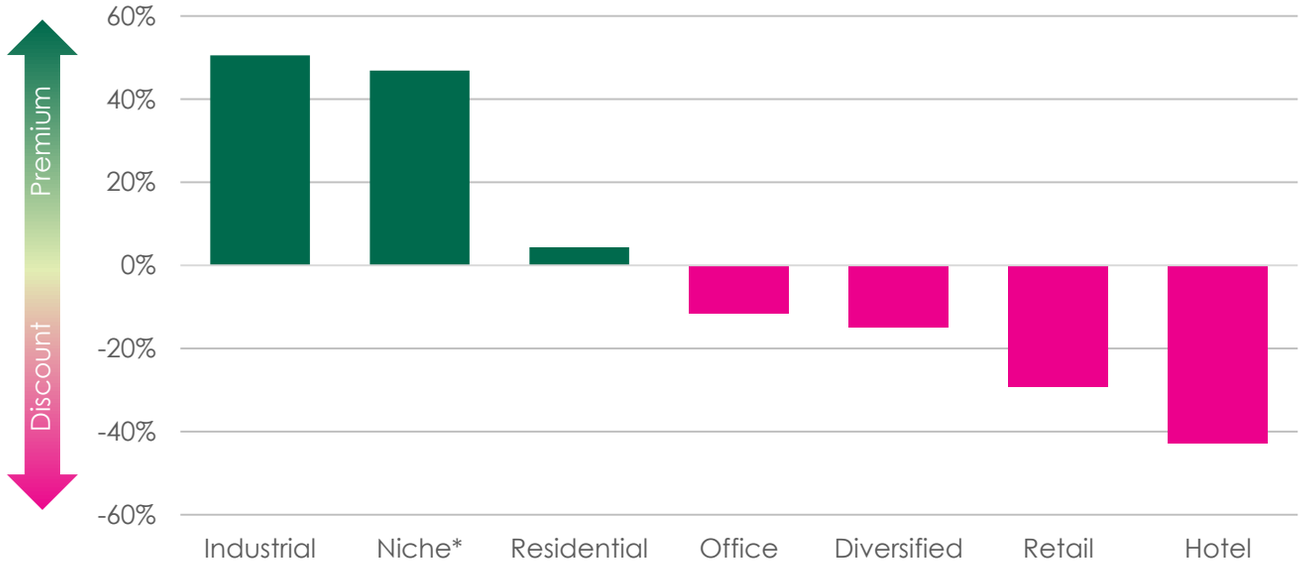
The escalating spread of COVID-19 triggered considerable stock market volatility, with the S&P Asia Pacific REIT Index falling -27% YTD as of 15 May 2020. In contrast, direct real estate asset prices have corrected by a much smaller magnitude, weakening by less than -10% in Q1 2020.

The significant fall in REITs' share price has seen many REITs trading at a discount to their Net Asset value (NAV). Some retail and hotel REITs listed in Australia, Japan and Singapore are trading at a NAV discount of 50% or more. Investors may consider platform acquisitions from entities wishing to realise NAV discounts.

While privatisation is another viable method to acquire underlying assets, investors must review ownership structures and their sponsor background as many REITs are controlled by cash-rich developers or local asset management companies.

Apart from privatisation, equity stake acquisition is another way to immediately access value resulting from the stock price correction. CBRE is already aware of several major players seeking value discounts. Recent examples include Blackstone's acquisition of a nearly 10% stake in Australian casino operator Crown Resorts, which also owns two major development projects in Sydney and Melbourne CBDs.

Figure 21: Weighted Average NAV Premium/Discount of Asia Pacific listed REITs^ by Sector



Note: * Niche includes data centres, healthcare, senior housing, self-storage, gas stations, agricultural and pubs.
^ The study covers REITs listed in Australia, New Zealand, Japan, Hong Kong and Singapore.
Source: Capital IQ, Company financial reports, CBRE Research, 15 May 2020.

INVESTMENT OPPORTUNITIES IN 2020 (CONT'D)

Real Estate Debt

With the Asia Pacific commercial real estate market already in the late phase of the upward cycle, the escalating pandemic has added to downward pressure on rents. As the weaker rental outlook is already affecting valuations, investors seeking greater downside protection may consider purchasing real estate debt. In Q1 2020, the average coupon rate of one to three-year US$ denominated corporate bonds issued by Chinese-listed developers ranged from 7% to 11%.

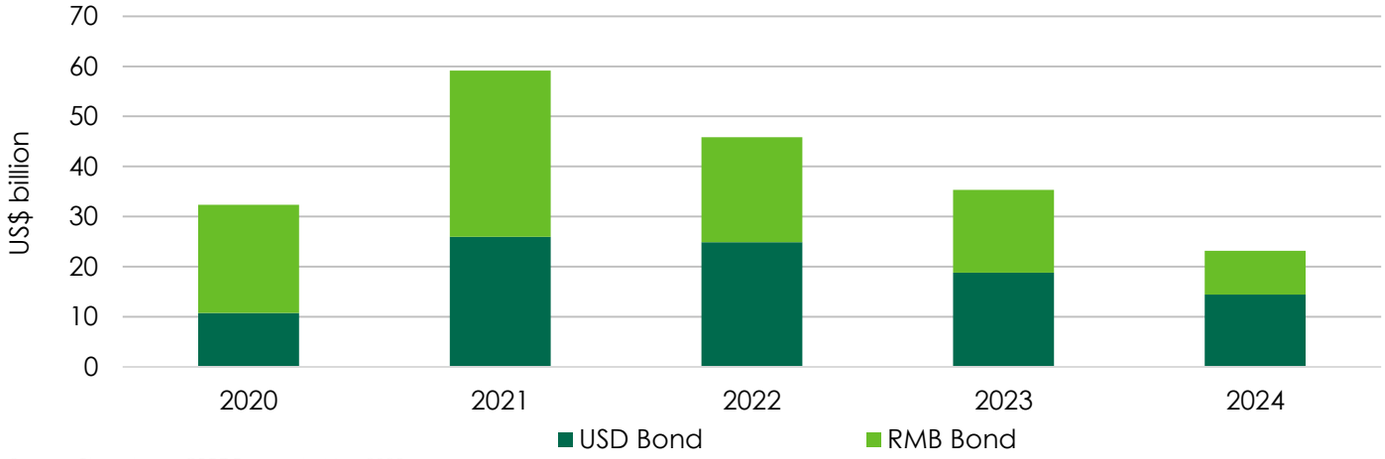
More conservative bank lending will reduce the proportion of senior lending in the capital stack. This will create room for mezzanine financing opportunities to expand debt portions. Korea may be a potential market for non-bank lenders as local saving companies have ceased providing mezzanine financing.

Although the People's Bank Of China has not pushed for deleveraging, listed Chinese developers remain under significant refinancing pressure. A total of US$137 billion in corporate bonds (comprising 45% US$ bonds and 55% RMB bonds) are due to be refinanced in the next three years. Non-bank lenders can also target small and medium sized developers to provide short-term financing or bridging loans until the residential sales market rebounds.

Sale and Leaseback Opportunities

Ongoing disruption to business activity has made it challenging for many businesses to maintain cash flow. This will encourage owner-occupiers to sell and then lease back properties to raise capital, creating opportunities for investors to acquire stable income-generating assets. CBRE sees prospects for investors to acquire properties from retailers and logistics operators in the air freight and forwarding industries; oil and gas companies; and the banking and finance sector.

Figure 22: Corporate Bonds Due for Repayment by Listed Chinese Developers in Mainland China and Hong Kong SAR



Source: Bloomberg, CBRE Research, May 2020.

WHAT'S NEXT

Figure 23: What's Next? – The Negatives, the Positives and the Unknowns

NEGATIVES

- Rent collection
- Closures pushing up vacancy
- Disruption to new supply

POSITIVES

- Gradual easing of lockdowns
- Resumption of business
- New best practices

UNKNOWNS

- Wide V-shaped recovery
- China-Plus-One supply chain
- Flexible working and omnichannel retail

Source: CBRE Research, May 2020.

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