COVID-19 OUTBREAK

POTENTIAL IMPACTS OF THE COVID-19 PANDEMIC ON COMMERCIAL REAL ESTATE IN ASIA PACIFIC

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KEY TAKEAWAYS:

1. There are differences in the likely severity and duration of the economic damage for different countries in Asia Pacific, but the views of economists are moving towards a consensus on the impact on global GDP.

2. Domestic consumption in China, through retail and travel, is expected to be hardest hit.

3. Wider Asia Pacific effects are likely to be seen through reduced regional tourism flows and supply chain disruption from mainland Chinese suppliers.

4. The Chinese government's strong response in addressing the spread of COVID-19, including a recent RMB 1.7 trillion injection into the economy and other possible future measures supports mid to long term market confidence.

5. China domestic retail expenditure, especially on travel, luxury retail, leisure and restaurants, will weaken in the near-term, but eCommerce may receive a boost.

6. Potential CRE impacts include:
   a. Reduced leasing and investment transaction activity in China for at least Q1 2020, although we expect property investment activity to recover in the medium-term;
   b. Immediate negative impact on short-term leasing and co-working activity;
   c. Prompt action by corporates is demonstrating strengthened business continuity planning (BCP) since SARS, the success of which may accelerate a move to more flexible working arrangements over the longer term;
   d. Lower outbound tourist numbers will negatively impact tourist expenditure and hotel occupancy across much of Asia Pacific;
   e. Hampered industrial production due to shutdowns and quarantine in mainland China and supply of components to global markets; and
   f. Potential benefits to logistics sector on the back of increased eCommerce.

EDITOR'S NOTES

The outbreak of the COVID-19 coronavirus has been devastating to all those affected, both in China and worldwide. Our thoughts go first to the victims, their families, and the health care workers battling the outbreak. The situation is shifting daily, bringing significant uncertainty. To help better understand the current and future impact on commercial real estate our Asia Pacific research team has assembled their initial guidance and analysis here. For your further questions please contact our research leads directly.

INTRODUCTION

The novel coronavirus outbreak, first reported from Wuhan city in Hubei province, central China, represents a new downside risk for the regional economy.

The first case of the coronavirus, now formally named COVID-19 by the World Health Organization, was reported on Dec. 31, 2019, and there have since been multiple developments with the virus and much speculation on the impacts. Here we take an objective view of the current situation and highlight potential impacts for the commercial real estate sector.

SITUATION REPORT

As at Feb. 17, 2020, there were more than 71,300 confirmed cases of COVID-19 infections worldwide, of which more than 70,500 cases were within mainland China.

New figures released on Feb. 13 had shown a huge spike in new cases in Hubei province, partly due to a broader definition with which to diagnose cases, and the death toll across mainland China is now more than 1,700 people. The global death toll from COVID-19 is now more than double that of the SARS epidemic of 2002-03, with many more times the number of people infected.

The surge of new cases has been a setback to the signs of hope that had been emerging. In prior days mathematical modeling had supported the views of experts that new infections could peak inside China in coming weeks, and there are hopes that warmer weather may help work towards containment. Four possible vaccines for COVID-19 are in development, although this is not a quick process.

For the global and Asia Pacific economies there have been immediate and highly apparent impacts. The importance of China today to economies and businesses worldwide has been placed in stark relief. Global supply chains have been disrupted, movements and meetings of people have been curtailed, and brick-and-mortar landlords and retailers, some barely clinging on in the face of changed consumer behavior and the unstoppable rise of eCommerce, have come under further pressure, perhaps terminally.

As always in moments of adversity, there is also opportunity. If there are no real winners, there are markets and businesses able to take advantage of the situation. Online shopping platforms have benefited, 'food at home' and delivery services are booming and supporting logistics space and services operators should see a lift. And, as core commercial real estate sectors such as retail and office see vacancies rise and rental rates fall, potential new entrants can setup and expand.

Governments and central banks have been mandated to respond to the emergency. The People's Bank of China has injected RMB 1.7 trillion into the economy, the Japanese government has announced a JPY13.2 trillion (US$120bn) package partly to strengthen resilience to natural disasters, the Singapore government is reported to be preparing a substantial package, and other administrations in the region are poised to act, either with rate cuts or stimulus measures.

Longer-term, we can expect that the fall-out from the pandemic may contribute to change and reshaping of business markets. Manufacturers and importers, already disrupted by U.S.-China trade tensions, will shift even more rapidly to secure a more diversified supplier base. Wellness and health and safety monitoring in buildings, such as HVAC and air filtration systems, will become a key competitive advantage. The healthcare sector and investment in healthcare overall should see renewed expansion. And systems and technologies to allow frictionless remote working and virtual team collaboration will become a corporate strategic priority.

ECONOMIC EFFECTS

Many observers and media have inevitably drawn a correlation between COVID-19 and the SARS (SARS-CoV) epidemic of 2002-03 to try to identify potential impacts, not least as the baseline events are similar.

However, the world in 2002-03 was very different to the world of today. The United States and its allies were soon to invade Iraq, the U.S. economy was in a fragile state, and China played a far lesser role in the world economy.

Initially, few economists were willing to venture firm views on the potential impact to global or national level GDP growth. However, as events have unfolded more estimates have been produced, with the consensus view that global GDP growth in 2020 will take a hit of approximately 0.2-0.3 percentage points. Impacts in China are likely to be larger, with consensus views ranging from approximately 0.4 percentage points to 1 percentage point.

In the case of SARS, China GDP fell by about two percentage points q-o-q in Q2 2003, but by the end of the year the negative effects had largely washed through the system due to a rebound in growth supported by pent-up demand.

Figure 1: Asia Pacific: Impact of COVID-19 on 2020 Real GDP Growth Forecast

Source: Oxford Economics

However, whether this forecast proves accurate or is even exceeded is dependent on the length of the outbreak and government fiscal response. Accordingly, many economists still believe it is too soon to assess the end impact. This view is supported by a recent Deloitte study which found that nearly 50% of CEOs surveyed are currently maintaining financial targets set for the year, and only 14% are lowering performance targets significantly.

Equities markets, being more liquid, responded rapidly and turned more risk-averse. Most selling activity occurred early in the week of Jan. 27, 2020, as investors sought safe haven assets such as gold and bonds. On that trading day the Dow Jones was down by 2.8%, the FTSE100 by 2.3%, and the Nikkei and All Ords by 2.0% and 1.5% respectively. As the news cycle continued and the virus spread further markets trended lower, with most reaching their low point at the start of February (Figure 2). However, since then a recovery has been in play as many markets have returned to levels prior to the sell off, with only the Hang Seng and Shanghai Stock Exchange trading lower. So far in particular this year, U.S. equity markets have proved resilient.

Figure 2: Major stock market closing prices in January, indexed to Dec. 31, 2019

110
108
106
104
102
100
98
96
94
92
90

31/12/2019 2/01/2020 4/01/2020 6/01/2020 8/01/2020 10/01/2020 12/01/2020 14/01/2021 16/01/2021 18/01/2021 20/01/2021 22/01/2021 24/01/2021 26/01/2022 28/01/2022 30/01/2022 1/02/2020 3/02/2020

Dow Jones FTSE 100 All Ords Nikkei

Source: S&P Dow Jones, FTSE, ASX, JPX

Within China, the lockdown of many cities, along with millions of residents unwilling to venture outdoors, will act as a brake on consumption as daily life is interrupted. This has included curtailment of lavish Chinese New Year expenditure, while extension of the new year holidays until Feb. 10, in an effort to contain the virus, has seen people away from work for longer. This will clearly have an impact on retail, leisure and tourism sectors.

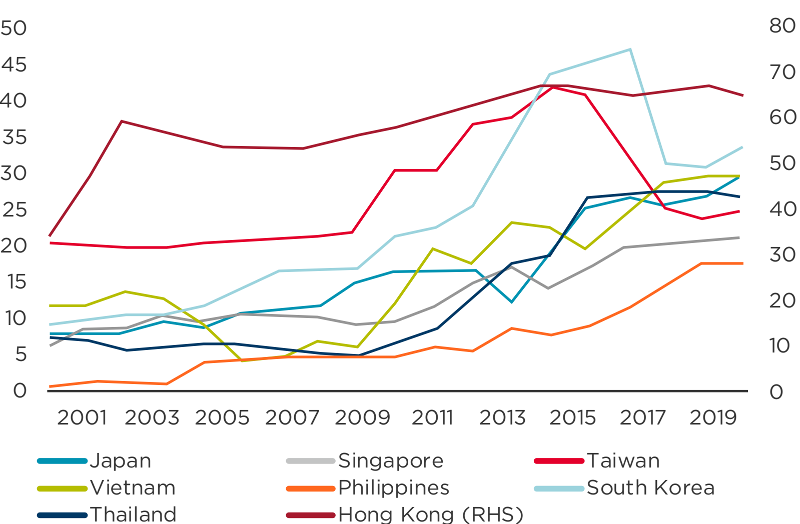
Impacts on industrial production are expected to be less than those on consumption. As an example, in Wuhan itself the authorities completed a new hospital in just 10 days.

Goods are also still being transported through China, although subject to quarantine zones. Despite this, demand for raw materials may be reduced, with negative effects spilling over to import partners and commodity producers.

It should not be forgotten, though, that the Chinese government is likely to prime the fiscal expenditure pump if any significant signs of weakness are seen. It has already injected RMB1.7 trillion into the economy and is poised to do more if needed. This should place a floor under any potential declines within the country and position it well for growth over the medium and long terms.

More widely, the travel ban imposed by the China government on outbound tour groups, coupled with restrictions on arrivals from mainland China implemented by countries both inside and outside of Asia Pacific are likely to have greater ramifications for the region. In 2018 there were almost 150 million Chinese international tourists – 38% higher than second-placed Germany at 108.5 million tourist visits. Within the Asia Pacific region, mainland Chinese tourists comprise around 40-50% of inbound arrivals in South Korea, Vietnam, Japan and Thailand; while they account for up to 65% in Hong Kong (excluding day visitors) (Figure 3). These figures are higher in absolute and relative terms than during the age of SARs, with tourists from China accounting for an ever-greater number and share of total tourism in the region.

Figure 3: Mainland Chinese arrivals as a proportion of total arrivals



Source: Tourism Economics, UNWTO

CRE EFFECTS

We have seen volatility in equity markets, a flight to safety in bond markets, and reviewed objective viewpoints on the manner, if not the scale, of economic impacts.

We now focus on commercial real estate. Again, it is important to note that while COVID-19 has added to the near-term downside risks, most concur that a majority of lost output will be gained back in future quarters. The overall longer-term fundamentals for the commercial real estate sector – positive economic growth, employment growth and robust relative value – all currently remain intact. There will be pain points, but they need to be viewed in context.

At the national level, we see impacts varying between countries. Unsurprisingly, commercial real estate is expected to be hardest hit in China, with negative effects rippling through all sectors. The extent of these impacts is highly dependent on the duration of the outbreak, though the retail, leisure and hotel sectors are likely to bear the brunt.

Regionally, the common theme is the decline in Chinese tourists across the region, which will negatively impact the tourism sector through decreased hotel occupancy and reduced tourism-related retail expenditure. Beyond this, impacts for countries across the region will be more nuanced, reflecting their individual economic ties to China.

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"It is important to note that notwithstanding the short-term impacts, the overall fundaments for the commercial real estate sector in the Asia Pacific region remain intact."

IMPACT OF COVID-19
on commercial real estate in Asia Pacific:

OFFICE:

TRANSACTION ACTIVITY IN CHINESE CITIES IS LIKELY TO BE CURTAILED IN THE NEAR TERM.

RETAIL:

CHINESE RETAILERS ARE LIKELY TO BE **HARDEST HIT**

ESPECIALLY TRAVEL, RESTAURANTS LUXURY GOODS AND LEISURE ACTIVITIES

LOCKDOWNS MAY PROVIDE A **BOOST** TO **E-COMMERCE IN CHINA**

TOURISM:

DOMESTIC AND INTERNATIONAL TOURISM **NUMBERS WILL BE DOWN**

CHINA IS RESPONSIBLE **for up to** 60% OF INBOUND TOURISM FOR **ASIA PACIFIC** COUNTRIES

LUXURY RETAIL AND HOTEL OCCUPANCY **MOST AFFECTED**

INDUSTRIAL:

IMPACT RELIANT ON **QUARANTINE PERIODS**

WORK CANNOT BE UNDERTAKEN REMOTELY AS IN OFFICE SECTOR

UPSIDE

POTENTIAL E-COMMERCE COULD BOOST **LOGISTICS SECTOR**

KEY MARKET OVERVIEWS

MAINLAND CHINA

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"The coronavirus outbreak will hit China's economy hard in the short-term, but we can hope that it will only impact the first half of 2020."

The epicenter of the COVID-19 outbreak is Hubei province in central China, accounting for approximately 80% of confirmed cases in mainland China at the time of writing. However, as the extended Chinese New Year holiday ends, and workers return to work, we might see an uptick in confirmed cases in major cities in other areas around the country.

Compared with the SARS (SARS-CoV) epidemic of 2002-03, which was mainly concentrated in Beijing, Guangdong province and Hong Kong, the COVID-19 outbreak is wider, with every province in mainland China recording cases. However, the data so far show that it is less deadly.

In the context of the overall economic impact, in 2003 Beijing and Guangdong accounted for 15.2% of China's GDP. In 2019, Hubei province accounted for just 4.6% of the nation's GDP.

However, in the short-term, COVID-19 will hit the economy harder than SARS. Given the more developed transportation network, government controls to contain the outbreak have been harsher, and these restraints have brought offline retail sales to a virtual standstill, which will further impact GDP in the short term.

Apart from the provincial capital city Wuhan, 11 prefectural cities and three county-level cities in Hubei province are now in a state of lock-down, and many more cities around the country face travel restrictions to varying degrees.

The SARS outbreak had only a short-term negative impact on China's economy, with consumer spending and GDP growth bouncing back after the outbreak. This time, with a faster and stronger response from the government, it is widely anticipated that the COVID-19 outbreak may only negatively impact the Chinese economy during the first half of 2020.

The potential damage to the economy is clearly now in focus for the Chinese government. In recent days senior leadership led by President Xi Jinping have called for the response to the emergency to shift to resuming economic activity, and local and provincial governments can already be seen to be responding, reports Oxford Economics.

The government has also come out with a series of focused fiscal and monetary policies to mitigate the economic damage. On the fiscal side these policies include tax concessions for companies that are directly affected by the COVID-19 outbreak, such as tourism and catering. Firms that produce medical supplies and medicines are also exempted from taxes and can obtain subsidies from the government. On the monetary side, apart from

the already mentioned injection of RMB 1.7 trillion, the People's Bank of China has established a RMB 300 billion special re-lending fund, which will be lent to selected companies at a rate of no more than 3.15%; 100 bps below the Loan Prime Rate, which is now at 4.15%.

As to the office market, near-term demand will be restrained until COVID-19 is contained. Domestic and foreign firms alike will be prudent in relocation or expansion activities, while small and medium-sized enterprises are likely to experience higher financial liquidity risks, further dampening the market. However, local governments are offering tax breaks and policy support to help companies weather the storm.

These measures will certainly help, but given underlying office market dynamics in mainland China, with total Grade A office supply for the region in 2019 amounting to 5 million sq m and total demand for Grade A office (in the form of net absorption) registering 2.6 million sq m during the same time period, prime office vacancy in many city markets has risen. What's more, further supply is on the horizon. This will place further pressure on landlords but could prove to be an opportunity for those occupiers looking to lock in leasing deals at attractive rentals in 2020.

Slower growth, weaker earnings and soft demand will also cause scheduled completions to be postponed. Rent levels are also likely to come under increased pressure as leasing activity is curtailed and if pricing remains the same, yield compression could well follow.

Short-term leasing activity and the co-working sector will likely be hardest hit, given significantly reduced desire for staff to congregate and interact face-to-face in one location, and the fact that the leasing or licensing arrangements around these may make it simpler for occupiers to exercise the flexibility of these agreements, and reduce or cancel their commitments. Nevertheless, we do not anticipate this will undermine the significance of the flexible workplace as an occupier strategy over the longer term, and it is exactly this flexibility that will prove attractive when making new leasing decisions.

It is worth noting in the longer-term the COVID-19 outbreak may drive new demand for space from expansion by healthcare, eCommerce and logistics related companies.

Ahead, we expect landlords and tenants to place greater emphasis on wellbeing and smarter workplaces, with factors such as intelligent building management, wellbeing and safety management key to enhanced office property competitiveness.

The retail market will also be impacted in the short-term, particularly the F&B, entertainment and service sectors. The authorities' emergency responses have included cancelling gatherings, extending the Chinese New Year holiday period, and closing public places such as bars and cinemas. Retailers have also shortened business hours or closed premises. Subsequently, landlords have reduced rents or offered rent free periods. Retailers with online channels have fared better, and business has increased significantly for fresh supermarkets and food delivery services.

In the short- to medium-term the retail outlook will remain cloudy, and we can expect overall vacancy rates to rise and average rentals to continue to fall off until the outbreak is contained and concluded.

As for the industrial market, the short-term impact on exports has included greater time and costs for entry-exit inspection and product quarantines. Many factories have halted production, damaging exports and therefore imports and production activity in importing nations. Measures to mitigate the outbreak will influence logistics activities in the short-term. Bonded warehouses may suffer from the export decline, although Grade A facilities in some mainland markets should see less impact given high demand and limited supply.

Finally, for investment, with business activity curtailed, we may see a slowdown in property investment activity in the short term. However, given the government's recent liquidity injection into the economy and other possible future measures, we expect to see property investment activity recover in the medium-term. And in the longer term, mainland China will continue to remain a favored destination for investors.

HONG KONG

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"The COVID-19 outbreak deals a second blow to Hong Kong's property market, already weakened from the social unrest in 2019, with most sectors to remain under pressure over the near-term."

The onset of the novel coronavirus (COVID-19) in early 2020 has come at a challenging time for Hong Kong. The economy is still reeling from the social unrest that swept the territory in the second half of 2019 and visitor arrivals remain well off their peak levels reached early last year.

As a result, Hong Kong's hotel and retail sectors have already been hit particularly hard, while the office market has come under increased pressure from depressed occupier demand in the face of uncertainty. Turning the corner into 2020, the outlook for the year was cautiously optimistic, buoyed by a recent reduction in U.S.-China trade tensions and a fragile calm returning after the escalating unrest in the second half of last year. The COVID-19 outbreak has threatened that outlook, forestalling any possibility of a near-term economic recovery.

The Hong Kong government has moved to enact several measures in recent weeks to contain the outbreak. Among them, key actions taken include:

- Restricting access to Hong Kong by residents of Hubei and individuals who have visited the province in the past 14 days;
- Temporary suspension of all tour groups and issuance of new visas for individual mainland Chinese visitors;
- Closing most border checkpoints between Hong Kong and mainland China, with only the Shenzhen Bay Port, Hong Kong-Zhuhai-Macao Bridge, and Hong Kong International Airport remaining open;
- Reduction of flights between Hong Kong and mainland China by approximately 50%; and
- Mandatory 14-day quarantine on all travelers coming from mainland China.

Through a combination of such measures, and the fact that the outbreak epicenter in Wuhan city is nearly 1,000 km from Hong Kong, reported cases of the virus to date in the territory remain moderate, numbering 57 as of Feb. 17. That is a significant contrast with SARS in 2002-03, during which 1,755 cases were reported in Hong Kong. As a result, while many countries have introduced bans on visitors from mainland China, most currently do not include those from Hong Kong. Similarly, most airlines have continued to provide service to the territory even as they have suspended connections to mainland Chinese cities. However, that may change, as some have now begun cutting services, citing weakened demand.

Comparisons to SARS are inevitable, and in terms of sectors affected the impact is expected to be similar, with hotels and retail bearing the brunt as tourism and local consumption both see sharp declines. However, this time the impact on the two sectors has the potential to be even more severe given how much Hong Kong has changed in the 17 years since SARS.

Over that period, visitors to Hong Kong from mainland China have increased exponentially. In 2002, visitors from mainland China totaled 6.8 million. In 2019, even after a sharp drop in tourism due to the social unrest, that figure had jumped to 43.8 million, representing nearly 80% of all visitors to the territory. At the same time, as incomes in mainland China have risen so has spending in Hong Kong. Average per capita spending by mainland tourists to Hong Kong has climbed from HK$5,639 in 2002 to HK$7,029 in 2018.

In the near-term, Hong Kong's retail sector will be hardest hit by the coronavirus outbreak, suffering from both a steep drop in tourism and declining shopping activity by locals seeking to avoid large crowds. Already severely impacted by the social unrest in recent months, retail sales in Q4 2019 plunged 22.4% y-o-y, the steepest drop on record. At the same time, average rents in the city's leading retail hub, Causeway Bay, fell by 14.9% in the second half of 2019 and were already forecasted to come under continued pressure through the first half of 2020. The current situation is likely to exacerbate that, leading to potential closures of some shops and F&B establishments, especially in core areas. Meanwhile, some major landlords of shopping malls in Hong Kong have temporarily lowered base rents by as much as 50-60% to support tenants struggling from the impacts of the virus. On the other hand, some F&B establishments in and around residential communities have reported good business, arising from some companies' work from home policies introduced in recent weeks.

The hotel sector will also remain under severe pressure in the first quarter as tourist arrivals see a sharp decline. Suffering from declining tourism in the second half of 2019, overall occupancy levels fell to a decade low of 61% in December 2019. Meanwhile, achieved room rates in December averaged HK$1,052, a y-o-y decline of 33.3%. As a result of the outbreak, occupancy levels and revenues per available room (RevPAR) are expected to drop further, increasing pressure on hotel operators.

The impact on the office market is expected to be less severe, but the outbreak does contribute to a continued sense of uncertainty that has led to muted demand in recent months. Many occupiers will likely continue to postpone major relocation decisions in the near-term as they address the more immediate impacts to their business from the outbreak.

The near-term outlook remains extremely fluid and uncertain as new cases of COVID-19 are reported. However, the experience of SARS does hold one important lesson: the impacts are likely to be short-lived. By August of 2003, both tourism and retail sales had rebounded to their pre-SARS levels, with office demand also picking up sharply in the second half of the year.

SINGAPORE

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"The disruption to market activity from the COVID-19 outbreak is expected to be relatively short-lived – even though the near-term impact may be relatively damaging – primarily due to the country's sound economic fundamentals."

Based on our current assessment, the economic impact of the novel coronavirus (COVID-19) outbreak is expected to be relatively short-lived (no more than two quarters), primarily due to the country's sound economic fundamentals. However, in the near-term the impact may be relatively damaging, with ripple and contagion effects posing potentially significant downside risk.

The Singapore government has implemented multiple lines of defense to help minimize the spread of the virus. However, with the latest GDP figures revised downward, the economy is expected to take a hit from the disruption of businesses. The most immediate impact will be mostly felt in the hospitality, retail and F&B sectors, with less effect on the office and industrial sectors. The government is planning to roll out a number of relief measures for businesses, expected to be announced in its annual Budget statement. Despite this, in the longer-term view the country's economic fundamentals remain robust.

Corporations may delay decision-making in Q1 2020 as they focus on tactical issues around operations in China. This is expected to impact activity in Q1, against the backdrop of an office leasing market already grappling with a slowdown arising from the U.S.-China trade war.

But fundamentally, Singapore is an international city with worldwide business links and has diversified its demand base of global occupiers over the years. Logistics supporting the eCommerce sector continue to present tremendous potential for Singapore and the neighboring markets of Indonesia, Thailand, Vietnam and the Philippines, even as supply chains are being disrupted.

The impact on the hospitality sector is more immediate. With millions in China under lockdown and restrictions on travelers from China, tourist arrivals, especially from mainland China are expected to slow in 1H 2020. Given that Chinese tourists make up about 20% of Singapore's international visitors, with about 3.6 million visitors in 2019, overall hotel revenue per available room (RevPAR) is expected to come

under downward pressure in the first half.

The slowdown in tourist arrivals will result in a decline in shopping spend, particularly among retailers and destinations which cater to mainland Chinese tourists. Tourists from China were the top spenders in the first half of 2019, spending close to S$2 billion on shopping, accommodation, F&B and so forth, with 51% on shopping alone. Consequently, leading tourist shopping destinations such as Marina Bay Sands and Orchard Road could be impacted if the outbreak and the travel ban persist.

However, landlords of major shopping centers are not yet under pressure to lower rents, especially if the overall situation improves in the next few weeks. Well-managed shopping centers also typically have sufficient potential tenants to take up any vacancy that becomes available. If the virus can be contained and it does not spread uncontrollably through the community the temporary decline in footfall at malls should recover over a short period of time.

Liquidity is still plentiful and investors continue to search for yield in the real estate sector. We expect that well-managed and well-located office and industrial assets will remain attractive to investors and occupiers who, typically take a medium- to long-term view when they purchase or lease these properties.

Following the COVID-19 outbreak, the medium-term outlook for the hospitality market is favorable, given the narrow hotel supply pipeline over the next few years and healthy visitor arrival estimates. A slew of new tourist initiatives and developments are expected to raise the appeal of Singapore as a regional tourist destination in Southeast Asia over the long term. These include continued investment in Singapore's aviation infrastructure (Changi Airport Terminal 5), and tourism attractions and developments such as the Mandai eco-tourism hub, Jurong Lake District, Sentosa redevelopment and AEI (asset enhancement initiatives) works at the two integrated resorts.

In the private residential sector, we expect some impact to the market in the near-term, but this will be transient as the fundamentals are strong. Some buyers may choose to stay away from show flats or to delay purchase decisions. Buyer sentiment is expected to be more cautious until the situation improves, which could potentially be in 2H2020. Nonetheless, underlying demand in the private residential market should remain solid and with pent-up demand accumulating, the market could potentially see a surge of transactions in 2H2020, post COVID-19 outbreak.

For your questions on the implications of the COVID-19 outbreak on markets in Indonesia, Vietnam and the Philippines, please contact Christine Li.

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"Japan's tourism and retail sectors are braced for impact from the COVID-19 outbreak, with visitor numbers hit hard."

The COVID-19 outbreak is predicted to exert a similar, though greater, pressure on Japan's economy than did the SARS epidemic of 2002-03. Japan is economically more deeply dependent on China today than in 2002-03, and the lockdown of Wuhan city and extension of the Chinese New Year holiday have already resulted in Japanese manufacturer factory closures.

Consumer product supply chains have been impacted, and trade performance is likely to worsen. Like other global players, Japanese retailers are temporarily closing their stores in China, and the outbreak has impacted directly on the Japanese economy by a fall in visitors to Japan during the Chinese New Year travel season. The country faces big challenges to manage the impacts, and from a real estate perspective, there are implications for different sectors.

The hotel sector will be the most impacted in Japan's real estate market. The inbound tourism market has been growing under the Promotion of Japan as a Tourism-Oriented Country policy, and total gross floor area of lodging facility construction starts has increased fivefold from 2011 to 2018. Even with the substantial new supply entering the market the occupancy rate has remained high, backed by the rapid expansion in inbound tourism numbers.

However, the situation is changing as the coronavirus outbreak continues, and the government's tourism targets are now faced with a major challenge.

China, the greatest source of inbound visitors to Japan at nearly 30% of the total, banned group international travel at the beginning of the Chinese New Year travel season. Around 26% of Chinese tourists to Japan arrived in group tours in 2019. If we assume a 26% decrease in tourists from China and a 2% drop in tourists from other Asian nations until the end of March, there will be a loss of 489,000 inbound tourists. If the virus proliferation spread cannot be checked promptly, then tourism from China may be cut by a half, with a 10% drop from other Asian nations and a 5% drop from non-Asian, until the end of March. In this scenario tourist losses will rise to 1.2 million. And in the worst-case scenario the impact may last to the end of May, which leads to a 2.9 million loss of inbound visitors. These scenarios do not factor in the possibility of local coronavirus outbreaks inside Japan.

The government's target of 40 million inbound visitors in 2020 now looks very demanding. Inbound visitor growth has already slowed in 2019, with travelers from South Korea, the second largest origin point, plunging by 25% in response to the Japan-South Korea trade disputes. Now, the gap of eight million tourists between the 2019 figure and the target for 2020 is widening further with the coronavirus outbreak. We expect investment in hotels and

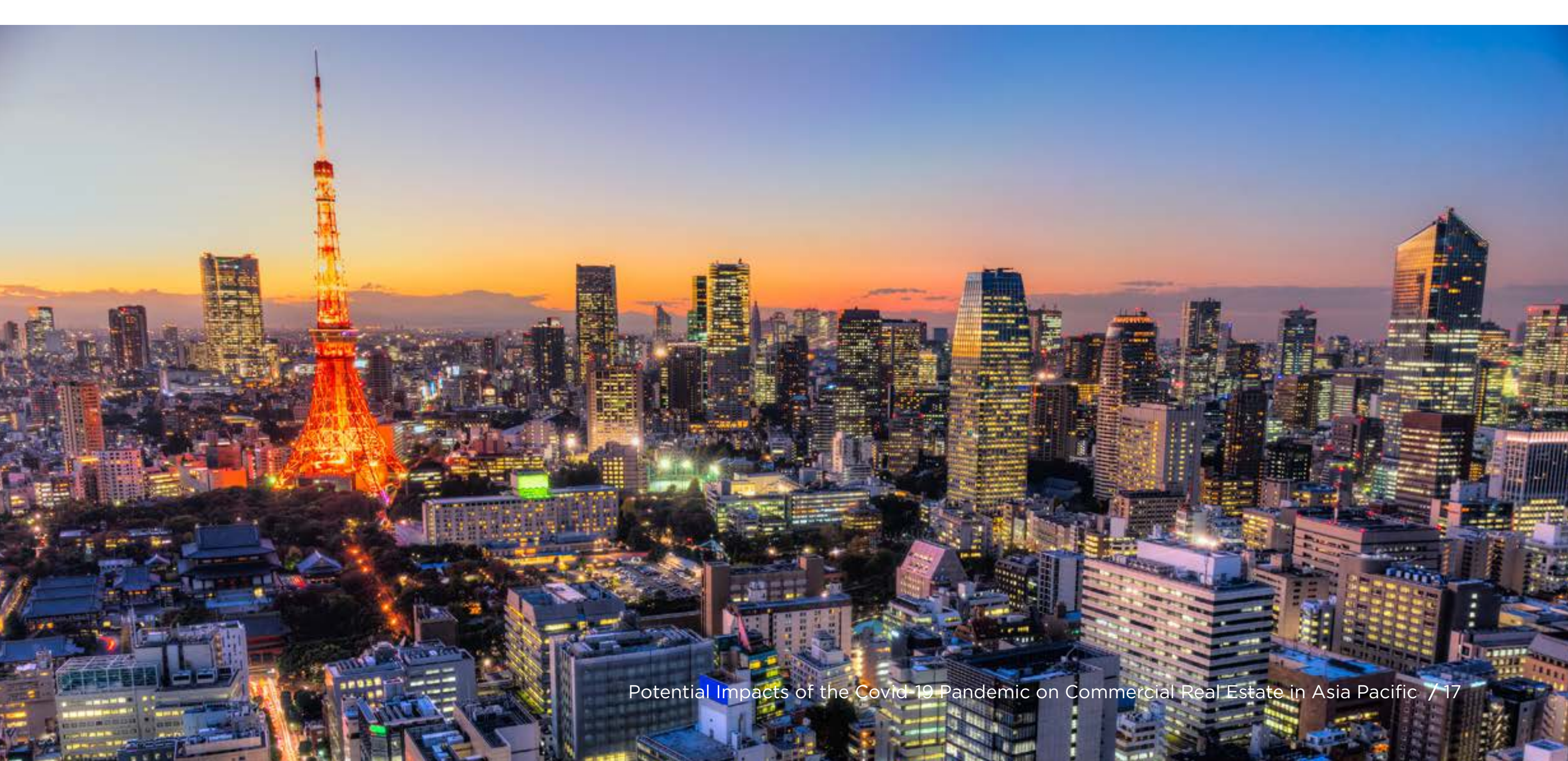
hotel development projects to slow before investors have a clearer picture of the market.

The retail sector is also braced for impact from the COVID-19 outbreak. Visitors from China had the largest expenditure among all tourist groups in 2019, with preliminary figures indicating a value of 1.8 trillion yen, or 37% of total tourism spending. Average spending on shopping by Chinese tourists exceeds 100,000 yen per person, slightly more than twice the overall average. Hence, a fall in Chinese tourist numbers will significantly impact the retail sector, especially on department stores and prime retail streets. (In contrast, South Korean tourists come in last in the list of average shopping spending.)

The ban on group tours from China has hit retailers hard as they aimed at a recovery over the Chinese New Year sales season. The consumption tax hike has already helped push retail sales down from the prior year and so, counting on the inbound spending which reached a record high last year, the tour group ban has come as a great disappointment to the sector. Some department stores have already revealed a decline in sales over the Chinese New Year season.

In terms of tourism destinations Osaka has enjoyed a boom in the past few years. The Shinsaibashi shopping district, known as the shoppers' paradise for visitors, has enjoyed probably the biggest benefit. A sharp increase in inbound visitor numbers and their spending has improved the profitability of high-street retailers, and the district has experienced a significant boost in demand for space. Drug stores have also been a major demand driver as Asian tourists, especially those from China, covet Japanese drugs, cosmetics, and beauty goods. However, while face masks, disinfectants and certain medications are greatly in demand amid the coronavirus outbreak, drug store sales have dropped this year as the high-spending tourists have not been present. We can expect the retail real estate market to experience a cool-down if the spread of the outbreak persists.

In the office sector, the outbreak is contributing to an acceleration of working style reform in Japan ahead of the Summer Olympics games. The promotion of flexible working is included in Abenomics policies, with legislation passed in 2018 aiming at reducing excessive working hours and making work more adjustable and diversified. Flextime and working from home are some examples of these reforms and have been implemented by some companies as a precautionary measure against a local outbreak. If the policy runs smoothly, these temporary measures may become permanent and initiate a change in working styles in Japan. Multinational companies are also promptly reacting to this event to protect their staffs based on experience from the past SARS/MERS spreads.



SOUTH KOREA

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"Concerns are mounting for offline retailers in the face of reduced footfall, as well as the office market."

The COVID-19 outbreak is a blow to South Korea's economy, with disruption to supply chains, reduced export activity and weakened consumer sentiment creating near-term impact on growth prospects. As a result, expectations for GDP growth for 2020 have been downgraded from 2.0% to 1.8% (Oxford Economics).

The bricks-and-mortar retail market has been hit hard, with reduced footfall at malls as people refrain from going out and growing alternative consumption through online channels. Consequently, concerns are mounting over vacancy in the offline retail sector. As well, some department stores and large discount stores, visited by confirmed carriers of the coronavirus, have been mandated to close temporarily. Duty-free stores in particular are expected to see a sharp drop in sales, due to a significant decline in footfall of visitors from China, who account for a large portion of duty-free sales

Hospitality and tourism industries are also under direct fire. Hotel reservations are plummeting due to guest cancellations and a general unwillingness to venture out. Currently, the cancellation rate at major hotels in Seoul is reportedly close to 15%. But a bigger concern is the sharp drop in future reservations. In particular, Jeju Island, which has seen a number of confirmed cases of the coronavirus, has been hit with a series of domestic tourist cancellations, with reservations by Koreans in Seogwipo plunging 30% y-o-y in the February-March period.

In terms of the investment market, REITs, considered a leading safe asset, could be negatively impacted if portfolio properties are mandated to undergo quarantine. The Korean stock market is also reacting in line with other global markets to COVID-19.

The Korea Economic Research Institute has forecast that if COVID-19 proliferates in the same way as the MERS epidemic in 2015, then the number of foreigners visiting Korea will drop by 1.65 million and tourism revenue will lose 4.6 trillion won.

Job seekers in at-risk industries are declining significantly: by 45,500 in wholesale and retail services, 15,800 in lodging services and 15,000 in restaurants and bars. However, If COVID-19 remains in circulation for nine months, as in the SARS epidemic, and tourism revenue drops more than 17.2% then then the number of job-seekers in the tourism industry is estimated to reach 55,600.

AUSTRALIA

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"The international COVID-19 outbreak comes on top of devastating bushfires in Australia and lands another blow on business and consumer confidence."

China is a significant trading partner of Australia. In 2018, 34% (A$118bn) of Australia's exports went to China and 24% (A$75bn) of imports were sourced from there. Service exports were also significant (A$18bn) in 2018, with education-related travel from China contributing A$12bn and personal travel (excluding education) A$4bn. The COVID-19 coronavirus outbreak has the potential to disrupt this trade, slow Australian's economy and to impact commercial real estate in a number of ways.

The tourism and education sectors will both suffer from travel restrictions stemming from the outbreak. China is Australia's largest source of short-term visitors. Around 1.5 million tourists from China visited Australia (the largest source, at 15.4% of total visitors) in the twelve months from December 2018 to November 2019, spending an estimated A$1bn per month. This equates to 0.6% of GDP over 12 months. And in the education sector, with universities, English-language colleges and schools reportedly expecting the arrival of 200,000 Chinese students this year, the potential loss is estimated at A$8bn.

In Australia's commodity driven markets, such as Perth and Brisbane, demand for office and industrial space may soften. Mining constitutes nearly 9% of GDP, and a slow-down in commodity exports may hinder miners and support industries, prompting delays in business decision-making. It is notable that mining represents around 18% of white-collar employment in Perth's CBD and 5% in Brisbane's CBD.

In the industrial sector, slower retail conditions have resulted in falling container volumes at Sydney's Port Botany, and this is reportedly already being felt in reduced demand for industrial space. If volumes fall further due to restricted output from China or reduced consumer demand from weaker sentiment, demand for industrial space may fall further, at least in the short-term.

There are also reports that reduced output in China may be affecting the supply of some building materials, and this may have a knock-on effect in construction activity.

In the investment market, mainland China was one of the top five sources of foreign capital for commercial real estate transactions in 2019, with Hong Kong the second largest source. Investors from China deployed significant capital with 21 purchases valued around A$2.0 billion and 15 sales at about A$1.2 billion. The coronavirus outbreak has clear potential to curtail travel and investment decision-making.

Finally, on top of the recent devastating bushfires, the virus outbreak and consequent potential slowing of economic activity may further deter business and consumer sentiment. The National Australia Bank business confidence index for December 2019 dropped 2 points to -2, the lowest level since July 2013. Consumer sentiment in January fell to 93.4, however, the decline mainly reflected the impact of the bushfires. If the weak sentiment continues, it may slow decisions for a wider range of businesses, and prompt consumers to reduce spending and increase savings.

INDIA

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"We do not anticipate a major impact from the COVID-19 outbreak on India's real estate markets."

Currently we do not anticipate an immediate major impact from the COVID-19 outbreak on India's real estate markets. We would view the situation in the context of it potentially being a precursor to a global slowdown which, if precipitated, may exert downward pressure on Indian real estate markets not unlike other major global markets.

India's commercial markets remain on a strong path even as the events around the COVID-19 coronavirus outbreak in China are unfolding. The country's office markets are largely driven by the services sector, which in turn is linked closely to the U.S. economy. With the U.S. economy remaining growth-oriented and India's services sector showing positive growth, property markets in India have remained strong over the past two years.

India's manufacturing sector is also largely driven by domestic demand. However, manufacturing does have significant supply-chain linkages to China, especially in component sourcing in the automotive and electronics sectors. This is likely to impact production targets, while supply chain disruptions may lead to increased costs when sourcing from alternative locations. Based on assessments of the likely duration of disruption before a return to normal, certain industries such as textiles, ceramics, engineering goods and chemicals may see a boost in export demand. A very significant shift is unlikely, but short-term gains for India may be consolidated over the medium to long-term as an alternative sourcing destination.

Real estate markets in India are not closely linked to China, nor is demand arising out of China yet significant. The entry of Chinese companies into India is still a relatively new trend and they are not yet big contributors to commercial real estate markets across most asset classes.

To date there has been no widespread outbreak of the coronavirus in India and very limited cases have been reported. While there may be regional disruptions for global firms in their Asia Pacific business from a business continuity perspective, the situation is still an evolving one.

For Indian commercial property markets, which remain driven by domestic sentiment and are linked more closely to the U.S. economic outlook and U.S. presidential elections in November 2020, we think it is currently premature to draw more extensive conclusions on the possible COVID-19 impact.

CONCLUSION

THIS TIME IS DIFFERENT

Many observers are drawing comparisons between the potential impact from the COVID-19 outbreak and the consequences of the SARS epidemic of 2002-03.

However, China is clearly more economically assertive and influential in global and Asia Pacific markets today than it was 17 years ago. In 2003 China contributed 4% to the world's GDP. Today that figure is around 16%, and disruption to the Chinese economy has global repercussions.

Within China, the impact of the COVID-19 outbreak is clearly visible. From the epicenter of Hubei province and around, eerie images of deserted streets and life at a standstill for millions of citizens in lock-down locations are now commonplace. With the virus active in all provinces, the cost of containment via mitigation measures is slowing economic activity and productivity throughout the country. Transport links are reduced or suspended, work-from-home directions are in place, bars and cinemas are closed and other retailers are cutting business hours or temporarily closing stores altogether.

Across Asia Pacific, aside from the terrible human cost, vital tourism and retail markets are most at risk of serious damage, at least in the short-term. Inbound tourists from mainland China have grown exponentially over the last 17 years, and the growing restrictions on their travel now materializing are hitting high-streets in the region.

The Asia Pacific hotel sector is also suffering, with guests from mainland China accounting for the largest group both in numbers and in spending. Although the industry has learnt lessons from past epidemics and the knock-on effects on travel, the sheer momentum in growth of visitors from China in recent years has led to increasingly mainland-focused business strategies and value propositions, an over-reliance that could now prove a tipping point. At tourist destinations across the region, downwards adjustments in revenue per available room (RevPAR) already have the potential to exceed those of the SARS epidemic, given the increase in hotel stocks since then.

We can expect to see investment activity in the retail and hospitality sectors to slow across the Asia Pacific region until the COVID-19 outbreak eases. However, we do not expect major price adjustments given recent reweighting of international real estate investment capital to Asia Pacific markets, and the number of opportunistic players that are active currently.

Some may argue that the COVID-19 outbreak represents a black swan event for real estate markets in the region. However, this may have been more accurately reflected by the SARS emergency, when firms and office workers were significantly less well prepared to respond. The lessons learnt from SARS led to strengthened corporate risk management, incorporating backup plans and remote working options as part of BCP efforts.

Today, forward-thinking corporations recognize the importance of incorporating flexible and remote working into employee value propositions in order to attract Millennials and Generation Z to their workforces, and advancements in office task digitalization over the last decade have supported this.

In the face of COVID-19, firms have largely demonstrated prompt BCP action, with timely decision-making and close monitoring of a highly fluid situation helping to stabilize the business environment and, we hope, auguring for an eventual full recovery from a traumatic episode.

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Potential Impacts of the Covid-19 Pandemic on Commercial Real Estate in Asia Pacific has been compiled by the Cushman & Wakefield Asia Pacific research team on the status of the outbreak as of Feb. 18, 2020.

This report was edited by Simon Graham, Research Editor, Asia Pacific.

Cushman & Wakefield (NYSE: CWK) is a leading global real estate services firm that delivers exceptional value for real estate occupiers and owners. Cushman & Wakefield is among the largest real estate services firms with approximately 51,000 employees in 400 offices and 70 countries. In 2018, the firm had revenue of $8.2 billion across core services of property, facilities and project management, leasing, capital markets, valuation and other services. To learn more, visit www.cushmanwakefield.com or follow @CushWake on Twitter.

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