COVID-19: IMPACT ON APAC OCCUPIER PROPERTY MARKETS

Options for Uncertain Times

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Summary & Recommendations

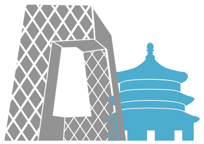
Colliers currently assumes that APAC markets will recover from COVID-19 in H2 2020. We show below our outlook for office occupiers in the region:

- **China.** Occupiers in sectors little affected by the virus should agree longer-term leases. Others must reinforce landlord relationships.
- **Hong Kong SAR[1].** Enterprising occupiers can negotiate better deals with responsive landlords in H1 2020.
- **Singapore.** Occupiers should rationalise space needs and adopt new technology. We advise flex-and-core strategy or split office locations.
- **Japan.** The Tokyo market still favours landlords. Tenants should lock in options soon.
- **Australia.** Impact levels rising. We are seeing delays in decision making. Strong demand for contingency work from home plans.[2]

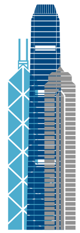
The World Health Organisation has recently stated that the outbreak of COVID-19 (coronavirus) has peaked in China. For now, following general market expectations and the lessons from SARS in 2003, Colliers assumes that COVID-19 peaks across Asia Pacific in H1 2020, with a recovery in H2, although the spread of the virus beyond Asia raises the possibility of longer-term disruption.

What does a scenario of market downturn in H1 and pick-up in H2 imply for office occupiers in Asia Pacific?

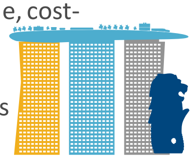
In **China**, whereas landlords are generally more positive, many occupiers are already seeing a decline in business from COVID-19. However, certain sectors such as online shopping, online education, online gaming, pharmaceuticals and healthcare are little affected, or may even be achieving sales increases. Occupiers in these sectors can negotiate better deals. We think landlords should appeal to these sectors and adjust their tenant mix.



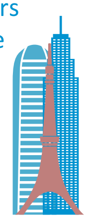
Hong Kong is going through a sharp downturn. However, falling rents and the prospect of a sharp recovery in sentiment in H2 suggest that now is a good time for growth sectors to expand at lower rental costs. Although in many Asian cities Colliers recommends decentralisation, in Hong Kong we are now tactically advising large tenants to reconsider Central, where vacancy rates have risen and rents are falling.



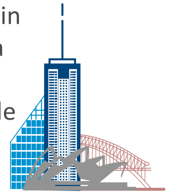
Singapore has seen modest impact from COVID-19, although occupiers have introduced work-from-home and split operation arrangements, while major events have also been cancelled. We expect occupiers to take a long-term view of their accommodation and focus on accelerated technology adoption, wellness certified buildings as well as flex-and-core™ strategy or split office locations. In the meantime, cost-conscious occupiers can find prime/Grade A bargains in the city fringes in preference to the CBD.



The impact of COVID-19 has been limited so far in **Japan**, particularly in the office market. In the meantime, Tokyo and other cities across the country are experiencing low vacancy rates and increasing office rents. As a result, occupiers should lock in space given the strong outlook for the market over 2020 and 2021.



Australia is still seen as a clean, health-conscious country with a world-leading healthcare system. COVID-19 has had minimal impact on the occupier market so far. Given the global uncertainty, some occupiers in affected sectors (e.g. travel, education) may halt longer-term occupancy decisions until they can get more confidence in longer-term impacts. As a result, we have noted a modest increase in flexible workspace requirements as a temporary solution.



[1] Special Administrative Region [of the People's Republic of China]. [2] Australia comment updated on 13 March, 2020.

COVID-19: PRESENT SITUATION

According to the World Health Organisation's (WHO) briefing on 26 February, COVID-19 (coronavirus) appears to have peaked within China,[1] even though the virus continues to spread globally. Comparisons between COVID-19 and the SARS outbreak of 2003 are natural. The Chinese economy is far larger and far more interconnected with the rest of the world than in 2003, so the impact of the COVID-19 outbreak looks set to be greater. Nevertheless, given market expectations and the lessons from SARS, it seems reasonable to expect a recovery in Asia Pacific markets over H2 2020.

We should caution that certain markets and sectors may continue to be affected by COVID-19 long after others have started to recover. In a recent study,[2] Oxford Economics has compared the impact to local and global supply chains of the 2020 coronavirus outbreak not with the outbreak of SARS in 2003, but with Japan's Tohoku earthquake in 2011. The report suggests that certain industries could be hit much more severely by coronavirus than others, as was true for the Japanese auto industry in 2011. This time, the industry set to be hit hardest looks like electronics hardware, with potential adverse implications for medium-term office space demand in markets such as South China, Taiwan and South Korea.

CONDITIONS BY MARKET AND OUTLOOK FOR H2 2020

China

2020 growth: 4.8%

Oxford Economics has cut its estimate of real GDP growth in 2020 from 6.0% in January to 4.8%, due mainly to the hit to economic activity from COVID-19[3]. H1 2020 is likely to see strain on both the manufacturing and service sectors. However, Colliers assumes that COVID-19 peaks in H1. The experience of SARS in 2003 suggests that economic activity in China may rebound rapidly from H2.

Official response: monetary and fiscal easing

Nominal interest rates have been broadly stable, with expectations of lower inflation explaining the increase in real (i.e. inflation-adjusted) interest rates over 2020–2021 currently predicted by Oxford Economics. However, the People's Bank of China has now eased short-term rates and injected RMB1.7 trillion (USD244 billion) into the money markets. The authorities have launched further monetary and fiscal support measures including tax concession. These easing measures should support confidence among property occupiers and developers.

On 26 February, the WHO announced that the COVID-19 outbreak breached its peak in China earlier in the month. While the coronavirus strained China's manufacturing and service sectors, its broader effects are still playing out at the time of writing and as a result, hard to gauge. In the meantime, to understand immediate market reactions, Colliers has carried out a telephone survey of over 700 landlords, investors and occupiers in China.* This survey reveals:

> Only one-third of the landlords (29%) expect rents to decline in 2020, while nearly half of the occupiers (45%) have already experienced a decline in business. Overall, landlords have a more positive outlook compared to occupiers.

> While the consensus is that H1 2020 will be subdued, with China's central bank providing USD244 billion in additional liquidity and local government authorities offering loans, tax cuts and subsidies to the hard hit small and medium enterprises (SMEs) sector, we expect demand to pick up in H2 2020.

[1] See https://www.who.int/dg/speeches/detail/who-director-general-s-opening-remarks-at-the-mission-briefing-on-covid-19---26-february-2020. [2] "Coronavirus: lessons from Japan's 2011 earthquake "(Oxford Economics, 26 February 2020). [3] See "China: Very weak data points towards sub-5% growth in 2020" (Oxford Economics, 2 March 2020. * See Colliers' report "Coronavirus: Impact on Chinese Real Estate" (13 February 2019), available online at covid19.colliers.com.

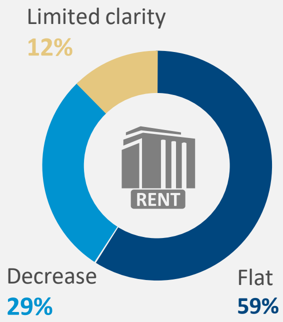
Colliers' outlook for occupiers and landlords in China, based in part on the results of the survey, and in part on our own research, is as follows:

> Since the outbreak appears to have levelled off, occupiers should work with their landlords to ensure a safe, clean workplace to help them get through this difficult period and attract talent in the future.

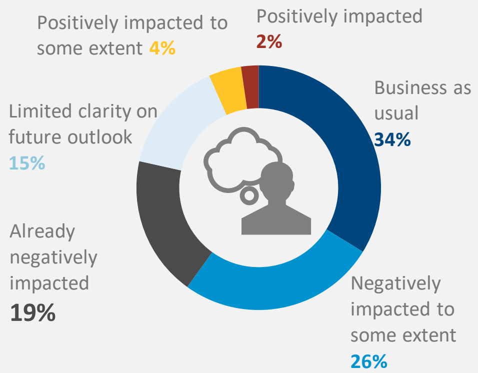
> Over the course of the outbreak, some landlords have actively reached out to their occupiers, which should result in a more intimate relationship, and we expect that occupiers will show their appreciation by staying over the long term. We believe landlords should take this opportunity to establish lasting relationships with their occupiers, especially SMEs, and proactively listen to their clients' needs.

> In business sectors like online gaming, online shopping, online education, pharmaceuticals and healthcare which are little affected by coronavirus, or which may even be seeing sales growth, Colliers believes occupiers should take this chance to try to negotiate favourable long-term leasing deals.

Landlords' 2020 Rent Expectations



Tenants' 2020 Business Outlook



Source: Colliers International

2020 growth: −2.8%

Oxford Economics has cut its forecast for 2020 real GDP growth in Hong Kong from −1.4% to −2.8%. After −1.2% in 2019, this implies two years of recession. Since COVID-19 hit Hong Kong in early 2020, the stock market has fallen 8% from a high on 17 January, indicating a decline but not a collapse in market sentiment.

Office: Rents to fall sooner, not more

COVID-19 may further depress leasing demand and office rents in H1, but we expect a rebound in rent in H2. We reaffirm our forecast that average Hong Kong and Central rents will fall by 8% and 13% respectively over 2020 as a whole.

COVID-19 has compounded Hong Kong's recent problems, notably large-scale demonstrations, the lagging effects of US-China trade tension and pressures on the important financial sector. We expect office rental growth to stay negative, with office rents and prices falling steeply over H1 2020 (especially in Q1). However, we think both rents and prices will rally in H2 assuming that coronavirus peaks in H1. For 2020 as a whole, we forecast a rental decline of 8% across the city and of 13% in Central. Looking forward, we expect:

> Deferred occupier expansion, driven by business uncertainties and the likely postponement of IPOs or companies' plans to open offices in Hong Kong, to contribute to the office market slowdown.

> While the challenging business situation persists, opportunities to sign new leases at attractive rents should arise. We think that landlords may need to be flexible in providing leasing incentives and discounts in order to attract tenants.

> We expect office markets to recover modestly after 2020, as the prolonged lack of supply should support a rebound in prices and rents, providing an opportunity for occupiers to lock in favourable terms now.

> Tactically, we recommend occupiers to look at Central now considering recent increases in vacancy rates and falling rents, together with Tsim Sha Tsui where we expect rents to fall by 8% over 2020.

2020 growth: 1.0%

Oxford Economics has cut its forecast for 2020 real GDP growth in Singapore from 1.4% to 1.0%. The STI stock index fell 7.5% over 22 January-28 February, signalling weaker sentiment.

Strong policy response

The 18 February budget included a SGD4.0 (USD2.9) billion Stabilisation and Support Package to help enterprises and workers through this crisis. Hotels will get a 30% property tax rebate; retail properties will get a 15% property tax rebate. Further off-budget measures may be adopted.

Besides, further monetary easing from the central bank is likely when it meets in April. Real (inflation-adjusted) interest rates are falling towards zero, and these loose monetary conditions should persist.

Singapore is a regional wealth hub and safe haven which should stay popular with occupiers over the long run. Global acknowledgment of how the country has handled COVID-19 should boost its reputation. As an open economy driven by international trade flows, Singapore is vulnerable to slowdown in China as well as the domestic market. Since China accounts for a far larger proportion of the global economy than in 2003, the impact of COVID-19 on Singapore is likely to be more severe than was the case with SARS in 2003. Nevertheless, we expect Singapore to be less affected than Hong Kong or mainland Chinese cities.

In response to local COVID-19 cases, the Singapore government raised its Disease Outbreak Response System Condition (DORSCON) level to Orange on 7 February, which led to major events being cancelled and many corporates initiating split operations or work-from-home arrangements. People are also reducing social contact and dining out. In the meantime, given China's contribution to the world economy and anticipated impact on Singapore, the government has announced a USD2.9 billion stimulus package as well as property tax rebates (not applicable to office occupiers for now). Based on our understanding of the Singapore office market, we suggest the following:

> Office leasing activity will slow as relocation and expansion plans as well as viewings are postponed.

> Occupiers will give priority to wellness certifications as a key criterion for building decisions.

> We advise occupiers to consider a flex-and-core™ strategy[1] or split office locations, and wellness-certified buildings, while accelerating adoption of new technology.

> Cost-conscious occupiers should consider city fringe locations such as Alexandra, HarbourFront and Paya Lebar. These areas offer Prime/Grade A offices with rents 22% lower than in the CBD, with good existing infrastructure and potential enhancement to amenities.

[1] For definitions, see "The Flexible Workspace Outlook Report 2019, APAC" report by Colliers International (June 2019).

2020 growth: close to zero

COVID-19 compounds existing pressures on the Japanese economy: weak domestic demand given the consumption tax hike and dull wages, and slowing trade. Oxford Economics forecasts real GDP growth of 0.3% in 2020, but this estimate looks vulnerable to downgrade.

Monetary conditions loose

Japan has limited fiscal flexibility, but minimal funding concerns. The latest budget measures are largely limited to temporary funding support for qualified SMEs. Very loose monetary conditions persist, with heavily negative real short-term interest rates; this should underpin confidence among occupiers.

While the impact of the coronavirus has been limited so far in Japan, the government has called for major events to be cancelled or postponed; in addition, a few major office shutdowns have been announced within central business districts. Separately, the government has instructed all public schools to be shut down until early April. From an office market perspective, Japan's key markets have been recovering since the start of Abenomics, and we expect this slow repricing trend to continue albeit at a more measured pace over 2020 and 2021.

In **Tokyo**, the market continues to favour landlords, with higher demand and limited supply leading to historically low vacancy rates. We expect little movement to flexible workspace with pre-commitments exceeding 85% for 2020 and 39% for 2021. In **Osaka,** short-term leasing activity is likely to fall further, given reduced desire to congregate and an almost non-existent supply pipeline until 2022. Slowing activity may also result in slower rental improvements than the consensus estimate. In such circumstances, we recommend that occupiers:

- Renew leases and lock in available positions with their landlords as soon as possible, since more relocation plans as well as viewings are postponed.
- Promote a flex-and-core™ strategy[1] as a way to mitigate larger public safety concerns arising from hot desk users in flexible workspace.
- Implement a flexible work arrangement in city campus format[1] to accommodate the government's guidance to minimise the time required for commuting.

Globally Australia is still seen as a clean, health-conscious country with a world-leading healthcare system. We expect more favourable demand from global occupiers over the longer term. There has been minimal direct impact from Chinese occupiers or other countries that have experienced COVID-19 cluster breakouts, since such tenants occupy minimal amounts of office space in Australia. There are reports of increasing interest in flexible workspace operations, as the uncertain outlook in a small number of occupier sectors means that longer-term decisions are on hold. Our outlook and recommendations are as follows:

- Australia's healthcare and strict quarantine measures make the country a safe choice for expansion by occupiers in the Asia Pacific region.
- Developers should look to touch-free access technologies which will be viewed more favourably for future developments, in addition to wellness-type amenities (gyms, yoga rooms, etc.) that are already established.

[1] For definitions, see "The Flexible Workspace Outlook Report 2019, APAC" report by Colliers International (June 2019).

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