Real Estate Outlook

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The air is wild with investment activity.

UBS

UBS Asset Management

Fergus Hicks
Real Estate Strategist

APAC outlook

Investment markets blow strong.

APAC economies slowed in the third quarter. Apart from China, countries are now looking to contain COVID-19 rather than eradicate it. In office markets occupiers are adjusting to hybrid working arrangements, retail markets showed some signs of stabilization, while industrial and logistics showed rental growth across the region. Investment markets were strong, with yields mostly flat or falling.

Market overview and outlook

Investment activity recovers to pre-crisis levels.

APAC's economic recovery paused in the third quarter, led by a slowdown in China where growth eased to 0.2% Qu from a 2.4% expansion in 2Q21. A number of factors weighed on the Chinese economy – weaker house building as developers deleveraged, electricity supply disruptions and the impact of COVID-19 outbreaks. Growth in Hong Kong was less than expected, at just 0.1% QoQ, while the latest forecasts from Oxford Economics show significant declines in GDP in Australia and New Zealand in 3Q21. Japan and South Korea are expected to show only modest growth of below 1% QoQ. However, we expect the recovery to regain momentum in 4Q21 and moving into 2022 as supply bottlenecks ease.

Compared to North America and Europe, the roll-out of vaccines in APAC has been much slower. Governments initially targeted zero-COVID-19 policies aimed at eradicating the virus rather than containing it. However, in both areas there has been change. Vaccination rates have picked up and are now not so different from other regions and, apart from China, governments are moving away from zero-COVID-19 policies. They are now looking to live with the virus rather than get rid of it entirely. This is leading to a gradual easing of travel restrictions, which could provide a much-needed boost for the region's tourism sector.

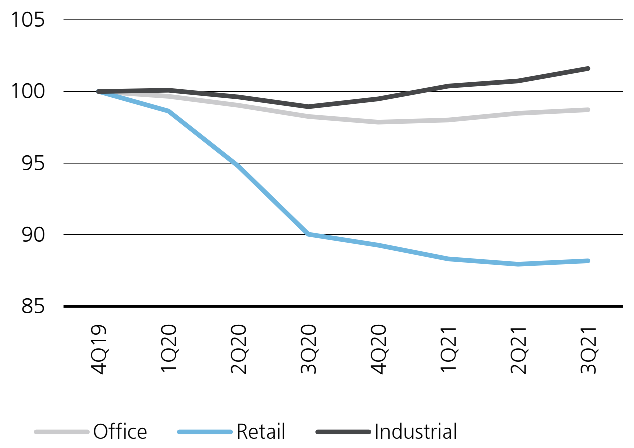
Conditions in office markets are mixed as corporates adjust to new hybrid working arrangements. Hong Kong and Tokyo were weaker markets in 3Q21, where CBRE reported falls in rents and rises in vacancy rates. Conditions in Hong Kong have improved from the deep downturn though, with new leasing demands from firms relocating and downsizing. The Singapore and Australia markets were stronger, but held back by new lockdowns. Beijing and Shanghai were also stronger and CBRE reported record net absorption for both of these markets in 3Q21. Seoul was the strongest market, where CBRE reported a fall in the vacancy rate and rise in rents as occupiers expanded.

Retail markets showed some signs of stability and, according to CBRE, prime high street and shopping center rents were flat or stable in most major markets in 3Q21. Shanghai bucked the trend and rents rose. There have also been small pockets of strength. For example, according to CBRE rents for large format retail in Australia were up 10% YoY in 3Q21. The electronics and household sectors in Australia have seen strong demand as people have upgraded their homes.

However, retail remains challenged overall. Travel restrictions are hitting the luxury and premium segments hard. This left the market reliant on domestic consumption, which continues to be hit by lockdowns and faces ongoing incursions from the ever-rising shares of online sales. A pre-requisite for a durable and broad recovery in the retail sector will be a full re-opening of international travel.

The industrial and logistics sector continues to be strong and CBRE reported rental increases across the region in 3Q21 (see Figure 1). The ongoing shift to ecommerce continues to create demand for warehouse space from logistics companies and retailers. Vacancy rates are generally low, which is putting upward pressure on rents. Indeed, a lack of available space is also holding back leasing activity in Hong Kong. A recovery in global trade volumes is also boosting tenant demand.

Figure 1: Asia Pacific prime rent indices (local currency, 4Q19 = 100)



Note: Indices refer to 9 cities across 6 countries.
Source: CBRE; PMA; UBS Asset Management, Real Estate & Private Markets (REPM), November 2021.

The investment market was strong and CBRE reported yields across sectors and countries as mostly flat or falling in 3Q21. It was notable that retail yields in Australia showed some declines, indicating that the market may be leveling off. APAC investment activity was strong in 3Q21 and, after adjusting for seasonal effects, rose back to pre-pandemic levels in USD terms and exceeded them by 14%. The rebound was driven by strong growth in the industrial and office sectors.

Strategy viewpoint

In China leaves don't fall, they fly.

Investors and managers are frequently asked what keeps them awake at night. There is no doubt that events unfolding in China took up much of everyone's mental bandwidth in the last few months. From the crackdown and scrutiny of various sectors in technology and education, to mounting fears of global financial contagion due to the debt woes of a property firm, investors are left pondering the landscape in China over the next few years. We are not political analysts and do not intend to put forth views on geopolitical developments. We do, however, seek to offer some clarity here on what the new China playbook will look like for property investors.

China is focused on achieving its long-term domestic goals of a more equal society with improved social welfare, better public services, and a stronger social safety net, amongst others. In order to realize these, Beijing will need to balance macro risks and social threats in parallel. And what we have experienced in the past months are mostly policy actions and responses that will nudge China towards these end goals.

Evergrande's over-leverage is symptomatic of the financial time-bombs already ticking in the Chinese economy. This was not something unexpected. China does not want to encourage further risk-taking and debt loading of companies should it bail out Evergrande. It also wants to ensure an orderly resolution of the issue to calm sentiment, keep the property market stable, and soothe affected homebuyers.

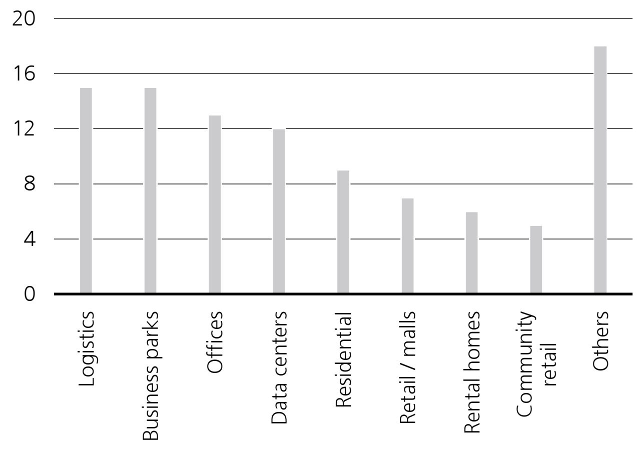
This balancing act is delicate in the short-term, but the longer-term stability offers much scope for real estate investors. The question is not whether investors should get exposure to Chinese real estate, but rather the forms and formats of real estate in China they should target going forward.

What the current climate is projecting is not a reflection of the structural prospects in China, which are still appealing on a selective basis. We believe a few themes will endure in the medium to long-term and investors would do well to get exposure to these.

First, assets that serve the New Economy are poised for long-term growth. *What is the New Economy?* These are high growth industries that sit at the fringes of technology and productivity and have strong policy support from the government.

Other than offices and logistics that lean heavily on technology and e-commerce, we think business parks, R&D facilities, data storage facilities and high-end manufacturing will do well in the New Economy narrative. According to Colliers's 2021 investor survey (see Figure 2), investors are almost equally split between their preferences for logistics, offices, business parks and data centers.

Figure 2: Investors' asset type preference in China (%)



Source: Colliers Radar, September 2021

Second, alternative niches such as cold storage, healthcare and multifamily will become mainstream in the years to come. This is less a prediction than an actual development. These niche sectors require higher levels of operational capabilities, but are underpinned by real demand. This is especially so given the accelerated changes in socio-demographic trends and preferences.

Third, the pressure on Chinese developers to ease up on leverage is intense and there is a crucial impetus to bolster balance sheets. Many developers are now open to disposing of their non-core commercial property assets. We believe this creates a tactical window for investors to gain access to a market that is traditionally tight on asset availability.

Last, and more broadly, the Greater Bay Area (GBA) is a metropolitan cluster that should see synergistic growth in the next decade. Real estate investors would do well to leverage on consumption and employment growth in the GBA, on top of its solid base of population.

For more information, please contact:

UBS Asset Management
Real Estate & Private Markets (REPM)
Research & Strategy

Fergus Hicks
+44-20-7901 6022
fergus.hicks@ubs.com

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