Keppel Capital watch

Asia Pacific Real Estate

It is Not Business as Usual

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Asia Pacific Real Estate
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Contents

Executive Summary

Post-COVID, the impact on office demand due to the increased acceptance of working from home (WFH) will be dependent on various factors; the negative impact could have been overstated. Occupiers are likely to review how they use their office space and re-assess what they need for the future, but not all will give up the office in a substantial way. The economic recession could have a larger impact on office demand in the near term.

COVID-19 accelerated the shift to online retail. Part of this growth was borne out of necessity, but there is no doubt that online shopping will form a bigger share of consumers' shopping in future as more people get used to it. In view of the longer-term structural challenges of the sector, we continue to prefer well-located suburban malls catering to non-discretionary spending and surrounded by sizeable population catchment.

In the industrial space, the possible shifts in the supply chains could benefit some emerging Southeast Asian countries, while demand for last-mile logistics space will increase amid e-commerce growth and consumer demand for faster deliveries. There could be opportunities to repurpose or convert older industrial facilities or convert underused or under-performing retail assets to logistics space.

We remain opportunistic on the hospitality sector as the recovery of international travel flows is heavily dependent on government decisions to reopen international borders. Increasingly nationalistic sentiment could also hamper the resumption of cross-border tourist flows.

Economic recovery going forward will be stop-start, depending if there are subsequent waves of infections and until an approved vaccine or effective treatments become widely available. The full economic impact of COVID-19 has yet to filter through, as economies are being propped up by massive monetary and fiscal stimulus. There could be further economic dislocations when such support measures are eventually dialled back or removed. It cannot be business as usual. We will continue to stay nimble and be prepared to pick up the unique opportunities that could present themselves due to the economic dislocations.

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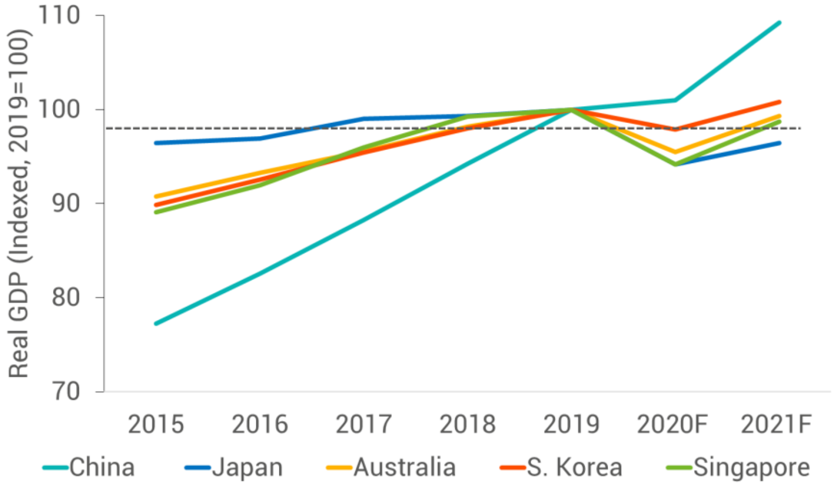
Introduction

The global spread of COVID-19 and the associated travel restrictions and social distancing measures necessary to contain the virus, have severely impacted economic growth. The global economy is now expected to contract 4.9% in 2020[1]. Within Asia Pacific (APAC), China is forecasted to eke out a 1% growth, while the rest of our key markets are projected to shrink (Figure 1). Even though most APAC countries have relaxed social distancing measures and are gradually reopening, it will take some time for economic activity to return to pre-COVID levels.

Figure 1: Other than China, most key APAC markets to contract in 2020



Source: IMF World Economic Outlook, Apr 2020 and Jun 2020 Update, Singapore MAS Survey of Professional Forecasters, Jun 2020

Economic uncertainty will persist so long as the threat of subsequent waves of infection remains. Against this macroeconomic backdrop, we discuss in this paper the changes brought about by COVID-19 and the impact on the real estate market.

Office: negative impact of WFH overstated

The world has just conducted its largest work-from-home (WFH) experiment, with many companies having to introduce some form of WFH policy overnight. The lockdowns-induced WFH practices have seemingly led to an increased acceptance of remote working and concerns that demand for office space could fall post COVID-19.

Post-COVID, in the short term, the negative impact on office demand is not likely to be that significant, given the need to maintain some form of social distancing in workplaces in the current environment. The trend of having open plan offices and falling office space per employee could reverse; cubicles could make a comeback and office space per employee may increase again. While social distancing measures may be less critical once there is a vaccine or cure for COVID-19, occupiers will also need time to reconfigure their space requirements and all things equal, are not likely to make any changes before lease expiries.

[1] IMF World Economic Outlook Update, June 2020

In the medium to longer term, occupiers will be able to review how they use their office space and may introduce a higher proportion of remote working and seek an increased desire for flexibility.

WFH impact dependent on various factors

However, increased working from home does not necessarily have to equate to a similar decrease in office demand. The negative impact of WFH on office demand could have been overstated. How WFH will eventually impact the office sector will depend on various factors:

(1) Some industries or work functions are more amenable to WFH

Some companies, such as those in the technology, media and telecommunications (TMT) industry, are more suited for WFH arrangements. For example, Twitter plans to allow some staff to WFH permanently while Google has recently told staff they can continue to WFH until July 2021 even as the company has reopened offices around the world for staff who are not able to work remotely. However, companies in industries such as education services, security, health and social services and some parts of the government or banking and financial services, may not be able to fully implement remote working practices.

Even within the TMT industry, not every firm will WFH. Companies such as Yahoo and IBM had previously reversed their remote working policies. As recently as August 2020, despite the tech industry's shift towards more remote working, Facebook announced that they have agreed to rent an entire office building with 730,000 sq ft of space in New York City.

Job roles that require face-to-face contact with clients cannot take the risk of going remote, while some employees do not have the option of working from home – either because their role could be too sensitive to be carried out in an unsecured location (such as the sales and trading functions of banks), or they need access to equipment or systems that are not accessible remotely.

(2) Inadequate digital infrastructure will temper growth of WFH trend

Not every company is equipped for remote working. Many companies were unable to provide the required technological support due to the sudden introduction of WFH on a large scale. In addition, there could be increased cyber risks from working remotely as home setups will not have the same level of network security as company systems do.

Slow or unstable internet connectivity in some countries could be frustrating for employees working from home. In Japan, while large companies such as NTT, Fujitsu and Hitachi have plans to continue with remote working (or "telework") even after COVID-19, there are smaller companies which have not implemented telework nor have the capacity to do so. A survey by the Tokyo and Osaka Chamber of Commerce shows that 48% of large corporations have adopted telework versus only 10-20% for small and medium-sized enterprises (SMEs) and reasons include a lack of infrastructure and worker skills to use digital tools[2].

Against a weaker economic outlook, smaller companies may not have the additional budget to set up new technology infrastructure given the uncertainty over company earnings.

(3) Smaller apartment sizes in Asia make it challenging to WFH

In Asia, smaller apartment sizes and/or multi-generational family units living together under one roof, make it difficult to have dedicated work areas at home and hence, less conducive for employees to WFH permanently. Average household sizes in Hong Kong and Singapore are larger at 2.8 and 3.3 persons respectively, compared to an average household size of 2.3-2.5 persons in developed markets UK, Australia and the US[3]. Additionally, average flat sizes in Hong Kong (40 sq m), Tokyo (69 sq m) and Singapore (90 sq m) are amongst the smallest in the world[4].

(4) Culture

In Japan, the practice of having to stamp official documents in person with carved seals ("*hanko*") hampers the growth of teleworking. Employees have to go into the office to get documents signed as the company seal cannot be taken out of the office. This made it logistically difficult for employees to WFH. Although the government has since issued guidelines in June to say that the *hanko* is not necessary when concluding contracts, we understand that in practice, official documents such as invoices and legal contracts still require the *hanko*. It is a complicated process and will require more time as well as detailed and unified laws to regulate or phase out the usage of the *hanko*. In addition, outside of Tokyo and Osaka, electronic documents are still not common in other parts of Japan. The lack of digital stamping technology and the inability to go paperless were amongst other challenges to teleworking cited by Japanese occupiers[5].

Another reason why remote working may not be as widely adopted in Asia is the tendency to associate and confuse long working hours with work performance. Being present at work is also linked with promotion prospects. Consequently, "face time" becomes important and employees may feel the need to put in long hours in the office to show their commitment and dedication. COVID-19 may not be strong enough to rewrite these entrenched cultural norms yet. Changing a long-standing non-flexible working culture has often been cited to be a major obstacle to introducing flexible or remote working[6].

[2] The Japan Times, What will happen to inclusion in COVID-19's wake?, 11 May 2020
[3] UN, Department of Economic and Social Affairs, Population Division (2019)
[4] South China Morning Post, Hong Kong, Singapore, Tokyo office markets likely to survive work-from-home arrangements as small flats seen limiting productivity, 8 July 2020
[5] CBRE Research, Japan Office Occupier Flash Survey, Q2 2020. The survey covered 361 occupier clients and was conducted from 21-31 May 2020
[6] The IWG Global Workspace Survey, March 2019. 15,000 business people across 80 nations were surveyed and 60% of business people still report that changing a long-standing non-flexible working culture is an obstacle to introducing flexible working

Office remains relevant

Following the widespread WFH experience, various surveys show an increasing acceptance of remote working: employees want the flexibility of being able to work remotely (not necessarily at home) at least part of the time while employers are open to letting some staff work remotely full-time or allow staff the hybrid solution of choosing to work remotely or in the physical office.

However, for the reasons noted above, we think that even if companies are more open to remote working in future, the negative impact on office demand may not be as huge as has been suggested. CBRE's 2020 Global Occupier Sentiment Survey in June found that only a minority of respondents (13%) believe that the importance of the physical office will decrease significantly.

The office is not just a physical space

It serves as a hub for employees to collaborate and innovate and to engage and train new employees. It creates opportunities for social interactions amongst colleagues, to build up company culture. Unless you work individually, face-to-face interactions encourage collaboration and innovation. WFH works better for employees who have been with their companies for a longer time and have established bonds with colleagues but it is more difficult for new joiners to build up the same relationships or be plugged into the corporate culture while working from home and to learn by observing the behaviour of their senior colleagues.

Many of us could emerge from this crisis craving face-to-face interactions with our colleagues. In a survey of 1,500 employees in Australia, China, Japan, Singapore and India, 61% of those working from home said they missed going to the office – human interactions and socialising with colleagues was the top reason cited for missing the office[7]. Note the earlier examples of Yahoo and IBM which reversed their remote working policies to promote more collaboration and innovation amongst staff and Facebook's recent lease of an entire office building in New York City.

The office is also a learning place for employees. Although training can be moved online, there are lessons that online training manuals cannot provide. If employees WFH, they would lose out on the opportunity to learn from their more experienced and older colleagues by listening and watching how they conduct business.

COVID-19 could accelerate other office trends

Decentralisation to pick up?

COVID-19 could accelerate the decentralisation trend in some markets, with companies maintaining separate offices in the CBD and in decentralised areas: allowing staff to work remotely in another office closer to their homes, cutting down commuting time and commutes on public transport, yet at the same time providing the office environment to instil

[7] JLL, Home and away: The new workplace hybrid?, July 2020

corporate culture and encourage bonding and interactions amongst colleagues.

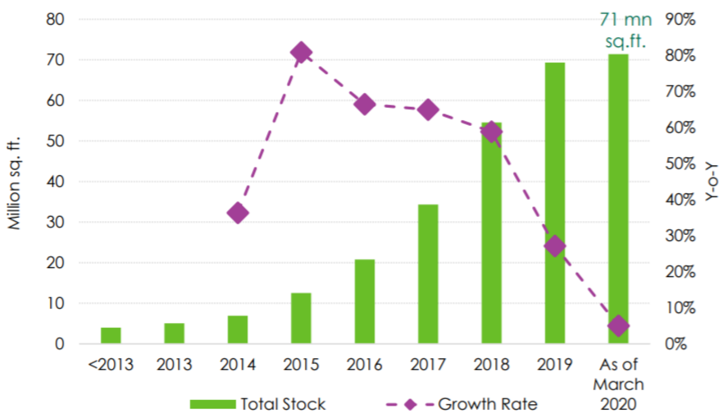
This, however, may not be possible for smaller companies which may not have the resources to maintain different offices. We could see more of these "hub and spoke" models in certain markets such as Australia and Japan but less so in a city-state like Singapore, where commuting times are much shorter. Ultimately, the decision to decentralise will not just be driven by COVID-19 and health considerations; other considerations such as the rental cost differential between CBD and decentralised offices and the availability of established decentralised office districts also play a part.

More consolidation in the flexible office sector

Occupancy at flexible offices (includes both coworking and serviced offices) also dropped during the height of COVID-19 since most people had to WFH. Operators had to shorten opening hours or close some outlets temporarily while the growth of new memberships was delayed as inspections had to be suspended amidst social distancing and lockdown measures. The occupancy in leading coworking centres in Greater China fell to 30-40% in the first eight weeks of the COVID-19 outbreak and similar figures were noted in other APAC markets[8].

Even before COVID-19, we were of the view that there could be consolidation within the flexible office sector given the rapid growth over the last few years. Flexible office space in APAC has tripled over the past five years, reaching 71 million sq ft by the end of March 2020, equivalent to about 4% of total APAC office stock[9] (Figure 2). COVID-19 could be the accelerant to more consolidations within the industry, as flexible space operators' profitability will be affected by their inability to operate at full capacity given social distancing measures and slow acquisition of new members. Smaller operators without a wide global network could struggle to survive.

Figure 2: Flexible office space in APAC tripled over last five years



Source: CBRE Research, June 2020

[8] CBRE Research, COVID-19 Implications for flexible space: What's next?, June 2020
[9] CBRE Research, COVID-19 Implications for flexible space: What's next?, June 2020. Based on CBRE's coverage of 18 APAC markets: Beijing, Shanghai, Shenzhen, Guangzhou, Hong Kong, Taipei, Seoul, Tokyo, Singapore, HCMC, Hanoi, Bangkok, New Delhi, Bangalore, Mumbai, Sydney, Melbourne and Auckland

Correspondingly, as flexible space operators have been one of the biggest drivers of office demand in recent years, closures of flexible offices could result in an increase in backfill vacancies. This could further dampen office rental growth going forward, especially in markets where there are already concerns of oversupply. According to CBRE, Shanghai is one of them, where flexible space has accounted for 15-20% of leasing demand in the past three years.

Notwithstanding the short-term challenges, there will continue to be demand for flexible offices because of the savings in fit-out costs and flexibility in lease terms, especially in the current weaker economic climate; and as an additional space for business continuity planning (BCP) or to accommodate social distancing measures post-COVID. There could also be an increase in flexible space operated by landlords themselves, as an amenity to complement their portfolio and/or as part of a suite of flexibility options offered to occupiers due to the current uncertain operating environment.

Economic recession could have a longer lasting impact

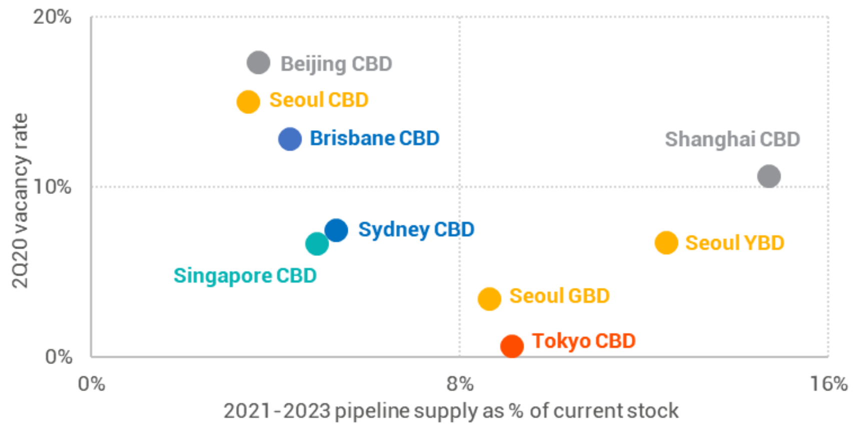
While COVID-19 is the more immediate concern, geopolitical and ongoing trade tensions add to the increased uncertainties for many businesses. The weaker economic environment will be exacerbated by the eventual removal of government support as economies restart post-COVID.

Some companies may not survive post-COVID while others whose businesses have been impacted may have to downsize once government support measures are removed. The economic recession will impact office demand and rental growth. During the last global recession in 2009 (the Global Financial Crisis (GFC)), Grade A or prime office rents across APAC fell on average by more than 20%, ranging from ~3% in Seoul to a decline of more than 50% in Singapore, based on data from JLL.

Economic recovery will be stop-start, dependent on whether there are new outbreaks and re-tightening or re-introduction of social distancing and lockdown measures. The longer the economic disruption drags on, the larger could be the impact on office demand and rental growth. Companies better able to adjust and adapt will be more resilient.

In light of the economic uncertainties, positive demand-supply fundamentals and tenant quality are important considerations. Going forward, larger supply pressure on high existing vacancies is expected in the Shanghai CBD and Seoul YBD markets while the Singapore market could be more resilient with a lower pipeline supply amid tighter vacancies (Figure 3). Companies looking to utilise the “hub and spoke” model will support demand for decentralised offices in some markets while smaller companies unable to invest in infrastructure to facilitate WFH will continue to support demand for secondary-grade offices.

Figure 3: Larger supply pressure expected in Shanghai CBD, Seoul YBD markets



Source: JLL REIS, KepCap Research
Data refers to Grade A offices except for Sydney and Brisbane data which includes all grades

Retail: not dead

The retail sector, alongside the hospitality sector, is the most negatively impacted sector during COVID-19, due to the travel restrictions and lockdown measures. Many non-essential retailers had to close their physical shops temporarily as consumers shifted online. For instance, in Singapore, online sales as a percentage of total retail sales rose from an average of 5.8% in 2019 to around 20% in 2Q2020, as physical shops were closed due to the country's "circuit breaker" period. However, it should be noted that e-commerce was already growing before COVID-19; the pandemic merely accelerated or necessitated the need to shop online.

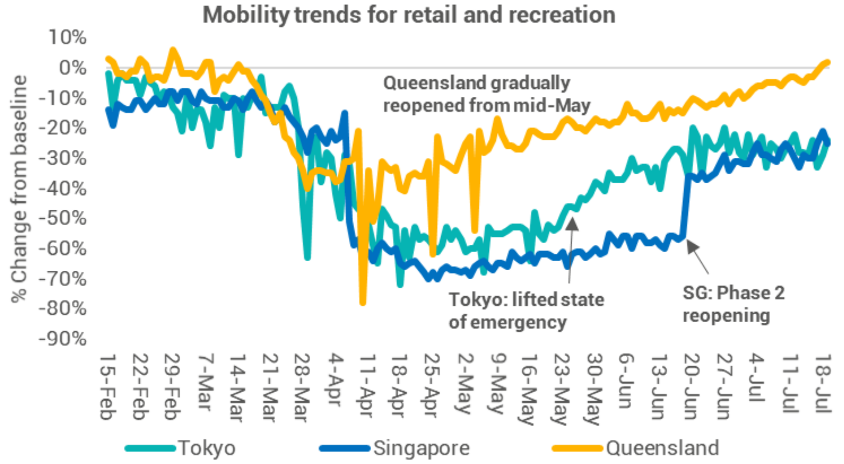
Structural changes already underway in the sector will gather pace post-COVID

As many retailers had to close their physical stores during COVID-19, they have had to rethink or accelerate their online strategies. However, as we had argued in previous reports, the shift online does not necessarily mean that brick-and-mortar retail will immediately become irrelevant.

Part of the growth in online shopping during COVID-19 was borne out of necessity. As lockdown measures ease and shops gradually reopen, consumers will start returning to the shops. For instance, traffic to retail and recreation spaces including restaurants and shopping centres picked up in Tokyo and Singapore when restrictions were lifted while in Queensland (Australia), traffic appears to be back to normal levels with the outbreak contained and the economy gradually reopening (Figure 4).

It is still more enjoyable dining in at restaurants as opposed to a food takeout or delivery. Heading to the malls is also not just about consumption; there is a social aspect to it as well. This is especially the case in some parts of Asia where the warm and humid weather makes it more pleasurable to meet friends or have a meal together at the mall.

Figure 4: Consumers head back to retail when they can



Source: Google COVID-19 Community Mobility Reports. Compared against baseline of 3 Jan-6 Feb 2020

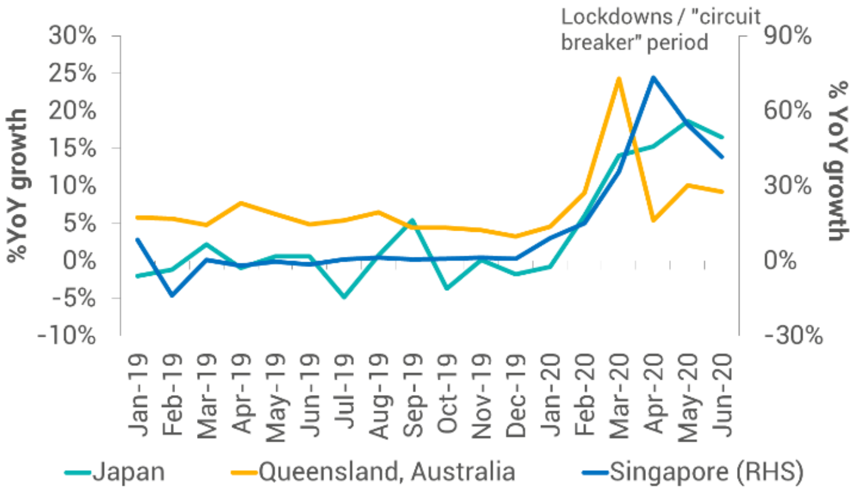
Note: The data above should not be compared across countries, as Google has cautioned that the location accuracy and understanding of categorised places varies from region to region.

Nevertheless, it will take time for traffic to revert to pre-COVID levels, especially for discretionary categories such as apparel or department stores. In-store shopping, dining in and entertainment options could still be limited due to social distancing measures or capacity controls at malls. The recovery of the retail sector is also dependent on whether there are subsequent waves of infections which will necessitate further lockdowns, such as in Melbourne which went into a 6-week lockdown from 8 July, which was subsequently extended till 13 September; or in Seoul where social distancing measures have been tightened following a recent surge in COVID-19 cases. Additionally, concerns over the economic and employment outlook could weigh on consumer sentiment and spending.

Suburban malls are likely to recover faster than downtown malls given the lack of international tourists. They are also more resilient, as they cater mainly to non-discretionary spending (such as groceries, food, services and other essential items) and will remain open even if there is another outbreak and lockdowns or social distancing measures are re-introduced. Data across various countries showed that supermarket and grocery sales surged during the lockdown or social distancing periods (Figure 5). For instance, supermarket sales in Singapore rose 73% yoy in April when the country first implemented its "circuit breaker", closing all non-essential retail shops.

Over the medium to longer term, retailers will still have to confront the pre-COVID structural challenges. The COVID-induced shutdown would have given many retailers the chance to relook or accelerate their omni-channel strategies. For instance, although Nike had to close 75% of its physical stores at the height of the COVID-19 outbreak in China, this was mitigated by a more than 30% increase in digital sales. Nike's digital sales were driven by their community engagement – usage activity for its personal training apps designed for home workouts increased 80% as China faced a national lockdown with residents staying at home[10]. Retailers better able to adjust will be more resilient going forward.

Figure 5: Supermarket and grocery sales surged during lockdowns



Source: Japan Ministry of Economy, Trade and Industry, Australian Bureau of Statistics, Singapore Department of Statistics, KepCap Research

Mall owners will also have to continue to evolve, embrace technology and create retail experiences that can better engage consumers to attract shopper traffic and the best tenants.

In view of the longer-term structural challenges of the sector, we continue to prefer well-located malls that are easily accessible by public transport, catering to non-discretionary spending and surrounded by a sizeable or growing population catchment. These malls are likely to be more resilient and receive higher shopper traffic.

Industrial: Opportunities with supply chain shifts

COVID-19 lockdown measures, border closures and travel restrictions disrupted global supply chains and impacted the operations of non-essential manufacturers, exporters and third-party logistics providers. The pandemic highlighted the need for companies to mitigate concentration risks in their supply chains as a shutdown of a single link can lead to production halts – China has a share of over 50% in the global supply chains of several manufacturing products, including precision instruments, automotive and communicative equipment and machinery products[11]. Many companies do not have alternative production or procurement plans.

However, an immediate massive outflow of manufacturing capacity from China is not likely as relocating supply chains is a multi-year project that involves long planning times and heavy investment; companies are not likely to make such major capex investments against the current macroeconomic backdrop.

[10] RetailWire, Can Nike's coronavirus playbook work for others? 27 March 2020
[11] Standard Chartered Research, COVID-19 – Impact on global supply chains, May 2020

COVID-19 could accelerate trends that were already underway, such as reshoring (or near-shoring) and the "China plus One" strategy. Companies had already been diversifying production out of China due to the US-China trade tensions and rising labour costs in China prior to COVID-19. COVID-19 has added further impetus to such trends so that companies can reduce their supply chain dependency on China or potentially any single location. Such moves could also be supported by government policies. For instance, the Japanese government announced in July 2020 that 57 companies will receive more than US$500 million in subsidies to invest in production in Japan while another 30 companies will receive money for investments in Vietnam, Myanmar, Thailand and other Southeast Asian nations[12].

Over the medium term, the relocation or diversification of supply chains could benefit other emerging APAC markets. Vietnam has already emerged as a popular destination. Almost half of the US imports in 2019 that shifted from China to other Asian emerging markets was absorbed by Vietnam[13]. Samsung now manufactures 50% of its smartphones in Vietnam[14] while Apple reportedly started production of around 30% of its AirPods wireless earphones (~3 to 4 million units) in Vietnam in 2Q2020[15].

Other alternative destinations include Indonesia, which is looking to attract global companies seeking to relocate from China with offers of speedy approvals and cheap land. President Jokowi has offered the 4,000-hectare Batang Industrial Park for investors yet to procure land for their facilities. Seven foreign companies, including Panasonic and LG Electronics, have reportedly confirmed plans to relocate their production facilities to Indonesia[16].

There could also be changes in inventory management. It is estimated that most manufacturers keep stocks worth only two weeks of demand[17], but uncertainties over future pandemics and trade tensions disrupting global supply chains again could see manufacturers shifting from the "just-in-time" model to a "just-in-case" approach. Going forward, manufacturers may want to keep more inventory and stockpile essential supplies, generating additional warehousing demand.

Demand for last-mile logistics space to increase

Post-COVID, e-commerce is likely to play a bigger part in consumers' shopping, which could lead to stronger demand for warehouses and last-mile logistics space. Consumer preferences for faster delivery mean that online sellers will need to have fulfilment centres in and around cities so that the time required to get an order to their customers can be shortened. The demand for urban last-mile deliveries is projected to grow 78% globally

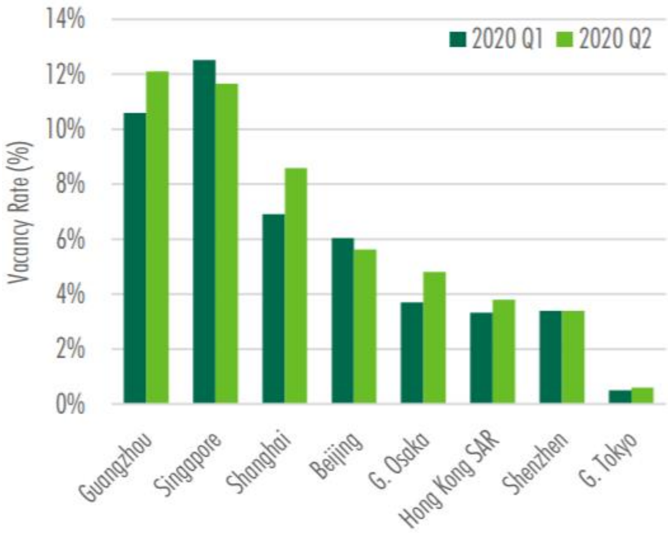
[12] Bloomberg, Japan starts paying firms to cut reliance on Chinese factories, 18 July 2020
[13] Kearney, Trade war spurs sharp reversal in 2019 Reshoring Index, foreshadowing COVID-19 test on supply chain resilience, 2020
[14] CBRE, Refocusing supply chains in the COVID-19 era, May 2020
[15] Nikkei Asian Review, Apple to produce millions of AirPods in Vietnam amid pandemic, 8 May 2020
[16] The Jakarta Post, Seven companies to relocate facilities to Indonesia, invest $850m, 30 June 2020
[17] Standard Chartered Research, COVID-19 – Impact on global supply chains, May 2020

by 2030, driven by an increase in same-day and instant deliveries (20-40% and 10% p.a. respectively) as well as an increase in online sales of other retail categories such as groceries (10% p.a. growth globally)[18].

Well-located urban logistics facilities can typically command higher rents. This is because real estate (or rents) typically accounts for around 4-5% of total logistics costs, while transportation makes up the largest share at about 50%[19]. Last-mile delivery is the biggest driver of overall supply chain costs (41%)[20] as the efficiency of urban deliveries is affected by traffic congestions or delivery routes. The savings in transport costs that are availed enable tenants to pay higher rents.

Demand for last-mile logistics facilities is thus expected to grow. These could include but are not limited to urban infill centres, courier and postal warehousing, fulfilment centres, cold storage or parcel pick-up and locker services. However, the availability of land to build urban logistics facilities is usually limited in densely populated cities. Vacancy rates in Melbourne and Sydney were noted to be below 4% in 1Q2020[21] while most other APAC markets registered vacancy rates below 10% in 2Q2020 (Figure 6).

Figure 6: Vacancy rates of logistics space in APAC



Note: CBRE tracks vacancy rate for selected major markets in Asia Pacific.
Source: CBRE Research, Q2 2020.

There are therefore opportunities to repurpose or upgrade older industrial facilities to meet the potential increase in demand for modern last-mile logistics facilities. Additionally, given the challenges in the retail sector, it will not be surprising to see an increase in the conversions of underutilised or underperforming retail assets to industrial or logistics space. JLL noted in a recent report that large format retail (LFR) assets in Australia can also potentially be redeveloped for industrial and logistics uses, as LFR sites

[18] McKinsey & Co, Re-thinking last-mile logistics, post COVID-19: Facing the "next normal", 9 June 2020
[19] Cushman & Wakefield, Last Link – Quantifying the cost, 2019
[20] Capgemini Research Institute, The last-mile delivery challenge, January 2019
[21] JLL, Coronavirus implications for Australia and New Zealand real estate, 20 March 2020

currently have low site coverage, are well-connected to transport infrastructure and near to population centres.

Post-COVID, we could also see more brick-and-mortar stores that are not doing well converted to "dark stores", which are local fulfilment centres for pickup and delivery. These stores have the added advantage of being located close to population centres for rapid delivery. Deliveries from these smaller fulfilment stores can be up to two times less expensive than from large centralised warehouses[22]. Supermarket chains such as Coles and Woolworths in Australia had already been operating dark stores pre-COVID-19 while Whole Foods recently converted stores in Los Angeles and New York to dark stores[23]. The increase in online shopping and the increased consumer demand for convenience and fast delivery could see more retailers setting up dark stores to fulfil online orders and provide faster deliveries.

Data centres: COVID-19 a catalyst to go digital

COVID-19-induced lockdowns and social distancing measures have resulted in behavioural changes and will lead to more online activities, such as companies building up their digital infrastructure to facilitate remote working or individual consumers spending more on e-commerce platforms. These will all be positive for data centre demand globally. To learn more about the challenges and opportunities in the data centre sector post-COVID, refer to our July 2020 publication titled "Data Centres: Not just Hype".

Hospitality: longest road to recovery

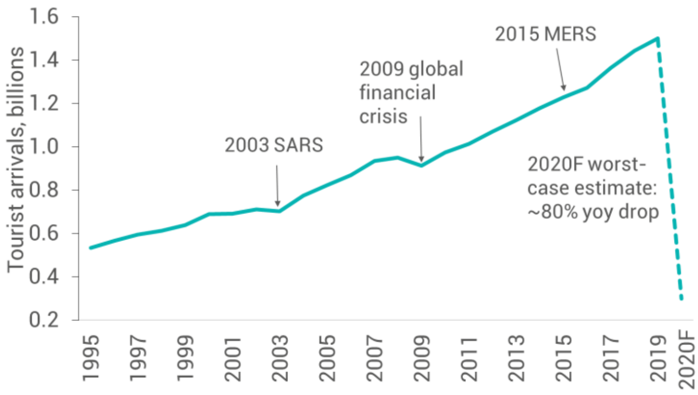
We anticipate that international travel restrictions will be the last measures to be removed and hence expect the hospitality sector to have the longest road to recovery. Besides COVID-related travel restrictions, cutbacks on individual and business travel are also expected with the looming recession. Given the depth and the global spread of COVID-19, it will take longer for international tourist flows to recover, compared to previous health crises such as the outbreaks of Severe Acute Respiratory Syndrome (SARS) in 2003, H1N1 in 2009 and the Middle East Respiratory Syndrome (MERS) in 2015 where the impact on tourism was more localised. In addition, the impact of COVID-19 on tourism will also be worse than during the global financial crisis in 2009 (Figure 7).

Although some countries have now begun to open up, most global destinations will still have some form of COVID-related travel restrictions in the near term. As at 19 July, 40% of all destinations (87 countries) have eased restrictions, led by Europe while 53% of destinations worldwide continue to have their borders closed to international tourists[24]. Depending on the duration of travel restrictions and closed borders, the World Tourism Organisation (UNWTO) expects international tourist arrivals to decline 60-

[22] JLL, Dark stores gain traction amid online shopping boom, 17 June 2020
[23] Forbes, Dark stores are the future of post-pandemic retail, 25 April 2020
[24] World Tourism Organisation, COVID-19 related travel restrictions – A global review for tourism, 30 July 2020

80% year-on-year (yoy) in 2020. International arrivals to the APAC region had already fallen 60% yoy in the first five months of 2020.

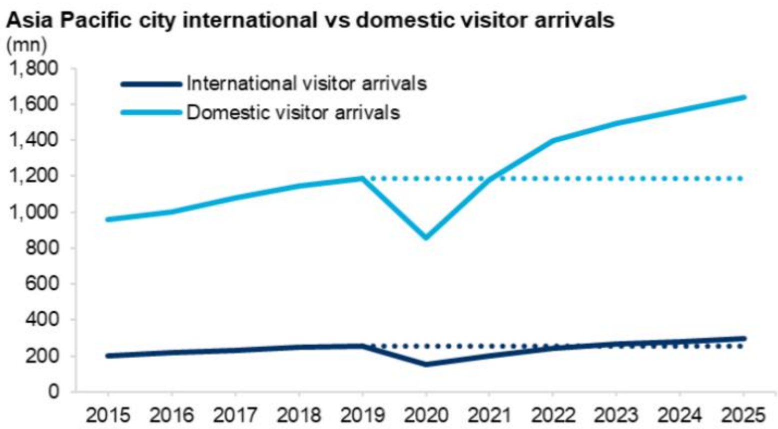
Figure 7: Impact of major crises on global tourist arrivals



Source: World Bank, World Tourism Organisation

Hotel occupancy across APAC fell to 28% and 36% in April and May respectively while revenue per available room (RevPAR) declined 78.1% and 68.5% yoy respectively over the same period[25]. Tourism Economics expects international visitors to APAC to return to 2019 peak levels only by 2023, while domestic travel will recover earlier and will return to 2019 levels by 2021 (Figure 8).

Figure 8: International arrivals to APAC forecast to recover only by 2023



Source: Tourism Economics

Domestic travel to recover earlier

Given the international border closures, it is not surprising that domestic travel will recover earlier than international travel. Indeed, we have noted the recovery in domestic travel in countries where restrictions have been eased. For example, in China, while daily trips by Chinese tourists (23 million) during the May Day holiday (1-5 May) were 53% yoy lower, this was an improvement over the 14 million daily trips made during the earlier Qingming Festival holiday (4-6 April), indicating some recovery in the domestic tourism sector.

[25] STR

By sheer numbers, the domestic tourism economy is more significant for some countries. Tourism Economics estimates that domestic tourism accounts for almost 80% of total visitor arrivals to APAC cities. For instance, more than 311 million domestic tourists made overnight trips within Japan in 2019, dwarfing the 31.9 million inbound international tourists. However, the recovery in domestic tourism is also subject to the threat of subsequent waves of COVID-19 infections, which could lead again to the closure of domestic borders, as was the case in Victoria state in Australia. In Japan, the recent spike in COVID-19 cases saw Tokyo excluded from the government's "Go to Travel" campaign, which provided subsidies of up to 50% on travel expenses within Japan.

Nevertheless, hospitality sector performance is likely to recover earlier in countries with a large domestic travel segment such as in Japan. For other countries which are highly dependent on international tourism flows, such as Singapore where international tourists in 2019 were 3.4 times of the total population, domestic tourism is unlikely to make up for the decline in international tourists and their typically higher expenditures.

Disruptor gets disrupted in the near term

Shared accommodation providers such as Airbnb could take longer than hotels to recover from the pandemic. While the near-term challenges are similar, and we expect bookings to increase (as they already have) after lockdown measures ease and domestic travel resumes, there could be lingering consumer concerns over the level of sanitation and cleanliness in shared accommodation as opposed to industrial-grade cleaning by hotels. The ease of cancellations and refunds that major hotels provided during the pandemic could also put them ahead in the recovery if consumers are worried that subsequent waves of infection could scupper travel plans again. In the medium to longer term however, we think that shared accommodation, as a cost alternative to travellers, will continue to co-exist with hotels.

Remain opportunistic on hospitality sector

We think recovery in the hospitality sector will ultimately be shaped by government regulations and possibly geopolitics. The pandemic could politicise travel and migration and entrench a bias towards self-reliance while the resumption of international tourism flows is very much dependent on government decisions to reopen borders.

Conclusion

Economic recovery going forward will be stop-start, depending if there will be subsequent waves of infections. We think that the full economic impact of COVID-19 has yet to filter through, as economies are being propped up by massive monetary and fiscal stimulus. There could be further economic dislocations when such support measures are eventually dialled back or removed. In summary, it cannot be business as usual. We will continue to stay nimble and be prepared to pick up the unique opportunities that could present themselves due to the economic dislocations.

Asia Pacific Real Estate
It is Not Business as Usual

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