CBRE Greater China

The Coronavirus Outbreak: What Does it Mean for Real Estate?

Ada Choi, CFA
Head of Occupier Research, Asia Pacific & Head of Research, Greater China

Sam Xie
Head of Research, China

Introduction

The outbreak of the Coronavirus (COVID-19) – which began in December 2019 and has intensified in the first few weeks of 2020 - poses a new downside risk to the Greater China and, to a lesser degree, global economy.

As of February 3, 2020, China had confirmed over 20,000 cases of the virus, over 60% of which are in Hubei province [1]. Globally, the World Health Organisation (WHO) had reported 153 confirmed cases across 23 countries on 3 February 2020. [2]

The Chinese government shut down transportation networks in Wuhan and surrounding cities in Hubei on 23 January 2020 and advised people not to leave the city - a measure not implemented during the 2003 SARS outbreak. Subsequently, cross-city transportation was also limited.

The impact so far: A comparison with the 2003 SARS outbreak

Although the virus has already spread across China, the number of cases is still highly concentrated in Wuhan city and Hubei province, which accounted for approx. 1.6% and 4.6% of China's GDP respectively in 2019. In contrast, several major cities and provinces including Beijing, Hong Kong and Guangdong – the country's leading growth engines – suffered SARS outbreaks in 2003.

[1] National Health Commission of PRC, Tencent News [link], February 4, 2020.

[2] World Health Organisation, February 3, 2020

Table 1: List of most affected markets and number of infected cases

	Markets	2019 n-CoV*	As % of total		Markets	2003 SARS	As % of total
1	**Hubei**	**13,522**	**66%**		**Beijing**	**2434**	**33%**
2	**Guangdong**	**725**	**4%**		**Hong Kong SAR**	**1755**	**24%**
3	**Zhejiang**	**724**	**4%**		**Guangdong**	**1514**	**21%**
4	**Henan**	**566**	**3%**		**Shanxi**	**445**	**6%**
5	**Hunan**	**521**	**3%**		**Taiwan**	**346**	**5%**
6	**Anhui**	**408**	**2%**		**Inner Mongolia**	**289**	**4%**
7	**Jiangxi**	**391**	**2%**		**Hebei**	**210**	**3%**
8	**Chongqing**	**337**	**2%**		**Tianjin**	**176**	**2%**
9	**Jiangsu**	**271**	**1%**		**Jilin**	**35**	**0%**
10	**Shandong**	**259**	**1%**		**Guangxi**	**22**	**0%**
Total Cases		**20,630**				**7335**	

* as of 3 Feb 2020

Source: National Health Commission of PRC, Tencent News [link], WHO, January 2020

Despite accounting for a relatively small portion of national GDP, Wuhan nevertheless holds great strategic importance due to its central geographic location. The city is a key transportation hub and is famous for its education institutions and technology sector. These attributes – combined with its large talent pool and easy accessibility to and from other parts of the country – helped Wuhan's GDP grow 7.8% in 2019, well above the national average of 6.1%.

Table 2: Key economic indicators of Hubei and Wuhan

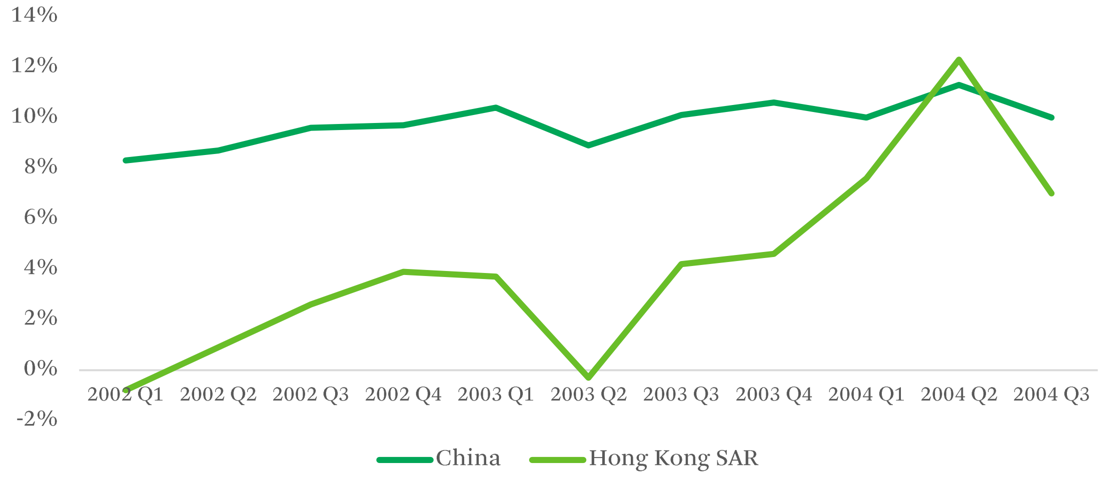
As % of China	Hubei	Wuhan
GDP (2019)	4.6%	1.6%
Retail Sales (Q1-Q3 2019)	4.9%	1.8%

Source: National Statistics Bureau, Statistics Bureau of Hubei, CBRE, January 2020

Table 3: Comparison of 2003 SARS outbreak and COVID-19 Outbreak

	COVID-19 Outbreak	2003 SARS Outbreak	CBRE View
Scale	Over 17,000 cases as of February 2	7,335 cases in Greater China and a global death toll of 774	The number of COVID-19 cases is already more than double of the scale of SARS
Affected sectors	Transportation, tourism, hotels and F&B	Transportation, tourism, hotels and F&B	Online shopping and food delivery are now much more advanced. This will cushion any shock to private consumption
Impact on retail sales	Shopping activity has fallen significantly as people have been advised to stay home. Many shops in Wuhan are closed including restaurant chains such as Haidilao and Starbucks.	China retail sales and hotel & catering y-o-y growth slowed by 2.4 ppts and 3.6 ppts, respectively in Q2 2003, and passenger traffic dropped by 23.7% y-o-y. Hong Kong SAR retail sales fell by 11% y-o-y in Q2 2003.	Retail sales will contract nationwide, with the most severe decline in Wuhan and Hubei.
GDP Growth	Major infrastructure improvements mean Chinese cities are now far better connected than in 2003, so downside risks could impact a broader geography. The positive impact of the Phase-One trade deal with the U.S. could be diluted.	China GDP growth slowed to 8.9% in Q2 2003, while Hong Kong SAR recorded a quarter of contraction (-0.3%) during the same period. Both economies rebounded sharply in H2 2003 after SARS was brought under control.	GDP growth is expected to dip in Q1 2020 but the impact should largely be confined to H1 2020 if the situation is brought under control and does not escalate significantly in major cities. Controls over the movement of people, which were not implemented during SARS, could lessen the scale of the impact.

Figure 1: Real GDP growth during SARS



Source: Oxford Economics, January 29, 2020

Chinese SARS expert Zhong Nanshan stated on January 28, 2020, that he expected the outbreak to peak by early to mid-February, should the control measures be effective. However, other authorities anticipate a longer timeframe, with Gabriel Leung, Dean of the Faculty of Medicine at the University of Hong Kong, expecting the number of infections not beginning to decline until mid-year. [3]

The economic impact

China

Advances in technology such as surveillance and big data along with more developed logistics infrastructure means the government is well equipped to move quickly to limit the spread of the virus. Should the virus brought under control within the next two to three months, the downside risk to China's full-year economic growth should be limited. The PBoC has already made swift movement to ensure liquidity in the financial market by injecting 1.2 trillion yuan via reverse repo on February 3, and CSRC also issued a circular forbidding short selling in the A share market. Authorities are expected to adopt more fiscal and monetary measures including:

- Tax reductions / exemptions for impacted industries (similar to those introduced following the SARS outbreak in 2003);
- Further reductions to the Reserve Required Ratio (RRR) and interest rates;
- Specific policy support for Wuhan and Hubei.

[3] SCMP China's 'demon' virus leaves health experts at odds on when infection rate will slow, January 29, 2020 [link]

Hong Kong SAR

The outbreak is likely to hamper any economic recovery in the Hong Kong SAR, which entered a technical recession in Q3 2019 on the back of widespread sociopolitical unrest. Small-and-medium sized retailers and tourist-oriented stores – which are already under severe pressure - will face the possibility of closure. Employment will experience downward pressure, with Hong Kong Statistics Department data showing that the unemployment rate following the SARS outbreak in 2003 reached 7.9%, also due to the residual impact from Asian Financial Crisis, 911 event and dot-com bubble burst in the previous years. The unemployment rate stood at 3.3% as of Q4 2019.

The Hong Kong SAR Government has already announced HK$10 billion of relief measures on 14 January, mostly targeting low-income families and addressing housing demand. The scale of this initiative could be increased further if needed.

Global

The size of China's economy makes it inevitable that a short-term slowdown will drag on global economic growth, with Asian countries and major trading partners likely to be most affected. However, it is too early to assess the impact on global trade, foreign direct investment and supply chains.

Interest rates will likely stay low or be reduced further in H1 2020. The U.S. Federal Reserve left its policy rate unchanged following its last meeting on January 29 and no rate hikes are expected this year.

The real estate impact

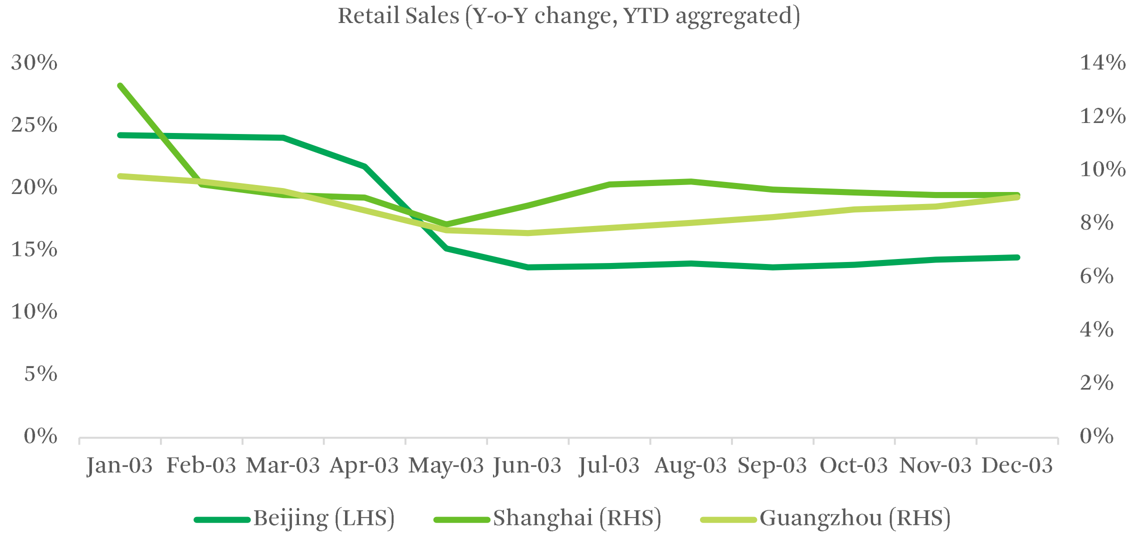
Retail

The retail sector will suffer the strongest impact from the outbreak, with shopping malls already having shortened their business hours as is customary during Chinese New Year. Several retailers closed stores completely following the outbreak, with Starbucks temporarily shuttering 2,000 outlets across China – more than half its total – from January 29, IKEA announcing the closure of all its China stores on January 30, followed by Apple on February 1.

A negative short-term impact on footfall and sales in brick-and-mortar malls and stores is therefore inevitable in the short term. Entertainment, F&B and fashion retailers will be most impacted as households curtail activities outside the home and cut back on discretionary spending. Retailers with omni-channel capabilities will be more resilient and may even outperform.

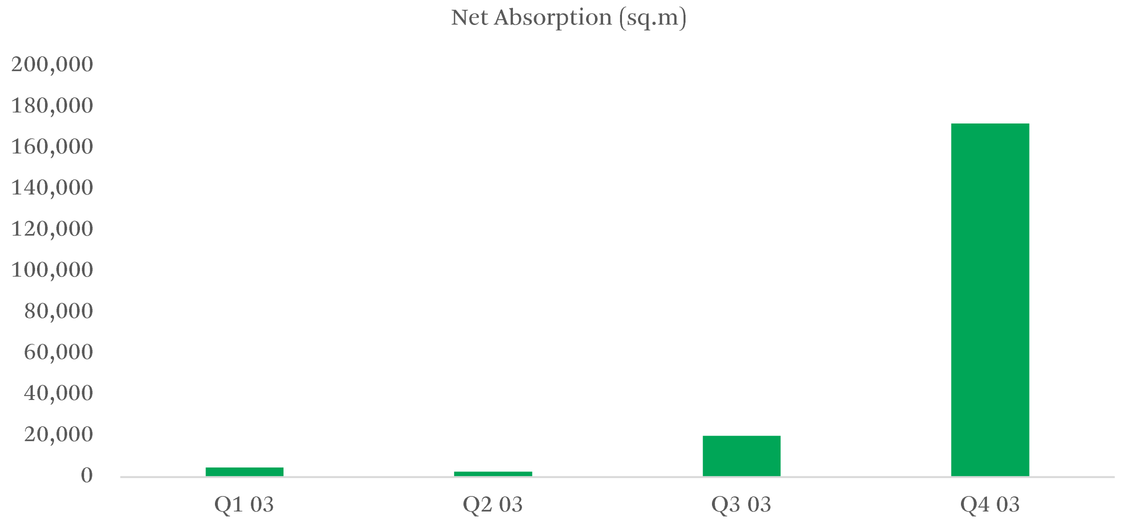
Beijing, Guangzhou and Shanghai all saw retail sales fall in Q2 2003 following the SARS outbreak. The impact upon Shanghai was comparatively lighter and briefer than in Guangzhou and Beijing. The latter was hit especially hard, with Beijing Wangfujing Group's department store revenue in Beijing falling by 21% y-o-y in H1 2003 and retail net absorption slumping to near zero during the same period, followed by a gradual recovery in H2 2003.

Figure 2: Retail sales growth during SARS



Source: National Statistics Bureau, Guangzhou Statistics Bureau, January 2020

Figure 3: Beijing retail property net absorption during SARS



Source: CBRE, January 2020

Following the outbreak of the COVID-19, several major retail landlords announced temporary rental cuts, which CBRE believes could help to alleviate pressure on retailers in the months ahead.

Table 4: Summary of measures announced by major retail landlords

Landlord	Actions
Wanda	Rents and property management fees will be exempted for all tenants in all malls from Jan 24 – Feb 25
Poly	Rents will be exempted for all tenants in all malls from Jan 25 – Jan 30
Powerlong	Rents will be halved for all tenants in all malls from Jan 25 – Feb 2
China Resources	Rents will be exempted for all tenants in all malls from Jan 25 – Feb 9
Seazen	Rents will be halved for all tenants in all malls from Jan 25 – Feb 13

Source: Company announcements, public information, January 2020

CBRE expects occupancy to remain resilient in existing malls in Wuhan but new malls in the city may be forced to offer more flexible lease terms or postpone opening dates. The impact on other cities will be limited.

Office

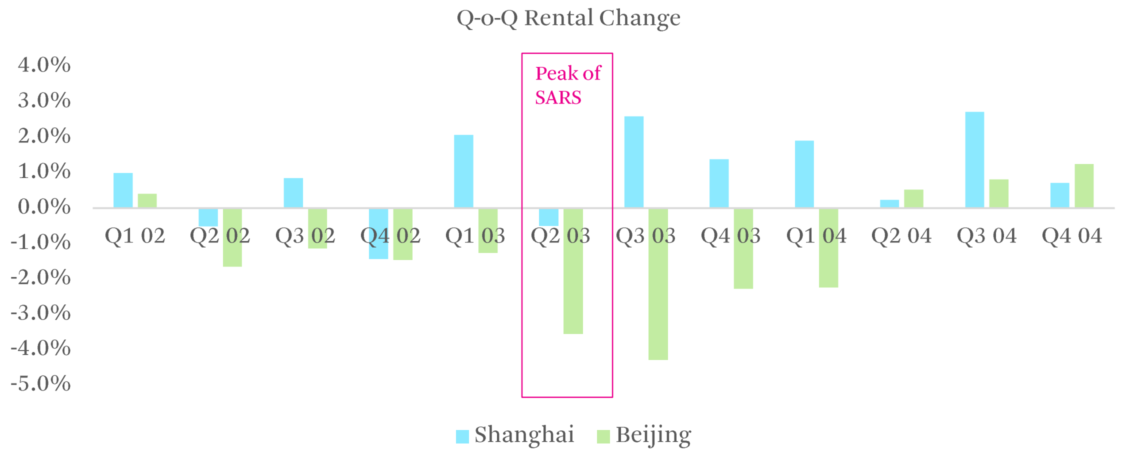
The national office market will be negatively impacted, with the outbreak already curtailing business activity. Leasing activity is expected to slow in Q1 2020, with many occupiers – especially those in severely impacted industries such as food & beverage, retail and transportation – likely to delay decisions involving large scale CapEx.

The degree of impact in individual cities will vary based on the severity of infections. As shown in Figure 4 and Figure 5, SARS had a more prolonged and deeper impact on the Beijing office market in Q2 2003 and Q3 2003 than it did on Shanghai, which saw comparatively fewer infections.

Provided the virus can be largely contained within Hubei province, its impact on the national office leasing market – with the exception of Wuhan – will be short-lived. Leasing activity is likely to recover as early as late Q2 2020, supported by the accelerated opening up of the financial sector to foreign participation.

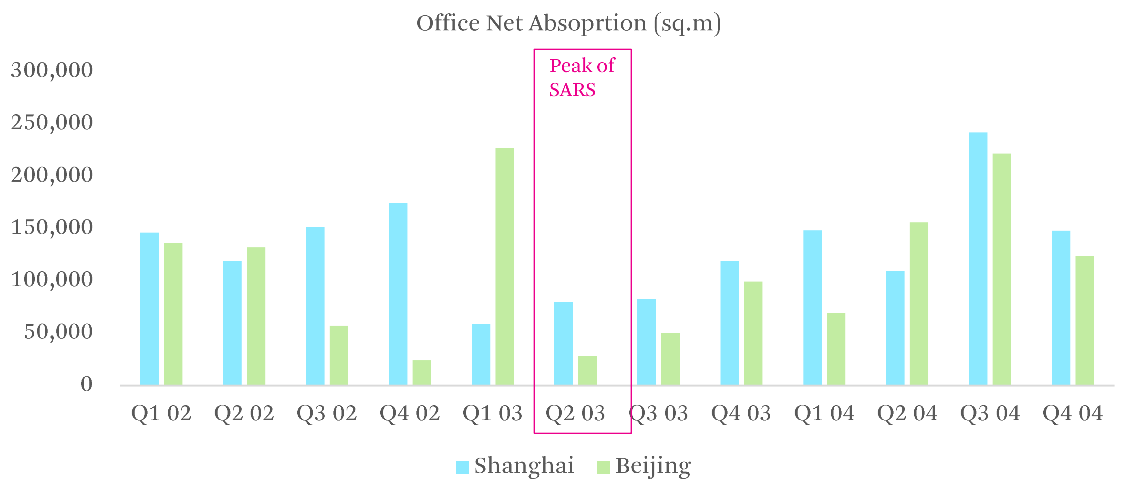
From a longer term perspective, the outbreak could encourage more occupiers and landlords to place a stronger emphasis on flexible working, property management, the workplace experience and employee wellness.

Figure 4: Office rental growth during SARS



Source: CBRE Research, January 2020

Figure 5: Office net absorption during SARS



Source: CBRE Research, January 2020

Industrial & Logistics

CBRE expects the outbreak to have a limited impact on the industrial and logistics market as e-commerce remains the dominant demand driver. On the manufacturing side, most factories are already closed until mid-February (or even longer) for the Chinese New Year holidays.

However, given Wuhan's status as a national strategic transportation and manufacturing hub, there may be disruption to supply chains – a situation that could worsen if the virus is not prevented from spreading to other major urban hubs.

Capital Markets

Real estate investment in China is expected to slow significantly in the short term as business activity declines and non-essential meetings and travel are cancelled. However, expected relief measures such as supportive monetary policy and interest rate cuts, will lend some support to pricing.

Highly-leveraged developers and landlords could come under significant pressure, particularly if they have limited cash flow during this period of reduced business activity. However, real estate debt will remain an attractive investment option.

Investors will strengthen their focus on gateway cities and assets providing steady income streams. Areas of interest will include logistics, with cold chain facilities for pharmaceutical products likely to emerge as a longer term focus. Investors are advised to adopt a wait-and-see approach towards retail and closely monitor individual asset performance.

CBRE GLOBAL RESEARCH

This report was prepared by the CBRE Greater China Research Team, which forms part of CBRE Global Research – a network of preeminent researchers who collaborate to provide real estate market research and econometric forecasting to real estate investors and occupiers around the globe.

For more information regarding this ViewPoint, please contact:

RESEARCH

Henry Chin, Ph.D.
Head of Research, Asia Pacific &
Europe, Middle East and Africa
henry.chin@cbre.com.hk

Ada Choi, CFA
Head of Occupier Research, Asia Pacific &
Head of Research, Greater China
ada.choi@cbre.com.hk

Sam Xie
Head of Research, China
Sam.xie@cbre.com