How will Asia Pacific emerge from the Covid pandemic?

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Asia was the first epicenter of the Covid-19 outbreak three years' ago and is likely to be the last region to emerge from the pandemic, with China finally easing Covid controls recently. This paper aims to map out what may lie ahead for the Asia Pacific region ("APAC") in the post-pandemic era, by looking at the region's economic resilience, cyclical recovery drivers, secular trends underpinning longer term growth and the associated opportunities in the APAC real estate sector for investors.

Strengthened economic resilience

Over the past few decades, APAC has experienced a few major crises – from the Asian Financial Crisis in 1997-98 and the dotcom bust in 2000-01, to the Global Financial Crisis ("GFC") in 2008-09 and the Covid pandemic. The result of this was that many Asian countries learned to build up their economic resilience to withstand external shocks and the region was in a much better shape before going into the Covid pandemic.

Compared to 30 years' ago, the region's foreign exchange reserves have grown 29 times, and its share of global goods trade rose from 25% in 2000-02 to 41% in 2021[1].Before the pandemic hit, China was already a top-five trade partner for economies accounting for 99% of global GDP[2]. By March 2022, China's GDP overtook that of the European Union and India surpassed the UK to become the world's fifth largest economy[3].

Despite the escalated geopolitical tensions, the regional trade networks within APAC have become more integrated over time. In 2020, amidst mobility restrictions and supply-chain disruptions, the intra-regional goods trade contributed around 60% of the total goods trade of APAC countries[4]. In addition, the Regional Comprehensive Economic Partnership ("RCEP")[5], which came into force in January 2022, has created the world's largest trading bloc[6]. The RCEP could help facilitate economic integration and pave the way for a more sustained recovery in APAC in the post-pandemic era.

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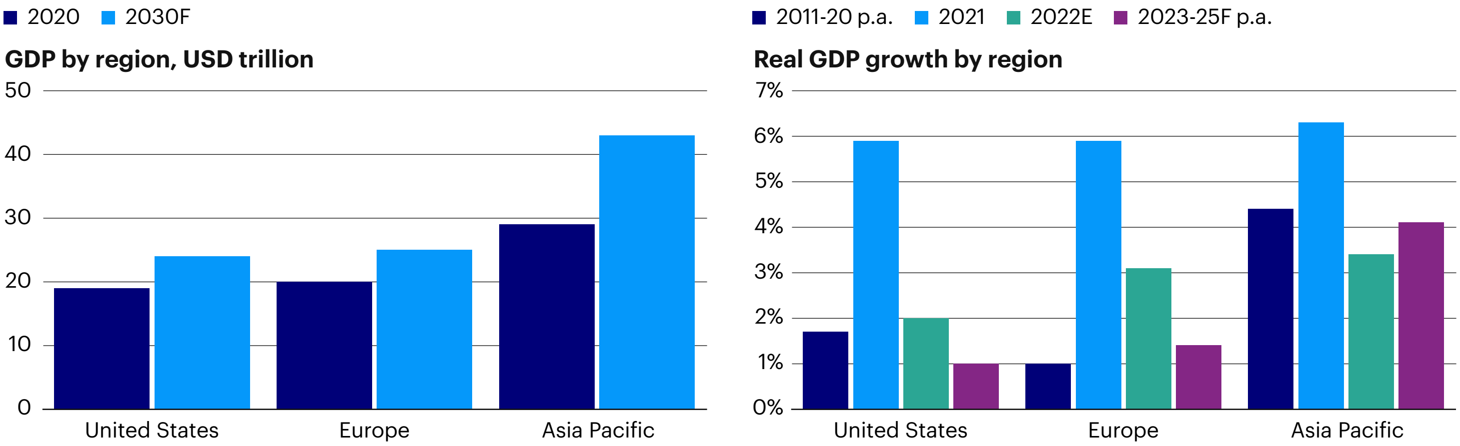
1 Source: McKinsey Global Institute, September 2019; United Nations Economic and Social Commission for Asia and the Pacific, November 2021.
2 Source: World Integrated Trade Solution Database, World Bank.
3 Source: McKinsey Global Institute, October 2022.
4 Source: Asian Development Bank, February 2022.
5 A free trade agreement among 15 APAC nations (incl. China, Japan, South Korea, Australia, New Zealand and Singapore). The key goals include eliminating 90% of the tariffs on imports among its signatories within 20 years and the establishment of common rules for e-commerce, trade and intellectual property.
6 Source: "RCEP agreement enters into force," Association of Southeast Asian Nations, January 2022.

Overall, APAC economies demonstrated more stable growth and less volatility before the pandemic. Even during the onset of Covid in 2020, the Asian economy contracted by 1.5% while the world economy shrank by 3.2%. As we move into the post-pandemic era, APAC's GDP growth is forecast to average 4.1% per annum in 2023-25 in real terms, outpacing that in the US and Europe by 1.0% and 1.4%, respectively[7]. With this growth trajectory, APAC could account for close to 40% of the world's GDP by 2030, up from 35% in 2020. (**Figure 1**)

Figure 1: GDP growth by region[8]



Note: constant (2015) prices and exchange rate.
E = Estimate; F = Forecast
Source: Oxford Economics, January 2023.

The possible "great reopening"

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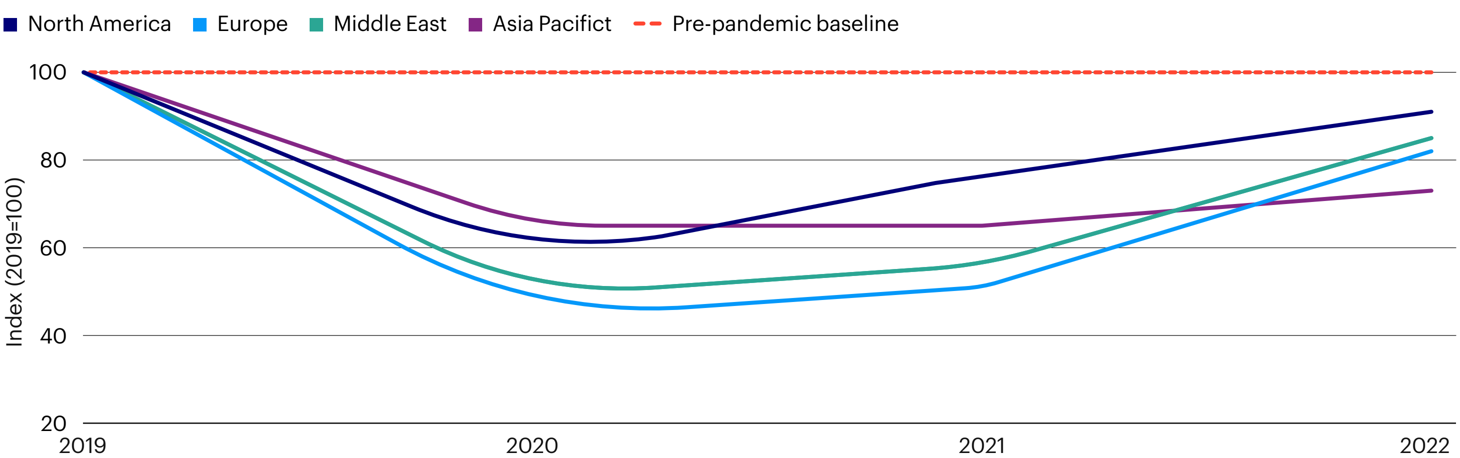
Staggered reopening is likely to sustain a prolonged **economic recovery**

After the synchronized global growth slowdown in 2020, factors such as differences in vaccination rates, stringency of containment measures, tourism dependency and the degree of policy support, meant that APAC countries recovered at different paces and the region has yet to experience the "great reopening" economic rebound as seen in the US and Europe. Now that China is on its way to reopening, although it is expected to be a bumpy ride in the coming months, we believe the staggered reopening is likely to sustain a prolonged economic recovery, and potentially offset the weaker external demand from the US and Europe going into 2023.

Figure 2: Scheduled airline capacity by region



Source: Invesco Real Estate using data from OAG, December 2022.

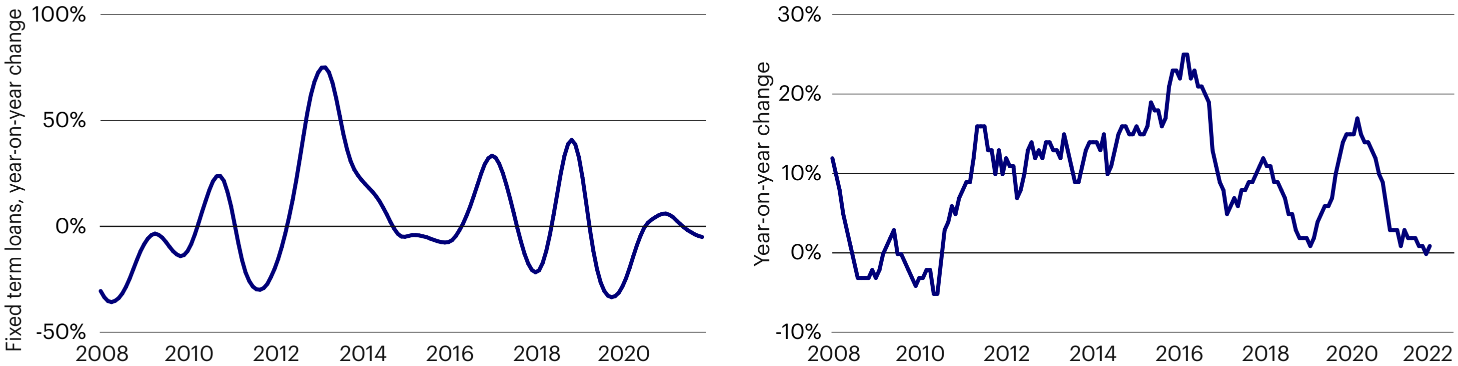
7 Oxford Economics, January 2023.
8 Oxford Economics, based on 2015 prices in USD, January 2023.

The biggest price dislocation since the GFC

Since 1H22, several APAC countries have been following the US Fed to raise interest rates. Compounded with the supply chain disruptions which began early on in 2020, the surge of development costs and construction delays have caused both lenders and real estate investors to be risk adverse, which resulted in a frozen credit market and a stalled investment market. Price dislocations were most apparent in South Korea and Australia. (**Figure 3**)

Figure 3: Credit markets in Australia and South Korea

Australia all lenders – new loan for construction | **South Korea insurance company – loans secured by real estate**



Source: Invesco Real Estate using data from Macrobond, January 2023.

In terms of relative pricing[9], many APAC markets have seen property yield spread over borrowing costs moving from positive to negative over the course of 2022, discouraging investment demand especially when the growth outlook is still uncertain. The two exceptions are China and Japan.

In China, yield spread was already in negative territory before Covid-19 hit, but it has recently turned positive after property yields softened and the central bank cut interest rates. In Japan, at the time of writing, the market is probably the only developed market with positive yield spread, which offers a wide yield spread even after the Bank of Japan (BOJ) changed its yield curve control policy[10]. Despite the BoJ maintaining the outright target at 0%, the move and the potential softening of long-term bond yields may impact the real estate required return going forward; but we believe the yield spread is enough to cushion the impact.

Subject to the pace and extent of rate hikes in the US, we believe we are seeing the biggest price dislocation since the GFC, and it could be a very rare opportunity in the coming quarters to capture attractive returns. In other words, we see this as a vintage year opportunity as, in our view, downturns can provide attractive prospects.

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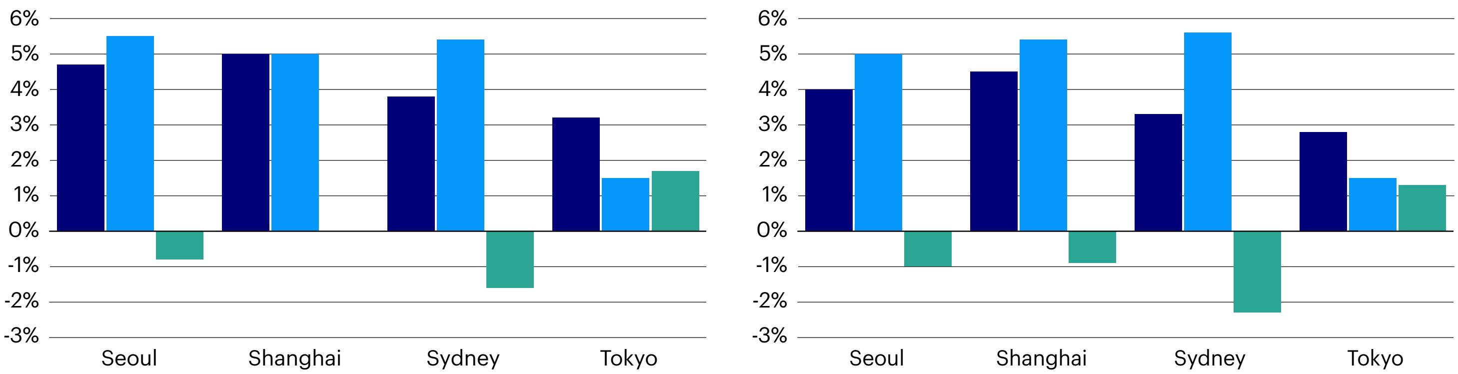
Japan is probably the only **developed market** with positive yield spread

Figure 4: Yield spread over borrowing costs

■ Stabilized cap rate ■ Average all-in borrowing costs ■ Cap rate spread

Logistics cap rates and borrowing costs (%) | **Grade A office cap rates and borrowing costs**



Source: Invesco Real Estate estimates, data as of August 2022.

9 Refers to property yield spread over borrowing cost. Depending on the leverage ratio, an investment with negative yield spread usually deters investors from buying unless there is a strong growth potential of income to follow.

10 Effective from 20 December 2022, the adjusted yield curve control polity widens the target band for the 10-year JGB to +/- 0.50% from the previous +/- 0.25%.

Similar (yet different) secular trends

We believe a few secular trends have significant investment implications to APAC real estate. In fact, these secular trends are not unique to this region, but the scale and pace of these shifts are much larger and faster in APAC, creating wider supply-demand distortion and market gaps in some markets.

2017 - 2021

APAC	US	Eurozone
3.6%	2.3%	0%

Private consumption grew at an average p.a.

(a) Growing affluence among urban cohorts

In the past decade, some 430 million people in APAC moved to urban areas. In the period 2017-21, APAC private consumption grew at an average of 3.6% per annum (vs. 0% in Eurozone and 2.3% in the US)[11]. In the coming decade, the urbanization trend is set to continue (with 394 million urban population growth projected in 2020-30) and half of the world's consumption growth is expected to come from the region, equivalent to US$9.5 trillion worth of opportunity. In fact, 80% of that growth may come from the top tiers of consumer class (i.e. upper-middle-income and above)[12]. This growth of the affluent urban population is expected to lead to a consumption upgrade that may have a bigger impact on some segments of real estate.

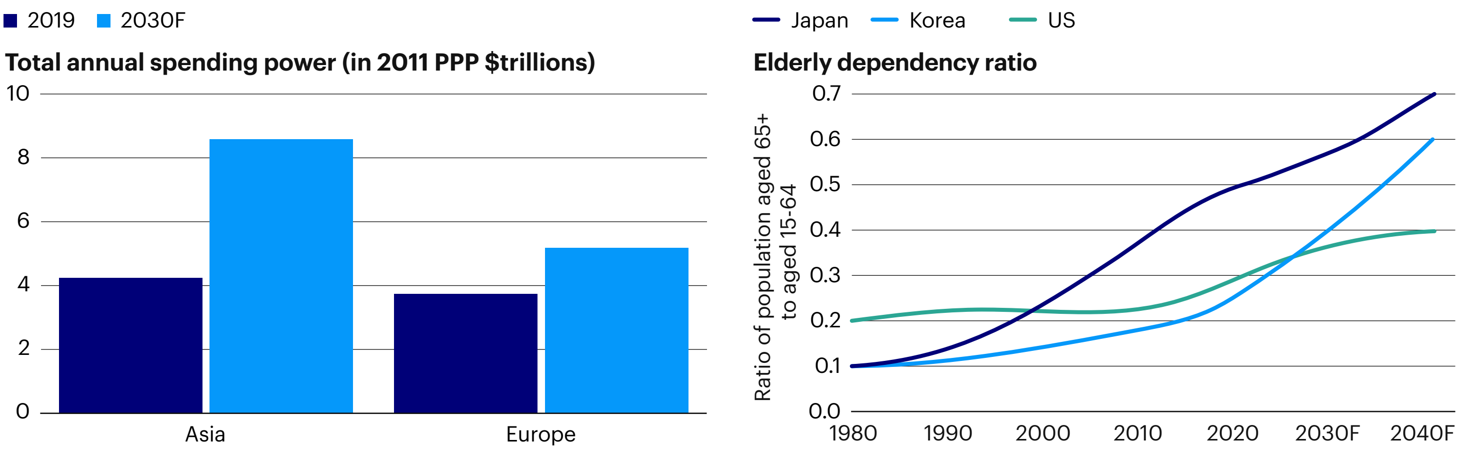
In South Korea and Japan, the **elderly dependency** ratios have risen rapidly

(b) Ageing population

Almost all advanced economies are facing ageing population and Asia is no exception. However, the pace of ageing in certain countries is much faster than others. In particular, in South Korea and Japan, the elderly dependency ratios (the ratio of the population aged 65+ to the population aged 15-64) have risen rapidly and are expected to trend above that in the US by 2030.

As societies age, more active and healthy elderly people live alone. As a result, seniors' consumption is expected to grow at 1.5-2x faster than the consumption growth of the general population. By 2030, the total annual spending power (in 2011 purchasing power parity (PPP) $) by people aged 60+ in Asia Pacific is expected to double[13]. We believe this population cohort is hugely under-served APAC.

Figure 5: Elderly dependency ratio and size of "silver economy"



Note: "Silver Economy" describe the system of goods and services aimed at elderly people for their consumption, living and health needs.
F = Forecast
Source: Oxford Economics, World Data Lab, World Bank, United Nations projection, September 2022.

Single-person households have different lifestyles, require different products and services, and ultimately drive a robust **"singles economy"**

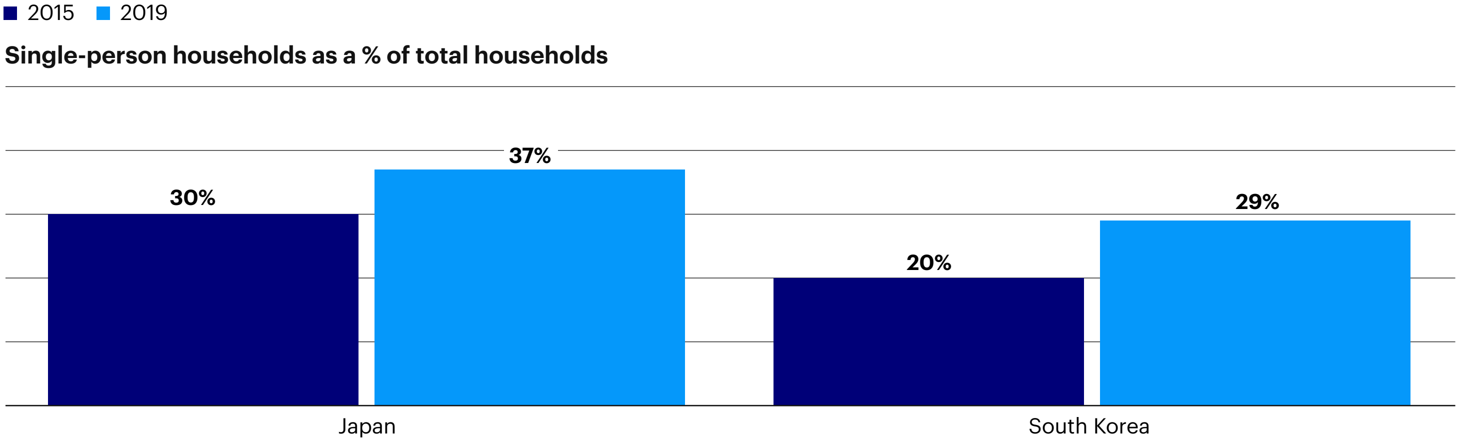
(c) Growing single-person households

In the past 20 years across APAC, most countries have experienced a decline in the average household size. In particular, single-person households are becoming a significant segment across the region. Almost one-third of households in advanced Asia and more than 15% in China are single-person households[14].

Single-person households have different lifestyles, require different products and services, and ultimately drive a robust "singles economy". They are therefore more inclined to order at home food deliveries and smaller portions of packaged food. They have more time for themselves, leading to greater demand for various forms of leisure such as travel. They tend to have higher mobility, are more receptive to changing work and residing locations. This trend could eventually lead to a growing demand for housing that caters for single persons.

11 Oxford Economics, September 2022.
12 McKinsey Global Institute, September 2021.
13 McKinsey Global Institute, September 2021.
14 McKinsey Global Institute, September 2021.

Figure 6: Single-person households as % of total households



Source: McKinsey Global Institutes, May 2020.

Maturing capital markets and growing institutional capital pool

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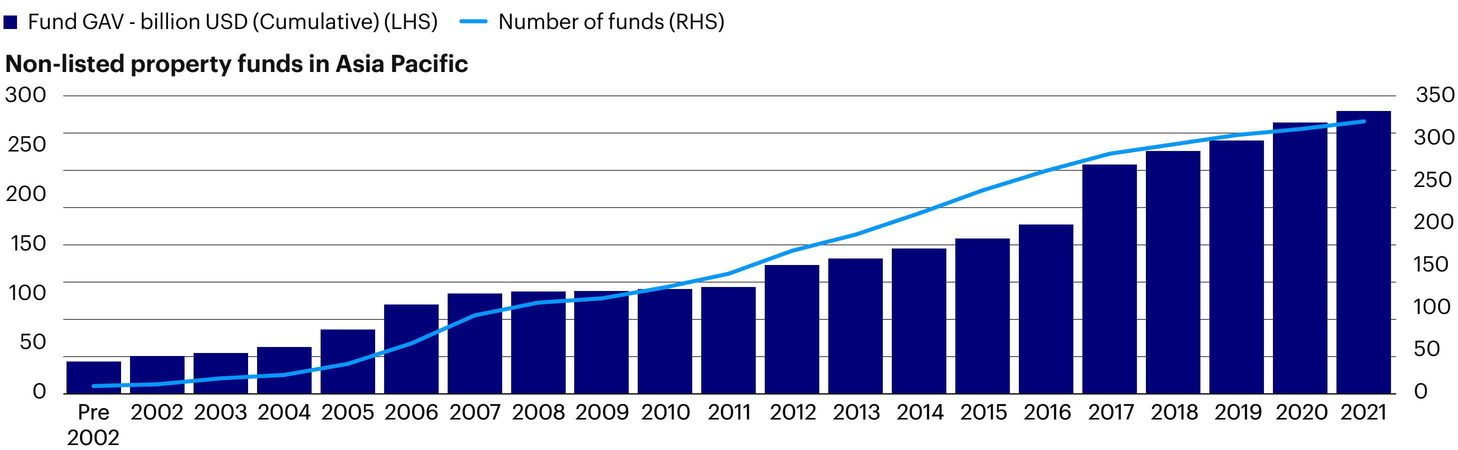
Private real estate sector in Asia Pacific has witnessed the strongest **growth at 22.7%** year-on-year relative to other asset types

Asia Pacific real estate has attracted growing investment interest. The size of the professionally managed real estate investment market in APAC expanded 16% from the pre-pandemic level in 2019 to USD 3 trillion in 2021. By portfolio types, the private real estate sector in Asia Pacific has witnessed the strongest growth at 22.7% year-on-year relative to other asset types[15].

In the first half of 2022, despite the slowdown of fundraising activity at the global level, fundraising in Asia Pacific has continued its momentum. The total dry powder targeting Asia Pacific real estate reached USD 57 billion by 2Q22, and the highest since the 2008[16]. Preqin has forecasted Asia Pacific-based real estate assets under management to grow from USD 108 billion in 2020 to USD 125 billion by 2025[17].

Figure 7: Non-listed property funds in Asia Pacific



Source: ANREV, March 2022.

Implications for APAC real estate: vintage year investing

We expect the secular trends we have observed to underpin fundamental demand drivers for years to come. In the near term, the big price dislocations, the frozen credit markets in some APAC countries and the cyclical recovery from border reopenings are expected to present compelling investment opportunities in the value-add/opportunistic space.

The following highlights the **key investment strategies** and approach:

(i) The tightened credit markets and erosion of liquidity may present recapitalization opportunities in the form of equity, structured equity, etc.

(ii) Acquire under-performing or mispriced real estate assets from lenders and other overleveraged or cash constrained owners who lack the capital to upkeep the properties.

(iii) Favorable supply-demand imbalance and/or shortage of high-quality space presents opportunities to pursue build-to-core strategy at attractive development margins.

15 MSCI Real Estate Market Size Report 2021-22..
16 JLL "Asia Pacific Capital Tracker 2Q22", July 2022.
17 Preqin Special Report "The Future of Alternatives 2025", November 2020.

Conclusion
Invesco Real Estate believes that the current credit market conditions and price dislocations in a number of APAC markets provide a rare attractive opportunity – what we like to refer to as vintage year investing.

Combined with strengthened economic resilience, a reopening upswing and secular growth drivers, the APAC real estate is well positioned, in our view, to produce compelling investment returns in the post-pandemic era with 2023 viewed as a vintage year opportunity.

Investment risks
The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Property and land can be difficult to sell, so investors may not be able to sell such investments when they want to. The value of property is generally a matter of an independent valuer's opinion and may not be realised.