Sector updates

Research Team

Asia Real Estate – Hitting the reset button

Asia | Real Estate

The Zero Fix – Opportunities and Challenges

China – Accelerating Asia's Ascent

Investment summary

2020 was a challenging year for Asia real estate stocks, which saw a stark underperformance relative to their respective country's benchmark indices. However, 2021 appears decidedly optimistic. We expect the sector recovery to be buttressed by the following key themes: i) Asian economies to lead the global economic recovery, with real estate a key beneficiary of the reflation trade; ii) hunt for yield to continue amid a low interest rate environment; iii) robust longer-term demand drivers such as rising affluence and urbanisation rates supporting development of the real estate sector in Asia; iv) rebound in investment volumes to help drive inorganic growth; v) investors' expectations are low, and valuations remain attractive. While we are positive on the real estate sector in Asia, it would be prudent to bear in mind the risks. The path to normalcy is likely to be uneven and bumpy, and the pace of the economic recovery will largely depend on how fast Covid-19 vaccinations are rolled out globally. We would thus look for real estate players with strong balance sheets, that are well-positioned to ride out this period of uncertainty. Investors should also be mindful of shifting policy risks on the residential front, as governments may step in with property cooling measures in line with the need to keep housing affordable. Following a screening of our real estate coverage universe in Asia ex. Japan, our top picks (in alphabetical order) are **Ascendas REIT (AREIT SP) [BUY; FV: SGD3.89]**, **CapitaLand Integrated Commercial Trust (CICT SP) [BUY; FV: SGD2.60]**, **CapitaLand Limited (CAPL SP) [BUY; FV: SGD3.75]**, **China Overseas Land & Investment (688 HK), [BUY; FV: HKD31.03]**, **China Resources Land (1109 HK) [BUY; FV: HKD44.84]**, **Longfor Group (960 HK) [BUY; FV: HKD54.32]**, **Mapletree Industrial Trust (MINT SP) [BUY; FV: SGD3.51]** and **Sun Hung Kai Properties (16 HK) [BUY; FV: HKD145]**.

- Expected recovery in 2021 underpinned by economic rebound, better containment of Covid-19 pandemic and rollout of vaccination programmes across the region
- MSCI Asia ex-Japan Real Estate Index trading at attractive valuations
- Preferred picks: AREIT SP, CICT SP, CAPL SP, MINT SP, 688 HK, 1109 HK, 960 HK and 16 HK

Challenges galore in 2020, but 2021 promises to be better

2020 was a challenging year for Asia real estate stocks, which saw a stark underperformance relative to their respective country's benchmark indices. This was due to strict lockdowns and unprecedented measures imposed during the Covid-19 pandemic. Human traffic to hotels, retail malls and offices saw significant declines as work-from-home and e-commerce trends accelerated, while borders were largely closed. However, sector performance was understandably bifurcated as real estate players with significant exposure to logistics and data centres outperformed hospitality, retail and offices. The residential sector also proved surprisingly resilient, given declining mortgage rates amid a low interest rate environment.

While 2020 was grim, 2021 appears decidedly optimistic, especially for the Asia real estate sector. This would be buttressed by an economic rebound, more effective containment of Covid-19, gradual rollout of vaccination programmes across the region and undemanding valuations.

Following a screening of our real estate coverage universe in Asia ex. Japan, our top picks (in alphabetical order) are **Ascendas REIT (AREIT SP) [BUY; FV: SGD3.89], CapitaLand Integrated Commercial Trust (CICT SP) [BUY; FV: SGD2.60], CapitaLand Limited (CAPL SP) [BUY; FV: SGD3.75], China Overseas Land & Investment (688 HK), [BUY; FV: HKD31.03], China Resources Land (1109 HK) [BUY; FV: HKD44.84], Longfor Group (960 HK) [BUY; FV: HKD54.32], Mapletree Industrial Trust (MINT SP) [BUY; FV: SGD3.51]** and **Sun Hung Kai Properties (16 HK) [BUY; FV: HKD145]**.

Exhibit 1: Preferred real estate picks in Asia ex. Japan

	Ticker	Ccy	Last Close ($)	Fair Value ($)	Dividend Yield FY-1	Dividend Yield FY-2	P/B FY-1 (x)	P/B FY-2 (x)	Potential Upside	Rating
Ascendas REIT	AREIT SP	SGD	3.07	3.89	5.1%	5.3%	1.4	1.4	27%	**BUY**
CapitaLand Integrated Commercial Trust	CICT SP	SGD	2.14	2.60	5.1%	5.6%	1.1	1.1	21%	**BUY**
CapitaLand Ltd	CAPL SP	SGD	3.11	3.75	3.9%	3.9%	0.7	0.6	21%	**BUY**
China Overseas Land & Investment	688 HK	HKD	18.12	31.03	6.5%	7.0%	0.5	0.5	71%	**BUY**
China Resources Land	1109 HK	HKD	31.25	44.84	4.2%	5.1%	1.1	1.0	43%	**BUY**
Longfor Group	960 HK	HKD	41.50	54.32	3.9%	4.9%	2.1	1.8	31%	**BUY**
Mapletree Industrial Trust	MINT SP	SGD	2.81	3.51	4.3%	4.7%	1.7	1.7	25%	**BUY**
Sun Hung Kai Properties	16 HK	HKD	108.80	145	4.7%	5.0%	0.5	0.5	33%	**BUY**

Source: Bloomberg, Internal estimates, BOS-Morningstar, as at 11 Feb 2021 closing prices

Note: FY-1 denotes current financial year; FY-2 denotes next financial year.

Key themes for 2021:

Asian economies leading the recovery; real estate a key beneficiary of reflation trade

As the world looks in anticipation to the recovery from the Covid-19 pandemic, Asian economies are expected to lead the global economic rebound. According to in-house projections, China's economy is expected to expand 8.1% in 2021 while the rest of Asia is forecasted to grow at an annual pace of 7.9%. This is higher than our global GDP growth forecast of 5.9%.

Exhibit 2: Global growth outlook

%	2019	2020	2021
Developed Markets	1.7	-5.0	5.3
US	2.3	-3.5	6.0
Eurozone	1.2	-7.3	5.5
Japan	0.7	-5.0	3.6
Emerging Markets	3.7	-2.4	6.3
China	6.1	2.3	8.1
Rest of Asia	5.0	-5.7	7.9
World	2.9	-3.4	5.9

Source: Internal estimates, as at 31 Jan 2021

With the rollout of vaccination programmes globally, we expect a gradual return to normalcy from 2H21 onwards. This will likely benefit the real estate sector as footfalls and tenant sales in shopping malls gradually recover while physical occupancies in offices increase with the relaxation of social restrictions in time to come. Meanwhile, logistics and data centres will continue to benefit from the tailwinds of higher e-commerce penetration rates and widespread adoption of technology - secular growth trends that have only accelerated with the pandemic.

Given that markets are generally forward looking, near-term equity prices may increasingly reflect such buoyant expectations, although volatility and uncertainties are expected.

Historically, earnings of cyclical sectors such as real estate have been more sensitive to economic growth. Given the positive economic backdrop, we expect earnings of the real estate sector to rebound, while the focus on reflation should keep the outlook well-supported. Real estate is also well-placed to ride out inflation concerns, as it is traditionally seen as a good hedge against inflation.

Exhibit 3: Historical average consumer prices and forecasts (annual percent change)

	2019	2020F	2021F	2022F	2023F	2024F	2025F	Trend
ASEAN-5	2.1	1.5	2.3	2.5	2.7	2.8	2.8	
China	2.9	2.9	2.7	2.6	2.6	2.6	2.6	
Hong Kong	2.9	0.3	2.4	2.5	2.4	2.4	2.4	
India	4.8	4.9	3.7	3.8	3.9	3.9	4.0	
Indonesia	2.8	2.1	1.6	2.5	3.0	3.0	3.0	
Singapore	0.6	-0.4	0.3	1.1	1.4	1.4	1.5	
Australia	1.6	0.7	1.3	1.5	1.9	2.2	2.4	

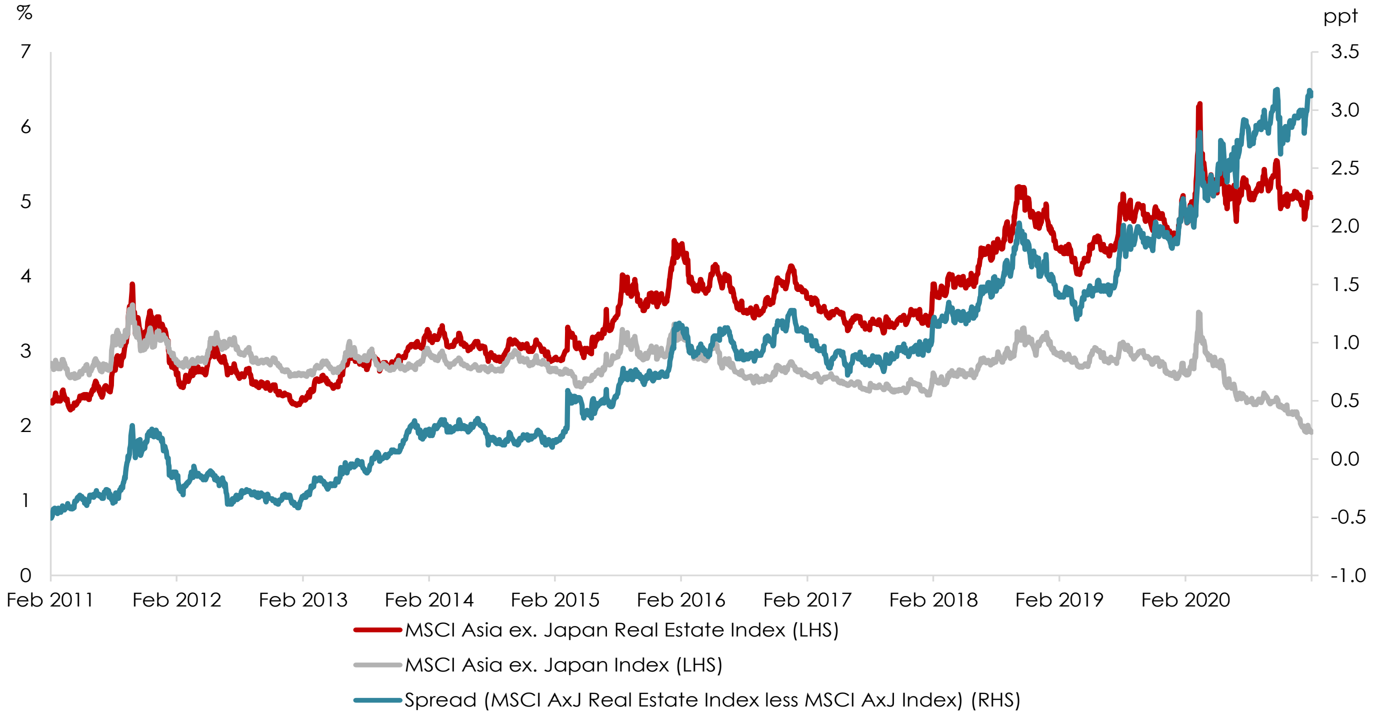
Source: IMF World Economic Outlook Oct 2020

Hunt for yield to continue amid a low interest rate environment

Even with the recent spike in the 10-year US Treasury yield, real yields remain negative. This, alongside the lower for longer interest rate environment, should continue to drive the hunt for yield, in which case the real estate sector is poised to benefit. For one, the MSCI Asia ex-Japan Real Estate Index offers higher dividend yields relative to its peers in the US and Europe, and also relative to the broader MSCI Asia ex-Japan Index. In fact, we note that the forward dividend yield spread between the MSCI Asia ex-Japan Real Estate Index and MSCI Asia ex-Japan Index has widened to ~315 basis points (bps), which is significantly above the past 10-year average of 81 bps.

Nevertheless, we are cognisant that dividends are not sacrosanct. Hence a bottom-up stock picking strategy to evaluate the longer-term sustainability of dividend payments should be a key consideration when investing in real estate stocks.

Exhibit 4: Forward dividend yield trend

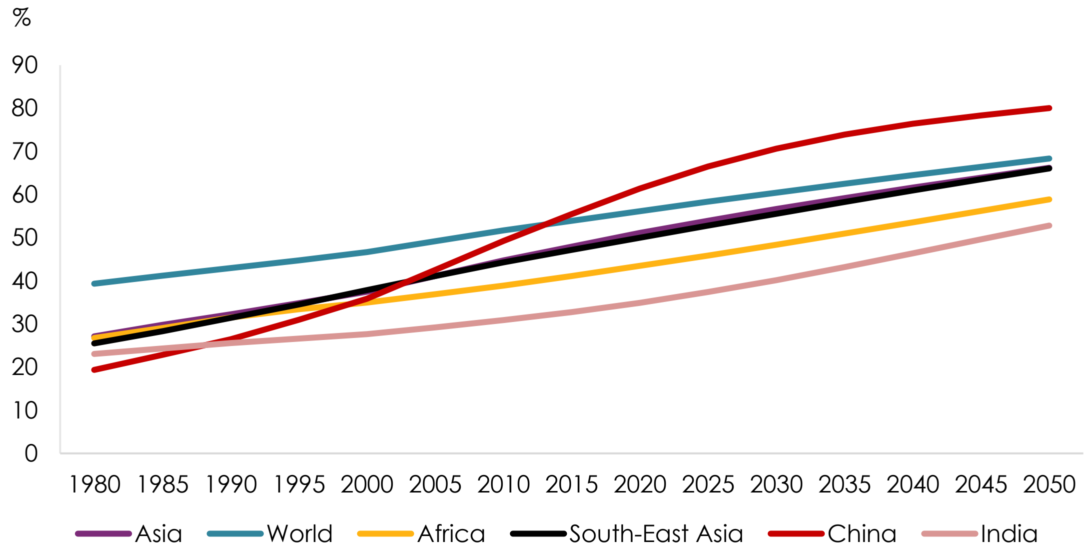


Source: Bloomberg, internal estimates, as at 9 Feb 2021

Robust longer-term demand drivers supporting development of real estate sector in Asia

Demand and supply dynamics for the real estate sector are highly localised and hardly synchronised across geographies, with country specific factors such as demographics, government policies, taxes and income levels more likely to influence the performance of the sector. We thus see positives from Asia given robust demand drivers underpinned by favourable demographics, rising urbanisation rates and growing middle-class in Asia. According to estimates from the United Nations, Asia's urbanisation rate is projected to increase from 51.1% in 2020 to 56.7% in 2030 and 66.2% in 2050. The rate of increase to 2030 is expected to be the strongest in Asia amongst the major regions, with China leading the charge.

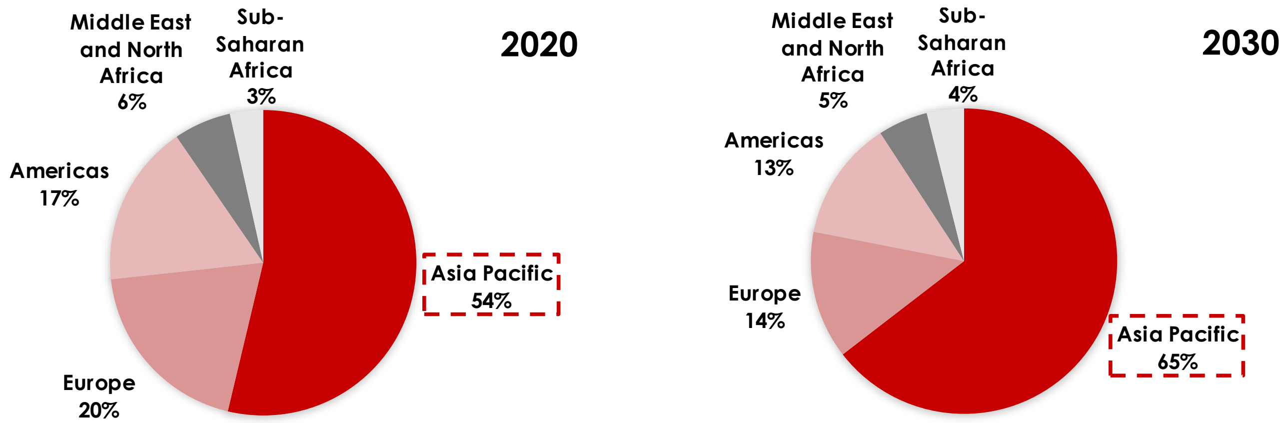
Exhibit 5: Increase in Asia's urbanisation rates likely to be driven by China and India



Source: World Urbanisation Prospects, United Nations estimates, 2018

The Asia-Pacific region is also expected to see a surge in its middle-class population, which would help to increase purchasing power and drive demand for higher quality housing. According to Brooking Institution, approximately 65% of the world's middle-class population is projected to come from Asia-Pacific in 2030, an increase from 54% in 2020.

Exhibit 6: Expected share of global middle-class by region



Source: Brookings Institution, Statista, World Economic Forum

Note: Percentages may not add up to 100% due to rounding. Middle class is defined as households with incomes between US$11-110 per person per day (PPP) in 2011.

Rebound in investment volumes to help drive inorganic growth

Capital recycling is a term we often hear within the real estate space. This relates to the divestment of assets (mostly non-core and/or underperforming) and reinvesting the net proceeds into higher yielding properties or those which a developer/Real Estate Investment Trust (REIT) believes it can value add to improve the operational performance of the assets. Capital recycling is a core part of a developer/REIT's business strategy. With borders largely closed and many countries in lockdown last year, investment activities and deal flows took a severe hit. However, this is expected to see a robust rebound in 2021, thus allowing real estate players to resume the acquisition of properties to drive inorganic growth. This would be supported by a recovery in risk appetites and ample liquidity in the markets. As it is, real estate market observer Jones Lang LaSalle (JLL) highlighted in its recent Asia-Pacific Capital Markets 2021 outlook report that it expects real estate investment volumes in the Asia-Pacific region to increase 15-20% in 2021.

Investors' expectations are low, and valuations remain attractive

Given the negative impact of Covid-19 on most real estate sub-sectors, downward earnings revision by the street has been prevalent, while we also expect a kitchen sinking 4Q20/2H20 as real estate players book in impairment losses and provisions on doubtful receivables. This sets the earnings bar and expectations for 2021 at a much lower base and does leaves room for potential positive earnings surprises, in our view.

Valuations for the Asia ex-Japan real estate sector are also attractive and thus could find favour amongst investors given the rotation to value trade. The MSCI Asia ex-Japan Real Estate Index is trading near its trough valuations from a forward price-to-earnings (P/E) basis and current forward price-to-book (P/B) ratio of 0.7x comes in at one standard deviation below its 10-year average of 0.8x.

Exhibit 7: Forward P/E trend of MSCI Asia ex-Japan Real Estate Index

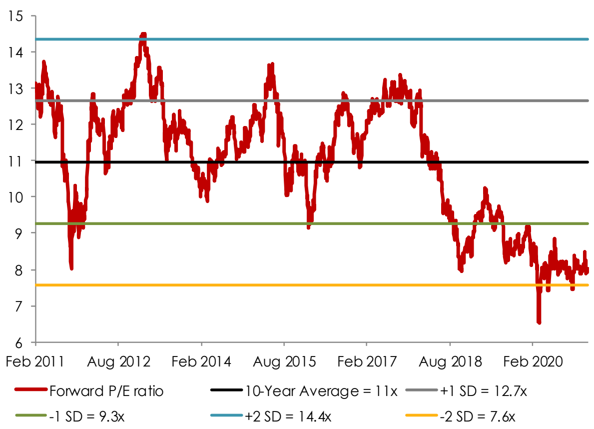
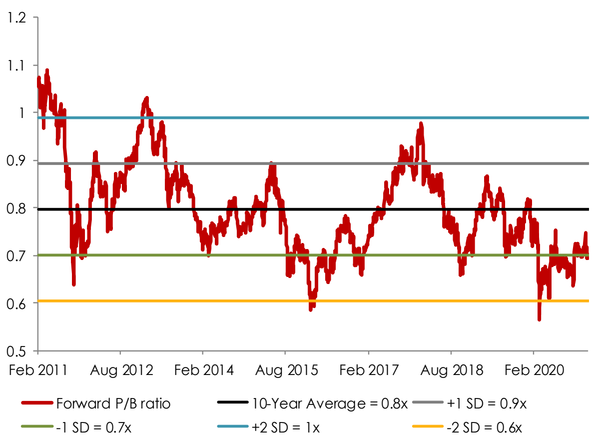


Exhibit 8: Forward P/B trend of MSCI Asia ex-Japan Real Estate Index



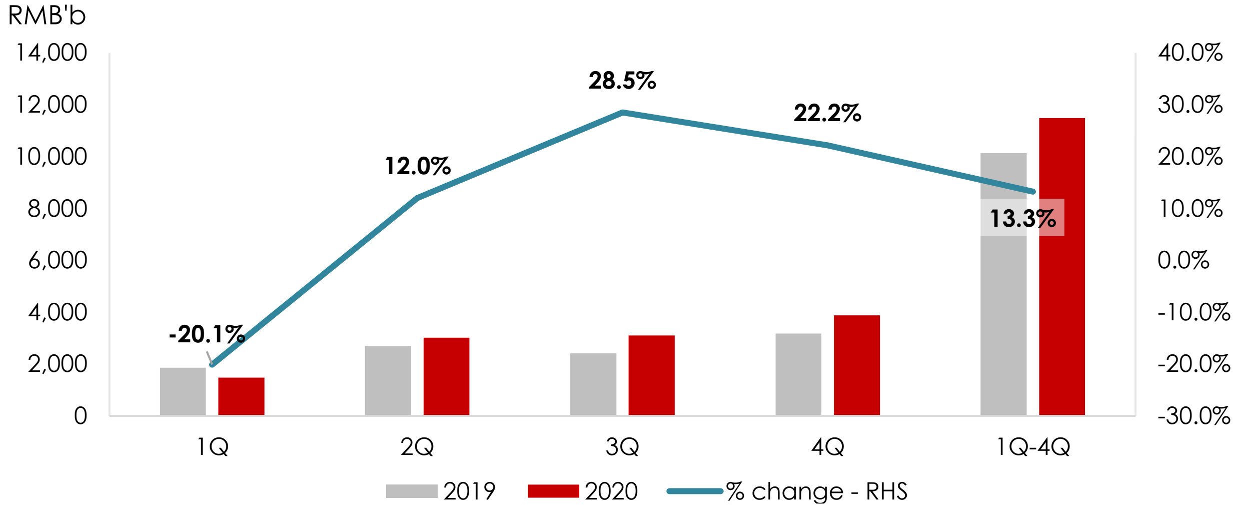
Source: Bloomberg, internal estimates, as at 9 February 2021

China

Real estate has been a bright spot for the Chinese economy in 2020 despite policy headwinds. The physical market has performed resiliently even though there was approximately 1.5-2 months of impact from the Covid-19 outbreak in early 2021 with the closure of showflats and delays in construction progress. Total real estate fixed asset investments rose 7.0% year-on-year (YoY) to RMB14.1t in 2020. Overall residential transaction value jumped 10.8% YoY in 2020 to RMB15.5t, driven by both volume and price increases.

Looking at the performance of the top 100 Chinese developers, we note that contracted sales fell 20.1% YoY in 1Q20 due to the pandemic, but rebounded to positive growth of 12.0% in 2Q20, 28.5% in 3Q20 and 22.2% in 4Q20, based on statistics from industry watcher CRIC. For the whole of 2020, contracted sales for the top 100 developers in China grew 13.3%, outpacing overall national residential transaction value growth. That said, there was a moderation in YoY growth on a monthly basis from Sep to Dec 2020. We believe this can be attributed to policy headwinds and increasing competitive pressures which led to lower sell-through rates.

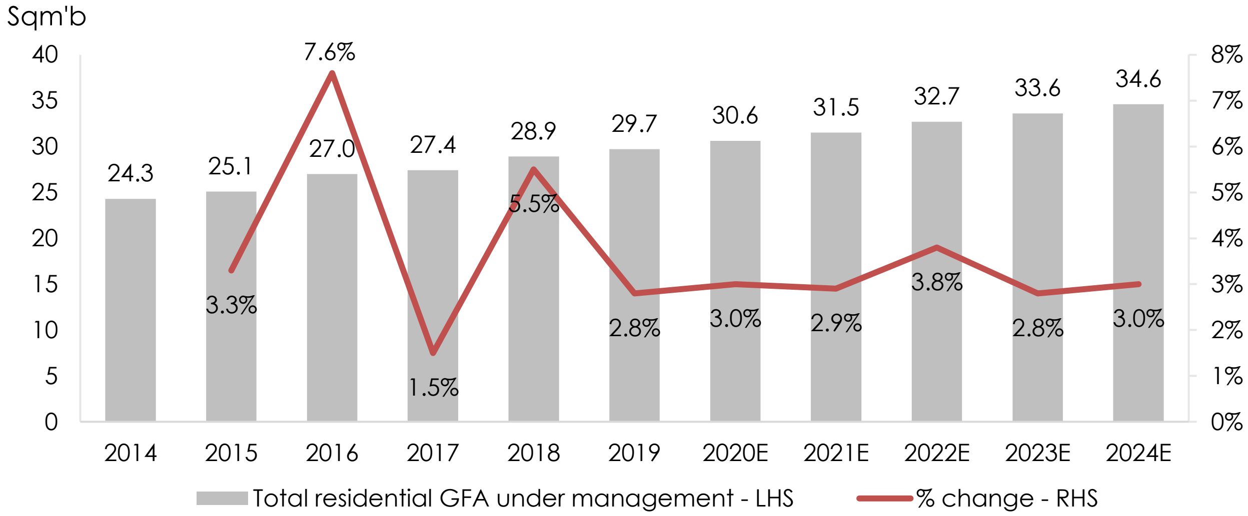
Exhibit 9: Contracted sales of top 100 developers in China



Source: CRIC

Although there are policy headwinds on the residential front as the government seeks to keep housing affordable, it does not take on a blanket approach to the sector as there have also been favourable policies being introduced with the aim of improving the quality of life of its people. The property management sector is one such beneficiary. For instance, China's Ministry of Housing and Urban-Rural Development (MoHURD) recently issued a notice and key points include: i) enhancing the property management fee pricing mechanism, such as basing it on CPI growth and service quality, ii) improving the quality and expanding the scope of property management services, iii) encouraging M&A in the property management segment, iv) strengthening the adoption of smart property management services such as encouraging the use of Internet of Things (IoT), cloud computing, big data and blockchain and v) encouraging the integration of online and offline services. The property management sector also tends to be more resilient than the property development sector, given that the former is relatively more recession proof and also asset light. Hence, this is another area which investors can look at to gain exposure to positive longer-term structural demand drivers for the Chinese real estate sector.

Exhibit 10: Trend of China's total residential GFA under management by property management companies

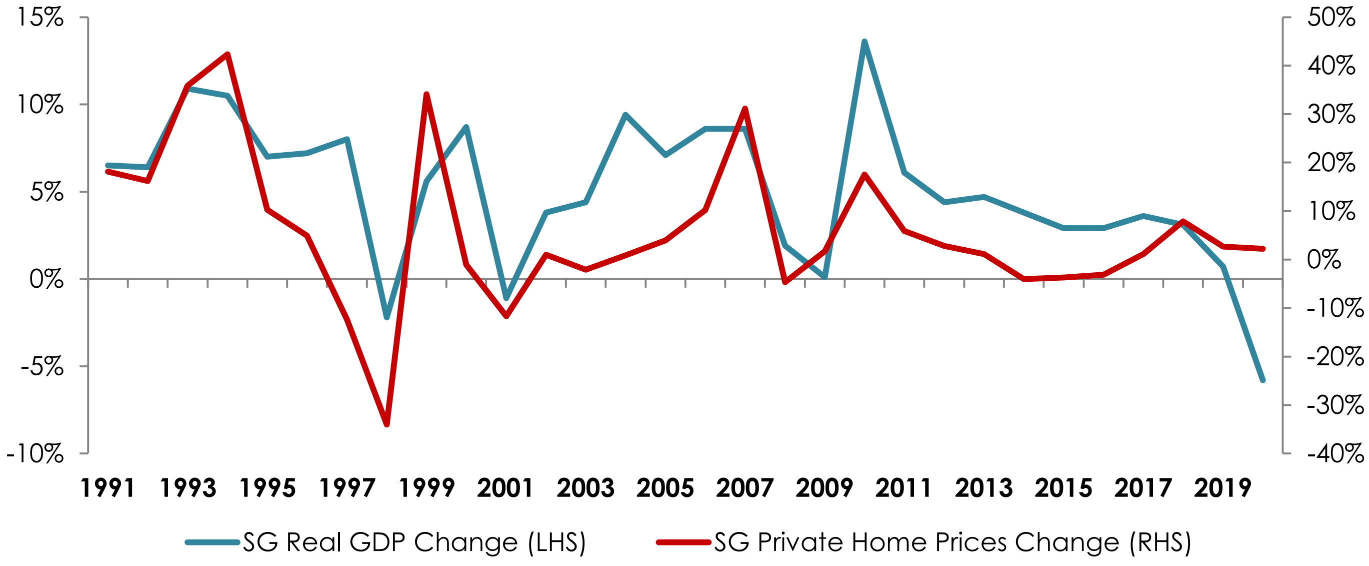


Source: Frost & Sullivan

Singapore

Singapore's residential property market also shines through for its resilience. Prices of private residential properties rose by 2.2% in 2020 despite the 5.8% contraction in its real GDP, according to the URA. We expect Singapore's private residential property prices to increase between 2-4% in 2021, underpinned by a steady recovery in the region, a recovering labour market, the low mortgage rate environment, potential return of foreign buyers and higher expected construction costs due to Covid-19 (some costs expected to be passed through in the form of higher prices).

Exhibit 11: Trend between Singapore's private residential price change and real GDP growth



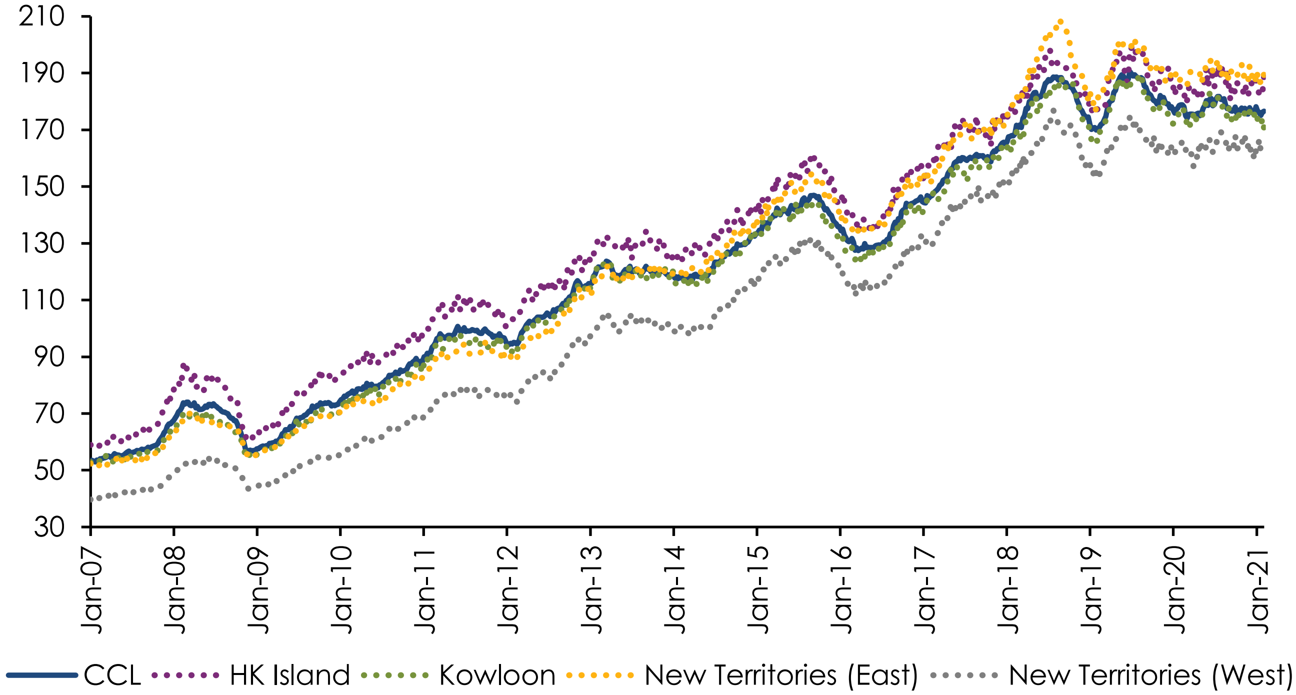
Source: URA, Ministry of Trade and Industry, internal estimates

We are also beginning to see green shoots of recovery for suburban retail malls, although downtown malls will take a longer time to return to pre-Covid-19 levels with global tourism still at a grind. The entry and potential future expansion of giant Chinese technology firms in Singapore could also alleviate some pressure from the consolidation of office spaces by companies amid the 'work from home' trend, although the current situation remains highly uncertain as many corporates are still evaluating their longer-term real estate space requirements. Singapore's data centre market will continue to benefit from healthy demand and supply dynamics as the government explores ways for renewable energy sources to be used for future data centres here. This would allow Singapore to expand in a sustainable manner as it strives to scale up its growth in the digital economy.

Hong Kong

Despite Hong Kong slipping into a recession even before the Covid-19 outbreak hit, its residential market has been largely resilient. Based on the Centa-City Leading (CCL) Index, secondary private residential prices in Hong Kong declined slightly by 1.1% in 2020, versus growth of 2.1% in 2019. For 2021 YTD (as at 7 Feb), the CCL Index is up marginally by 0.2%, with the strongest growth coming from New Territories West (+2.1%). On the other hand, secondary private home prices were down 2.7% in Kowloon. The overall market this year would likely be supported by a rebound in GDP (+4.3% in 2021 based on Bloomberg consensus estimates), continued low interest rate environment and supply, coupled with favourable government policies such as relatively high LTV ratios for property values up to a certain threshold.

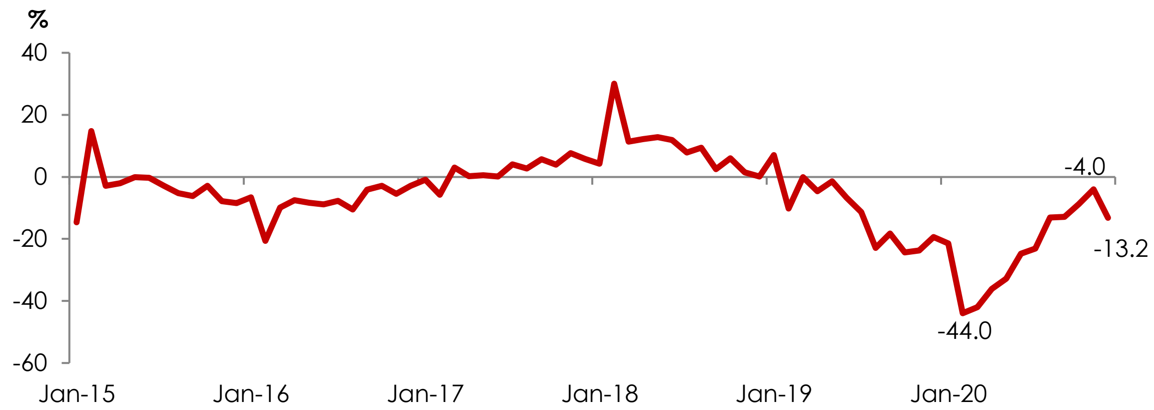
Exhibit 12: Hong Kong's CCL Index declined slightly in 2020 despite macro headwinds and Covid-19 impact



Source: Centa-City Leading Index

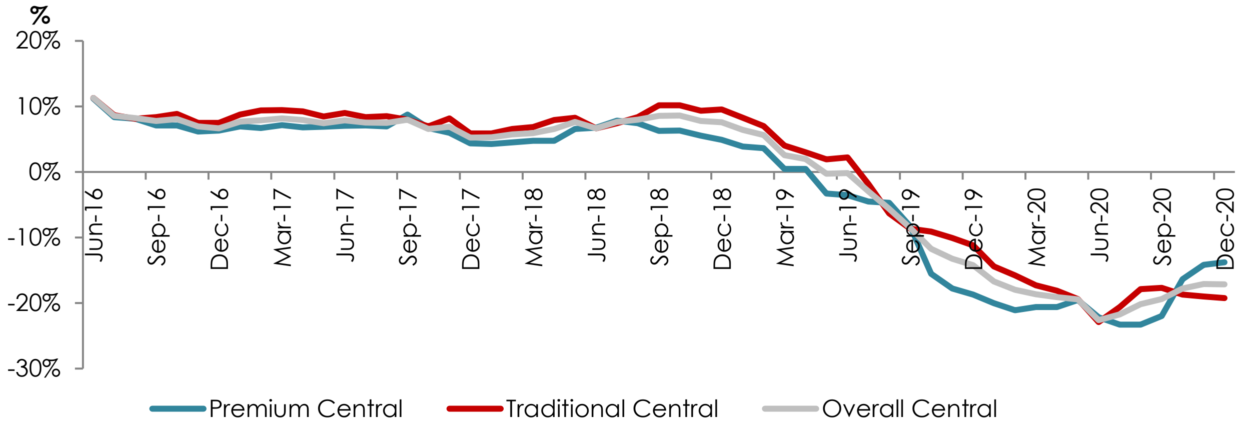
As for Hong Kong's retail scene, the YoY decline in retail sales had been moderating every month from Feb to Nov 2020 despite new waves of Covid-19 and restrictive measures imposed. However, retail sales for the month of Dec bucked the recovery trend, falling 13.2% on a YoY basis. This highlights the challenges ahead, although the commencement of Covid-19 vaccinations after the Lunar New Year period should help to provide some uplift to sentiment. For the office sector, net effective rents in Premium Central, Traditional Central and Overall Central declined by 13.8%, 19.3% and 17.2% in 2020 as compared to end-2019 levels, respectively, based on data from Knight Frank. Although the overall office leasing environment remains subdued, there are signs that the worst could be over.

Exhibit 13: % YoY change in Hong Kong retail sales (non-seasonally adjusted)



Source: Refinitiv, Internal estimates

Exhibit 14: % YoY change in net effective rents on HK$ psf/month basis

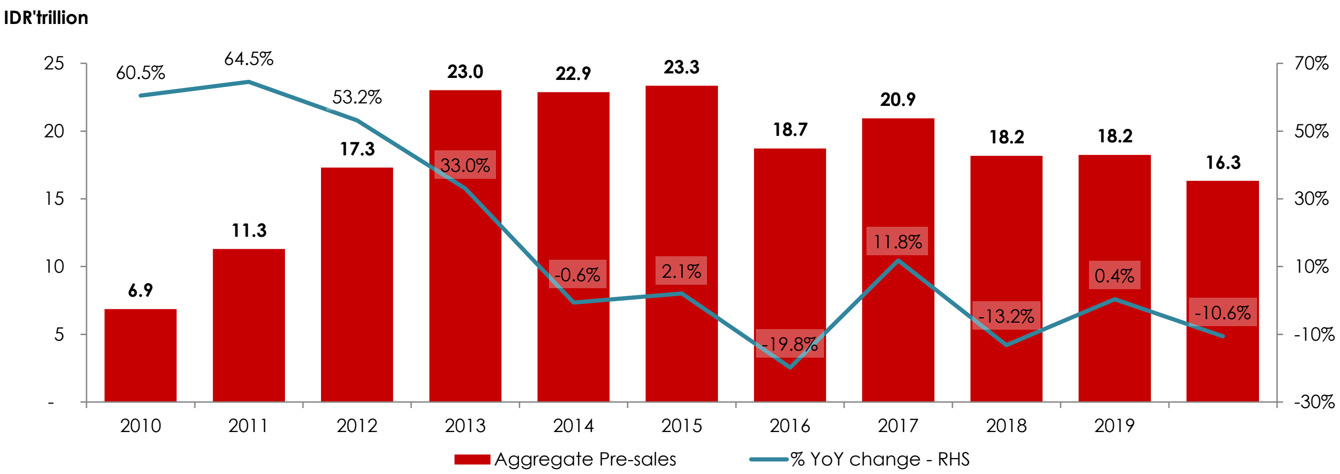


Source: Knight Frank Research, Internal estimates

Indonesia

Notwithstanding the high number of Covid-19 cases in Indonesia, there are signs of a clear recovery for its property sector in 2021. Based on the pre-sales of major Indonesian developers we track, performance for 4Q20 was solid. On an aggregate basis, Bumi Serpong, Ciputra Development, Pakuwon Jati and Summarecon Agung, recorded pre-sales of IDR5.1t in 4Q20, representing YoY and quarter-on-quarter (QoQ) growth of 14% and 8%, respectively. Aggregate pre-sales for these four developers saw a sharp QoQ dip of 43% in 2Q20 due to the pandemic, but rebounded 99% QoQ in 3Q20 and 8% in 4Q20. For 2020, total pre-sales for these four developers fell 11% to IDR16.3t, with only Bumi Serpong recording a slight increase. That said, Summarecon, Pakuwon and Bumi Serpong have provided guidance for pre-sales in 2021 to increase by 6%, 36% and 8%, respectively. Ciputra has yet to release its target for the year, as at the time of writing.

Exhibit 15: Aggregate pre-sales trend for Bumi Serpong, Ciputra Development, Pakuwon Jati and Summarecon Agung



Source: Company filings, Internal estimates

Risk factors

While we are positive on the real estate sector in Asia, it would be prudent to bear in mind the risks. The path to normalcy is likely to be uneven and bumpy, and the pace of the economic recovery will largely depend on how fast Covid-19 vaccinations are rolled out globally. We would thus look for real estate players with strong balance sheets, that are well-positioned to ride out this period of uncertainty.

Investors should also be mindful of shifting policy risks on the residential front, as governments may step in with property cooling measures in line with the need to keep housing affordable.

For instance, the Chinese government has warned that "housing is for living in, and not for speculation". It introduced new measures such as the "three red lines" financing rule in August last year in a deleveraging drive and also imposed further restrictions on real estate related loans including mortgages recently.

In Singapore, macroprudential policies have been in place for several years to ensure that the appreciation of home prices is kept in line with economic fundamentals.

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