Singapore and the Region to Weather Post-Brexit Hangover

July | 2016

The UK property market has been ranked a top five global investment market for decades, and has been a prime destination especially for regional investors from Singapore, China and Hong Kong. While the aftermath of Brexit is still unfolding, the immediate effects – gyration in currency markets and a US$3 trillion sell-off in global stock markets before a bounce which started last Tuesday – have been a source of concern, we do not believe that this short-term turbulence represents the onset of a new Global Financial Crisis (GFC).

We expect the economic impact of the Brexit vote on the Asia Pacific region to be limited. The UK is a fairly small export destination for the region, accounting for just about 2% of total exports. While knock-on effects on the EU, which accounts for an estimated 12% of exports from Asia Pacific, could have a deeper impact, the largest economies of France and Germany, however, are expected to remain resilient.

So what does it mean for real estate investors, particularly the Singaporean retail investors and developers buying properties in UK? What about occupiers such as multi-national corporations currently using Singapore as a regional headquarters? What is the implications on the Singapore residential and commercial properties, as Singapore is typically more susceptible to external shocks than bigger economies in the region despite its safe-haven status?

While the Brexit vote has led to some uncertainty and caused Singaporean investors to re-evaluate their exposure to the UK, those who take a longer-term view cannot ignore the robustness and resilience of the British market, which is one of the most highly-regulated, liquid and transparent in the world. This is not expected to change anytime soon.

Hospitality and retail sectors, in particular, could stand out due to the favourable exchange rate effect. With the British pound sinking to its weakest level in decades, UK, an all-time favourite leisure destination, will see tourism demand spike over the short to medium term. Corporate travelling will be more frequent, thanks to the complex issues linked to Brexit, which should keep corporates and professional services busy. This will in turn boost occupancies and average room rates for hotel and serviced apartments, making hospitality a particularly attractive real estate sector despite the current supply overhang in London.

UK's retail business has already started to look up after the big drop in value of the pound offered bargain shopping for British products. Weak pound is likely to help lift the sales of luxury goods which will bode well for retailers such as Burberry and Harrods. This shot in the arm will underpin the retail businesses in the UK, benefiting the real estate retail business.

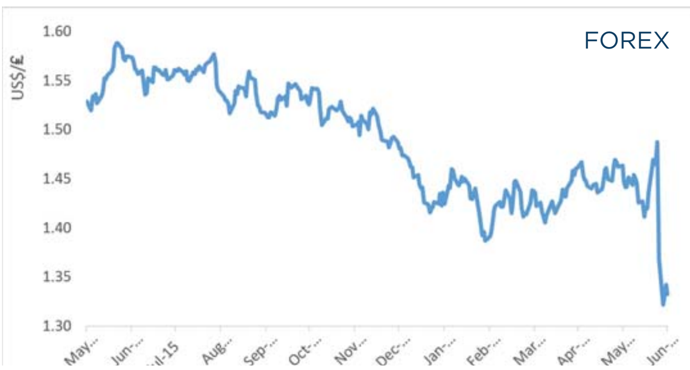
Any temporary dip in residential properties in the UK could present buying opportunities, given UK is one of the top outbound real estate investment destinations for Singaporeans. Properties in Britain, Malaysia and Australia accounted for 91 per cent of total transactions by value and 76 per cent by number in the 1H2014, according to the Monetary Authority of Singapore. Data in subsequent years is unavailable. However, caution has surfaced; United Overseas Bank (UOB) suspended its loan programme for London properties last week.

The Knock-on Effect on Singapore

Inbound corporate travelling from UK and Europe into the Asia Pacific will probably take a backseat for now due to post-Brexit uncertainties. With banking and financial services still finding its footing, the sector is unlikely to hire more and could take even longer to recover from the aftermath of the GFC after Brexit. In fact, some of the UK and European banks could even cut back in Asia headcounts and service lines with the aim of stemming losses incurred back home due to the subdued trade volumes post-Brexit. Along with weaker economic conditions, Singapore residential rental market could expect further weaknesses as fewer expatriates and supply glut put pressures on occupancy and rents.

However, the immediate Fed rate hike which is no longer on the cards could spur interest in private properties as upgraders and investors take advantage of the lower mortgage rates. In addition, Singapore's prime luxury property will be the asset choices of the rich should the wealthy around the world takes a flight-to-safety route to ride out the volatility post-Brexit.

On the commercial property front, decision making is anticipated to slow within certain global business sectors as occupiers pause to gain a better understanding of the ramifications for their operations. However, it is also anticipated that until there is further clarity surrounding the terms of the potential exit of the UK from the EU – something yet to be enforced – that their occupancy decisions will continue to be based primarily on local market conditions rather than global uncertainty.



Source: Investing.com, Cushman & Wakefield

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That said, capital expenditure could still be held up, as corporate clients review their strategies and adopt a wait-and-see attitude. As Singapore faces a large supply of office buildings in the next six to twelve months, downward pressure on office rents could persist in the near term. Companies still on expansion trail such as technology and insurance, could take advantage of the current opportunity and move to better and more efficient buildings as landlords are likely to be more receptive to rental incentives and favourable lease terms.

In addition, Singapore could see fresh inflows of capital especially as its office market negotiates the current rental down cycle. While a recovery in Singapore's office market is likely to be gradual especially as it works off the large volume of new supply, we can expect Singapore to benefit from its stature as a global financial hub.

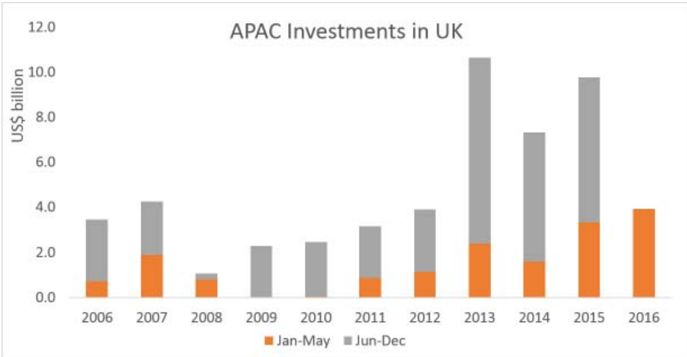
On the Asia Pacific front, consumer and business confidence metrics will be some of the most important indicators to monitor as they have strong correlations with leasing fundamentals and ultimately signal the future direction of vacancy and rents. However, beyond the short-term volatility, we do not expect the secession to materially impact occupier markets in Asia Pacific other than perhaps through some rebalancing of portfolios. The region's growth and attraction remain very much conditioned on structural factors such as its favourable demographic base, rapid urbanisation and a rising consumer class especially among emerging countries.

The downward pressure on interest rates will sustain the appeal of real estate, especially in markets offering attractive yield spreads, which could draw additional capital to the region. Hence, while we anticipate a pause in investment activity in the near term as investors take stock of the situation, we expect continuing favourable financial conditions to boost liquidity and drive property markets in Asia Pacific.

Gateway cities will benefit in the short term where fundamentals and attractive pricing allow. We expect Asia Pacific to gain from the diversification of funds from the UK, driving heightened investment activity in core safe-haven Asian markets. Japan and Australia have been primary destinations for foreign capital over the last three years. Opportunities in Hong Kong, South Korea and China resulting from corporates and developers selling their assets to pare down debt and recycle capital could draw more investor interest.

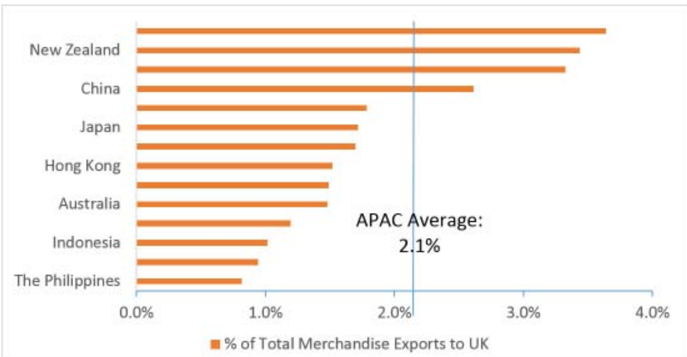
In the long run, we expect the region to weather any Brexit-induced volatility as favourable domestic factors take center stage once again, cementing Asia Pacific as the fastest-growing region in the medium term. This, in turn, should ensure that fundamentals in the region's commercial remain compelling.

INVESTMENTS



Note: excluding land/residential
Source: Real Capital Analytics, Cushman & Wakefield

EXPORTS



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