

RESEARCH



CHINESE OUTBOUND
REAL ESTATE INVESTMENT:

CHANGING CURRENTS, RISING TIDES

OCTOBER 2016



KEY TAKEAWAYS

- ◆ Chinese capital outflow continued strongly in the first half of 2016. Despite the somewhat lower volume in this period, there are deals both completed and on-going in the second half, which promise to bring the full-year results on par with last year's.
- ◆ The US is now firmly established as the most important destination for Chinese capital. Investment grew strongly in the first half of the year, with New York once again the favoured destination, attracting most of the capital inflow, although West Coast tech hubs also saw increased interest from Chinese companies. Meanwhile deals in offices continue to dominate the market.
- ◆ London attracted a significantly increased Chinese capital inflow in the first half of the year. There was no sign of tapering off even after the Brexit vote. Large private investors have taken the lead over insurance giants, favouring the City and West End locations.
- ◆ The volume of Chinese investment in Australia is down considerably year on year because of a lack of mega-deals in the first half. Amid competition from other Asian buyers, however, there is a strong appetite from Chinese investors and recently developers for en-block commercial properties in both Sydney and Melbourne, attracted by rental growth supported by strong tenant demand and a supply shortage.
- ◆ Hong Kong offices attracted more interest as the city positions itself as the international financial centre closest to Mainland China. For Chinese developers, Hong Kong residential land is considered attractive compared to hotly contested land markets in major Chinese cities.
- ◆ Going forward, continued RMB devaluation, tightening capital outflow controls and a low interest-rate environment should continue push Chinese investment capital into tangible assets, especially real estate. However, risks caused by policy uncertainty may erode market fundamentals and impact investment in the near to medium term.

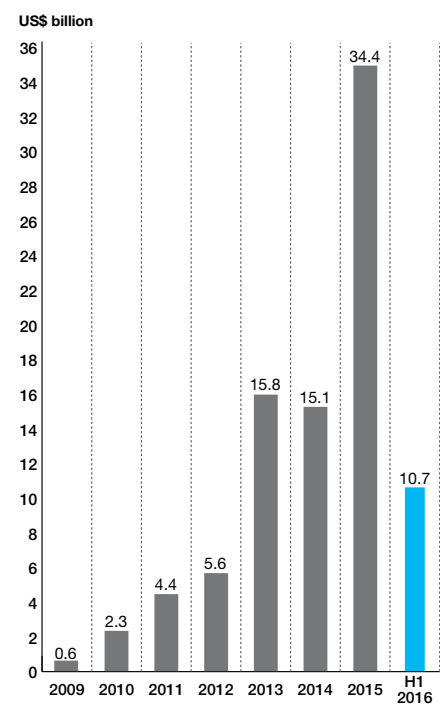




Riding on last year's strong momentum, the waves of Chinese outbound capital continued in primary real estate markets around the world in the first half of 2016.

Looking at the total volume, the US\$10.7 billion invested actually represents a 13.6% drop compared to the same period last year. But this should be considered in the context of some of the biggest real estate deals in Chinese outbound investment history early last year, such as the US\$1.9 billion purchase of New York's Waldorf Astoria. Nevertheless, Chinese investment was gaining momentum as we crossed the half-year mark. Since June there have been deals in the making that promise to turn 2016 into another productive year.

Figure 1
CHINESE GLOBAL REAL ESTATE INVESTMENT IN H1 2016



Source: Real Capital Analytics, Knight Frank Research

UNITED STATES

The US market attracted US\$5.1 billion worth of Chinese investment in the first half of the year, up 21% year-on-year (YoY).



Table 1

TOP CHINESE REAL ESTATE INVESTMENT DEALS IN THE US, H1 2016

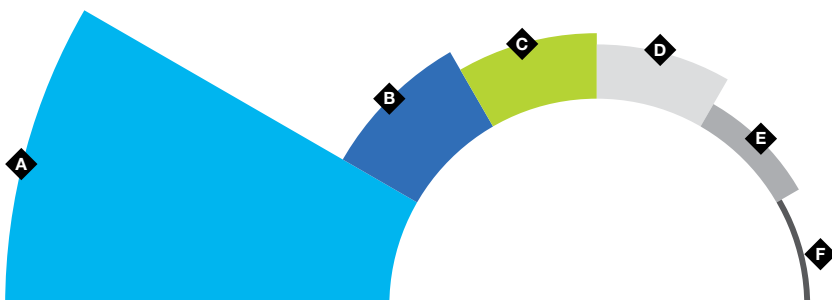
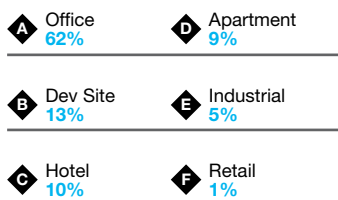
Date	Purchaser	Property Name	Location	Property Type	Consideration (US\$ million)
May	China Life Insurance (JV with RXR Realty & David Werner RE)	PaineWebber Building	New York	Office	1,650
May	China Investment Corporation	One New York Plaza	New York	Office	700
Mar	HNA Group (JV with MHP RE Services)	850 Third Avenue	New York	Office	463
Jun	LeEco	Yahoo Dev Site	San Jose	Dev Site	250
Feb	Landsea Group Holding Ltd	Former Spansion HQ	San Jose	Dev Site	186
Jan	Cindat	100 Varick Street	New York	Dev Site	135
Mar	China Orient Asset (JV with Bainbridge Companies)	Devonshire Hills (359)	New York	Apartment	94
Apr	Cindat	Holiday Inn Express Times Square	New York	Hotel	79
Mar	China Orient Asset (JV with Bainbridge Companies)	Devonshire Hills (297)	New York	Apartment	77
May	Ping An Insurance	FedEx - Fife, WA	Seattle	Industrial	74

Source: Real Capital Analytics

Chinese investors, like most international investors, are again focusing primarily on the major markets, especially New York, which attracted 80% of Chinese investment in the US. Remarkably, the amount of Chinese capital invested in New York from January to June was



Figure 2
SECTOR SHARE OF CHINESE INVESTMENT IN THE US, H1 2016



Source: Real Capital Analytics

equivalent to 81% of Chinese capital invested in the city in all of 2015.

A large share of this (62%) was in office deals, as Chinese institutional capital continued to chase trophy assets. A joint venture involving China Life, for example, bought the PaineWebber Building in New York for US\$1.65bn. Both CIC and HNA group also splashed out on New York offices this year.

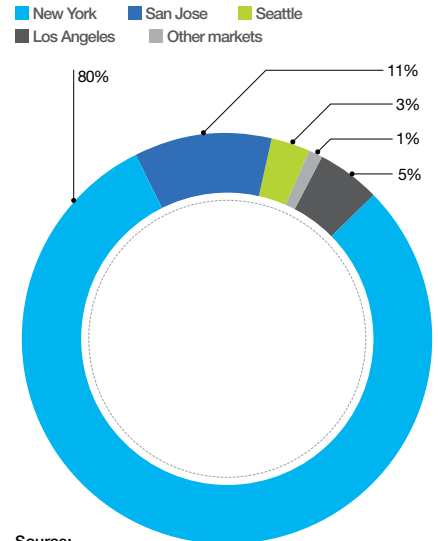
Major hubs on the west coast, such as San Jose and Seattle, also drew interest from Chinese investors, particularly hi-tech-related development sites and industrial properties. For example, LeEco acquired the former Yahoo site, where it reportedly plans to set up regional R&D headquarters.

As the Fed-led low interest-rate environment persists, Chinese investors, like all investors chasing yield, will continue to favour tangible assets such as real estate in the next few years. Added to this is the slow devaluation of the renminbi against the US dollar, which has resulted in a sense of urgency for Chinese investors to invest in USD-denominated assets.

Some investors may wait for the coast to clear regarding the presidential election, but barring a major political upset, the US should see slow but stable GDP growth of around 2%, according to IMF's latest forecast. This will put the US ahead of other developed countries, where the danger of a recession continues to linger.

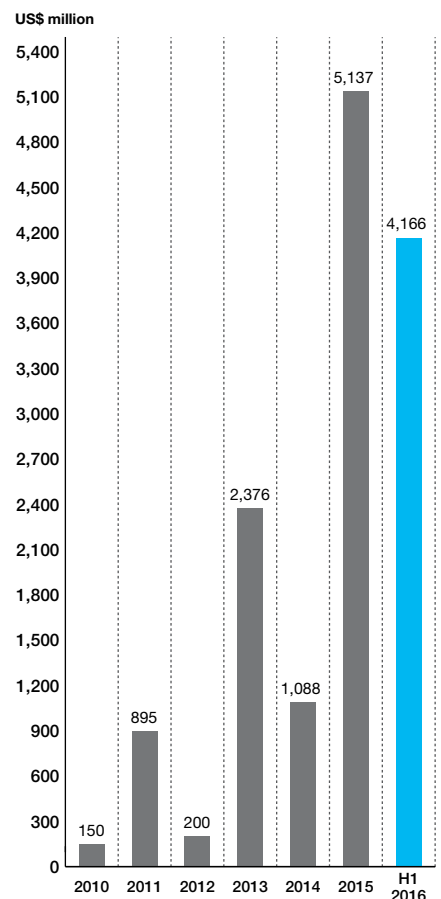
Added to this advantage is the significant market depth, not just in New York, but in a number of coastal hubs and high-tech centres, making the US the foremost investment destination for Chinese capital.

Figure 3
LOCATION SHARE OF CHINESE INVESTMENT IN THE US, H1 2016



Source:
Real Capital Analytics

Figure 4
CHINESE REAL ESTATE INVESTMENT IN NEW YORK IN H1 2016



Source: Real Capital Analytics

UNITED KINGDOM

In the six months leading up to the Brexit vote, London, which drew the lion's share of Chinese investment in the UK, saw a number of large en-block deals, which contributed to the US\$1.7bn in total volume, a whopping 75% uptick year on year.

Even though there were only a limited number of transactions, London's status as a key international financial centre and the perceived stability of the UK economy definitely contributed to this tremendous growth.

One interesting aspect of these deals is that private banks, developers and conglomerates such as Baosheng Bank and Fosun became noticeable part of the investment landscape, which was crowded last year with major insurance companies. This is partly because they are able to make decisions more quickly. They tend to favour the City and West End over Canary Wharf, partly because of pricing.



Table 2

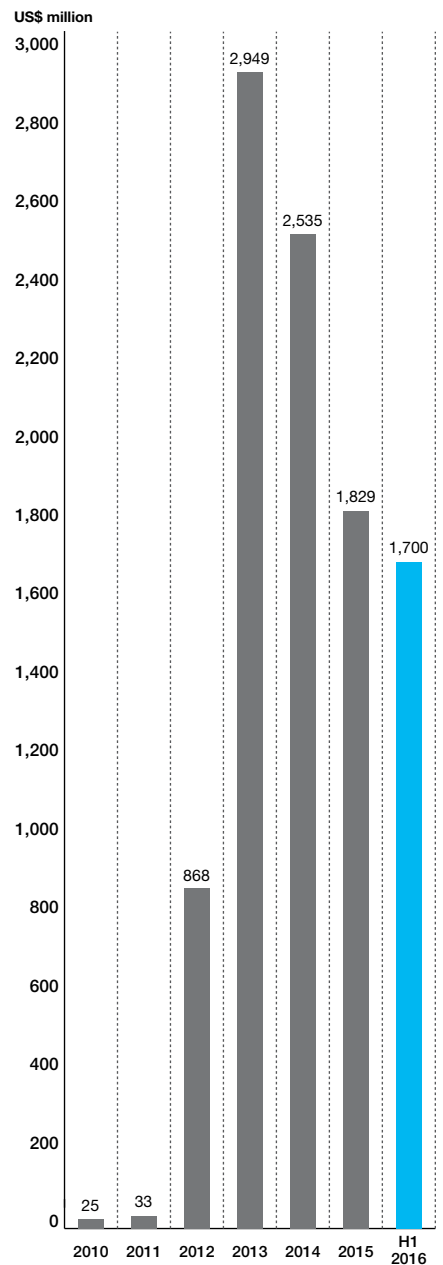
TOP CHINESE REAL ESTATE INVESTMENT DEALS IN LONDON, H1 2016

Date	Purchaser	Property Name	Location	Property Type	Consideration (US\$ million)
Apr	China Life Asset Management (JV with Brookfield Europe)	Aldgate Tower	London	Office	496
Mar	Fosun International Ltd (JV with Resolution Property PLC)	Trinity Tower	London	Office	395
May	CITIC Capital JV Cindat	Curzon Plaza	London	Dev	262
Jan	Chinese Overseas Land and Investment	The Helicon, 1 South Place	London	Office	189
Apr	HNA Group	17 Columbus Courtyard	London	Office	188
Jan	Baosheng Bank	31 Old Burlington Street	London	Office	44

Source: Real Capital Analytics



Figure 5
**CHINESE REAL ESTATE
INVESTMENT IN LONDON
IN H1 2016**



Source: Real Capital Analytics

Even after the Brexit vote, Chinese investors' interest in London seems undiminished, as there have been a few major office transactions since July. For example, through its majority-controlled SRE group, China Minsheng Investment Corp, said to be China's largest private investment conglomerate, bought Societe Generale's London headquarters for GBP84.5 million (US\$110 million) in September. Meanwhile, Vanke reportedly bought London's Ryder Court for GBP115 million (US\$149 million) through Hong Kong-listed Vanke Overseas.

While economists have torn up their previous forecasts of a UK recession, the negotiation process for Brexit will still mean increased political uncertainty in the short term. During this period we expect overseas buyers to focus on Central London, particularly districts popular with technology and media firms, instead of looking at the wider UK. The fall in the value of the pound and recent yield softening has made London more attractive than some other global hubs.

AUSTRALIA

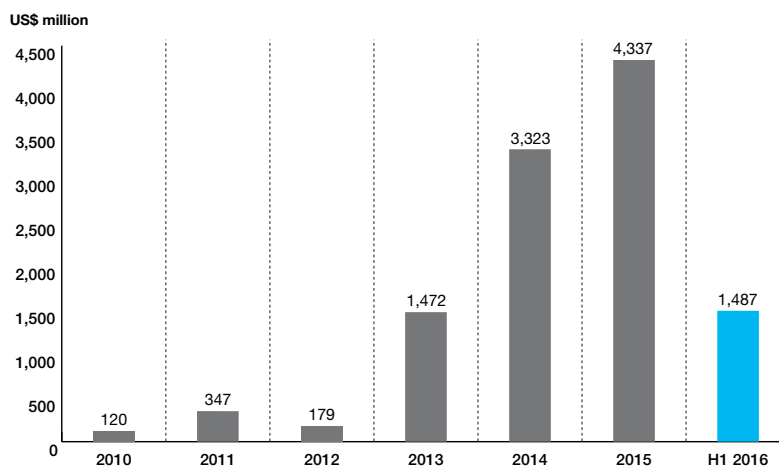
Chinese investors and developers spent US\$1.7bn in Australia in H1 2016, a 37% decline YoY. With the absence of mega-deals, such as CIC's record breaking purchase at US\$1.8bn for an office portfolio, the volume of office deals dropped 65% and hotel deals dropped 42% YoY. Meanwhile, investment in development sites stabilised.

Despite this, Chinese and other Asian capital continues to be drawn mainly to the office markets in Sydney and Melbourne. Tenant demand from various sectors remains strong, but lack of supply has caused rents in both cities to rise and vacancies to fall. Yields, meanwhile, have been tightening, but are still above long-term bond yields.

Fewer buying opportunities, coupled with the positive rental outlook, have already attracted large Chinese private developers such as Poly Group and Shanghai Shenglong to the office market. Since June there have been a number of major deals in the making, which will underpin the investment market outlook for 2016.

Figure 6

CHINESE REAL ESTATE INVESTMENT IN SYDNEY AND MELBOURNE IN H1 2016



Source: Real Capital Analytics





Table 3

TOP CHINESE REAL ESTATE INVESTMENT DEALS IN AUSTRALIA, H1 2016

Date	Purchaser	Property Name	Location	Property Type	Consideration (US\$ million)
Jun	Zhengtang Group	W Sydney Hotel	Sydney	Hotel	379
May	Greenland Group	165-175 Mitchell Road	Sydney	Dev Site	198
Feb	Perth Upper China	Forrest Centre	Perth	Office	156
Jun	Zhengtang Group	The Ribbon	Sydney	Apartment	131
Jan	Heisheng	1270 Richmond Rd	Sydney	Dev Site	101
Jun	Bank of China	140 Sussex St	Sydney	Office	95
Jun	LYZ	Computershare	Melbourne	Industrial	65
Feb	Poly Real Estate Group	Park Rd And Berry Ln	Sydney	Dev Site	55
Mar	Shandong HYI	170 Victoria	Melbourne	Dev Site	46
May	N/A	93 Lorimer	Melbourne	Dev Site	46

Source: Real Capital Analytics

HONG KONG

Despite its relatively smaller market, Hong Kong has attracted Mainland investors because of its role as the international financial centre closest to the Mainland and the increased financial cooperation between the two sides.



Table 4

TOP CHINESE REAL ESTATE INVESTMENT DEALS IN HONG KONG, H1 2016

Date	Purchaser	Property Name	Location	Property Type	Consideration (US\$ million)
Feb	Everbright Group	Dah Sing Financial Centre	Hong Kong Island	Office	1285
Feb	China Vanke	New Kowloon Inland Lot No. 6534	Kowloon	Dev Site	168
Jun	Chinese investor	The Centre (79F)	Hong Kong Island	Office	64
Apr	Sunlink Group	Hing Man Estate	Hong Kong Island	Retail	27
May	Shanghai Electric	Lippo Centre II (Unit 1-3 on 9F)	Hong Kong Island	Office	27
May	Brilliant Circle Holdings	AXA Centre (Unit 1-3 & 5-9 on 12F)	Hong Kong Island	Office	27
Apr	Hengli Group Co Ltd	Mei Chung Court	New Territories	Retail	26

Source: Real Capital Analytics

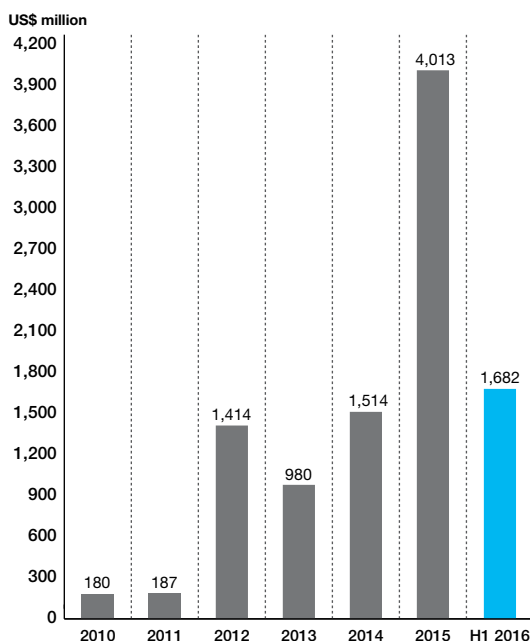
In H1 2016, Hong Kong attracted over US\$1.68bn worth of Chinese investment, down only 9% from the US\$1.86bn recorded in the same period last year.

Since last year, a series of currency and stock connect schemes between Hong Kong and the Mainland have attracted new tenant demand from across the border. As Hong Kong office rents remain the highest in the world, any opportunity to own a trophy Grade A office asset in the CBD cannot be ignored. Following Evergrande's US\$1.6bn purchase of the MassMutual building last year, Everbright group dished out US\$1.28bn on the Dah Sing Financial Centre in H1 2016. In July, Cheung Kei Group, a private developer from Shenzhen, bought the East Tower of One Harbour Gate in Kowloon for US\$580 million. Thanks to the severe shortage of en-block Grade A office buildings for sale, any property offered for sale is guaranteed to attract Mainland institutional investors and prominent developers, who are willing to pay higher prices.

The Hong Kong residential land market also offers better opportunity than some of the hotly contested Mainland markets. As witnessed in a recent land auction, Mainland developers are prepared to pay a higher premium in order to secure market share in the city and take advantage of anticipated growth in residential prices.

Figure 7

CHINESE REAL ESTATE INVESTMENT IN HONG KONG IN H1 2016



Source: Real Capital Analytics

DRIVERS, OUTLOOK & RISKS

Global gateway locations have seen undiminished interest from Chinese investors. This has certainly been helped by a number of favourable local market conditions, including market depth, rental growth prospects, and cheaper currencies.

The biggest push, however, is from the Chinese economy itself. Despite the talk of a prolonged slowdown, the country's GDP growth has stabilised at above the 6.5% level. The central government's current target is to double the size of the country's GDP within 10 years. Long-term market reform aside, they will achieve this mainly through two approaches – infrastructure investment and real estate market-led consumption.

The nature of the planned economy ensures that a drastic economic slowdown is unlikely. However, this may fuel high land prices in the country's major cities. This, in turn, would encourage capital to diversify and seek overseas opportunities. The risk for Chinese investors, and developers in particular, is that the often complicated laws, regulations, approval processes and planning issues in gateway markets could diminish the willingness to explore those markets more deeply. In contrast, locations closer to home, such as Hong Kong, are more easily monitored and controlled.

Feeling the pressure from the RMB's steady devaluation against the US dollar, Chinese investors, particularly private conglomerates, have tended to invest aggressively in hard assets. The demand for real estate has coincided with a relentless buying spree for companies, infrastructure and manufacturing facilities. This certainly bodes well for gateway markets, at least in the short term.

Although China's capital outflow control has been a push factor so far, it could be a double-edged sword. It was designed to prevent the erosion of the country's vast foreign exchange reserves, but its stringent requirements have made it very difficult for some investors, especially smaller ones, to get foreign exchange clearance. To manage this, some sizeable investors have been investing through their overseas subsidiaries. The risk, however, is that over time, these subsidiaries will also run out of funds if the grip on foreign exchange reserves is not loosened. This is something that all destination markets should keep a close watch on.



GLOBAL BRIEFING

For the latest news, views and analysis
on the world of prime property, visit
KnightFrankblog.com/global-briefing

CAPITAL MARKETS

Paul Hart

Executive Director, Greater China
+852 2846 9537
paul.hart@hk.knightfrank.com

Bunny Wang

Senior Director, Head of International
Capital Markets and International
Project Marketing, China
+86 21 6032 1758
bunny.wang@cn.knightfrank.com

Tommy Zhang

Associate Director, Beijing
+86 10 6113 8039
tommy.zhang@cn.knightfrank.com

RESEARCH & CONSULTANCY

David Ji

Director, Head of Research &
Consultancy, Greater China
+852 2846 9552
david.ji@hk.knightfrank.com

Regina Yang

Director, Head of Research &
Consultancy, Shanghai
+86 21 6302 1728
regina.yang@cn.knightfrank.com

Vincent Li

Assistant Manager, Research &
Consultancy, Beijing
+86 10 6113 8017
vincentx.li@cn.knightfrank.com

Ocean Ruan

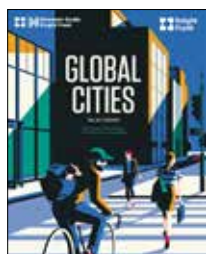
Senior Manager, Research &
Valuation, Guangzhou
+86 20 3839 6438
ocean.ruan@cn.knightfrank.com

Sam Lau

Senior Analyst, Research &
Consultancy, Greater China
+852 2846 4876
sam.lau@hk.knightfrank.com

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide, including developers and investors, as well as financial and corporate institutions. All recognise the need for the provision of expert independent advice, customised to their specific needs.

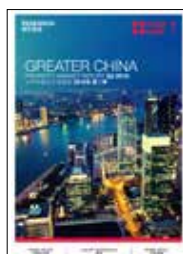
RECENT MARKET-LEADING RESEARCH PUBLICATIONS



Global Cities
The 2017 Report



Chinese Outbound
Report 2016



Greater China
Quarterly Q2 2016



Asia-Pacific Capital
Markets Report
July 2016

Knight Frank Research Reports are available at
KnightFrank.com/Research

© Knight Frank 2016

Knight Frank Petty Limited. This document and the material contained in it is general information only and is subject to change without notice. All images are for illustration only. No representations or warranties of any nature whatsoever are given, intended or implied. Knight Frank will not be liable for negligence, or for any direct or indirect consequential losses or damages arising from the use of this information. You should satisfy yourself about the completeness or accuracy of any information or materials. This document and the material contained in it is the property of Knight Frank and is given to you on the understanding that such material and the ideas, concepts and proposals expressed in it are the intellectual property of Knight Frank and protected by copyright. It is understood that you may not use this material or any part of it for any reason other than the evaluation of the document unless we have entered into a further agreement for its use. This document is provided to you in confidence on the understanding it is not disclosed to anyone other than to your employees who need to evaluate it.

