RESEARCH

ASIA-PACIFIC CAPITAL MARKETS

MAY 2015

ECONOMIC SNAPSHOT | OCCUPIER MARKETS | INVESTMENT MARKETS | INDIAN REITS | CAP RATE DECOMPRESSION AND RENTAL GROWTH

ECONOMIC SNAPSHOT

Significant headwinds despite recovery in the West

KEY FINDINGS

Although recovery in the West would lend support, economies in Asia-Pacific continue to face significant headwinds (page 2)

While falling vacancies accelerated the rental growth of offices, that of retail space slowed (page 4)

After a slower start in 2014, investment volumes picked up speed in H2, compressing prime yields further (page 8)

We consider the rental growth required to achieve an internal rate of return (IRR) target when interest rates normalise (page 11)

Global backdrop

Before zooming in on Asia-Pacific, let us set the scene by first scanning the global economic landscape.

The world's largest economy, the US, has produced some mixed signals about the strength of its recovery of late. Since late 2014, the Institute of Supply Management (ISM) reported a slowing pace of expansion in the manufacturing sector. In March, the increase in non-farm payrolls also dipped drastically. However, the situation should improve now that the West Coast port strike and the bitter winter are over. Already, four-week average initial jobless claims were at the lowest level since mid-2000 in early April and Markit registered a "rebound" in new orders, a forward looking indicator, in March. More importantly, the services sector, which accounts for four fifths of the US' GDP, as reported by both the ISM and Markit, is expanding at a solid pace.

Many economic observers have also lamented the recent deceleration in the growth of retail sales and personal consumption expenditure (PCE). However, this is the combined result of inclement weather and falling inflation, which in turn is due to cheaper energy and a strengthening Dollar reducing import costs. In real terms, PCE actually increased at a four-year high rate in February. With consumer confidence back to pre-crisis level, the growth of PCE, which accounts for almost 70% of the US' GDP, is expected to remain healthy.

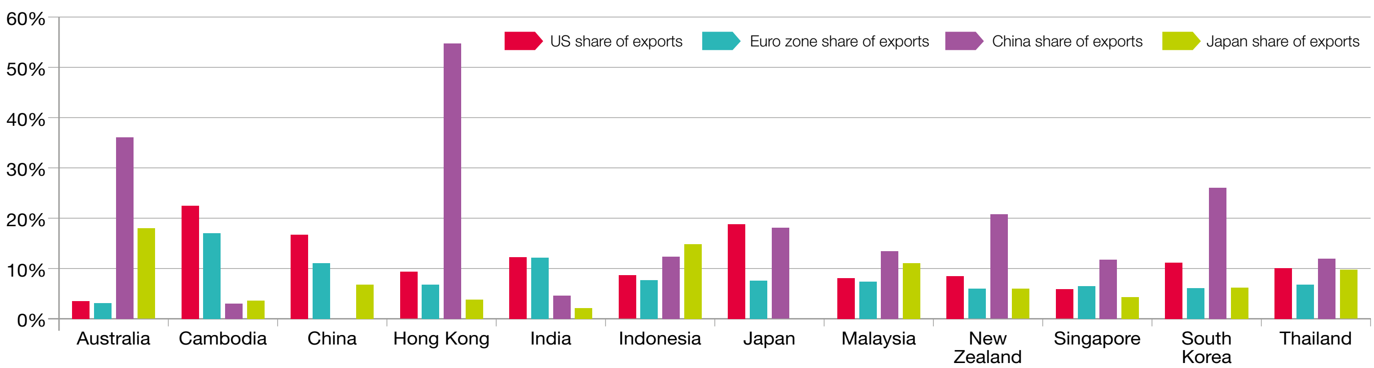
If growth picks up speed significantly as it did in the middle of last year, the Federal Reserve could hike rates faster than what the consensus currently expects. While a strong Dollar would create a headwind to exports, external trade constitutes a small share of the US economy and the adverse impact would be more than counterweighed by the improvement in domestic demand.

There were some sparks of hope in the Euro zone recently. Retail sales soared at the fastest rate in more than nine years as consumer confidence climbed to a 92-month high in March amid considerable improvements in the labour market since late last year. On the back of lower energy costs and a weaker Euro following the European Central Bank's quantitative easing programme, Markit's composite PMI surged and the new orders index in particular reached a multi-year high in March.

Despite all these, we do not anticipate a steep rebound in growth. For one, European leaders are still pursuing a concerted austerity policy in the face of a weak aggregate demand. There is also a real risk of "Grexit", which will create panic if it ever happens.

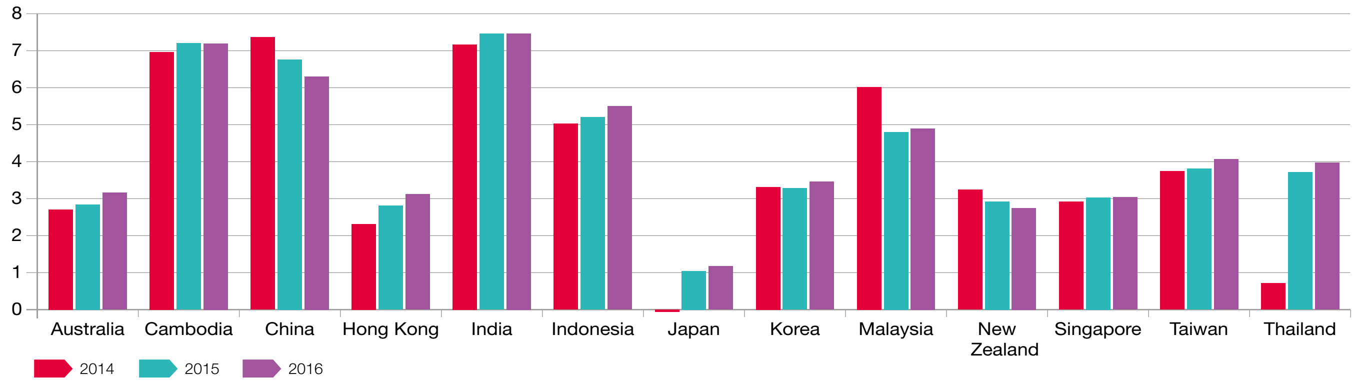
The implications on Asia-Pacific: on the one hand, a strengthening US economy coupled with an appreciating Dollar will lift external demand for the region's outputs; on the other hand, a weaker Euro could erode the export competitiveness of the region and offset

FIGURE 1
Export Exposure to US, Euro Zone, China and Japan



Source: IMF, Knight Frank Research

FIGURE 2
Real GDP Growth per Annum (%)



Source: IMF World Economic Outlook Database April 2015, Knight Frank Research

some positive impacts from a more stable Euro zone (see Figure 1).

However, the impacts are not as straightforward as presented in Figure 1. The shifts in monetary policies and the resultant currency movements affect China and Hong Kong more for instance as their currencies are managed against the Dollar to different extents. In addition, besides trade, the financial channel is another way in which countries may be affected.

Asia-Pacific in focus

While the Chinese Yuan has weakened slightly against the Dollar, despite allegations of under-valuation by the US, it has appreciated significantly in trade-weighted terms, especially against the Euro. This has raised concerns as the country is still battling its overcapacity problems, as a result of which producer prices have experienced outright year-on-year deflation for three years. The problem is magnified by the gloomy residential market which has undergone 10 consecutive months of price correction thus far. **China's** slowdown will continue to weigh on the region, especially **Hong Kong** and commodity exporters. With the government wary of inflating the property market further with cheap money, there is even speculation that it may devalue the Yuan.

The good news amid all these is that employment remained intact, as the services sector provided support for the economy and consumption overtook investment as the strongest growth driver, in line with the reform the government is implementing.

The economy of **Japan** is not out of the woods yet. Retail sales grew for six consecutive months a quarter after the hike in consumption tax in April 2014, and industrial output jumped smartly in January compared to the previous month, sparking hope of a recovery. All these have turned negative recently. However, data in February were affected by the seasonal effect of Lunar New Year. Ignoring this distortion, capacity utilisation has actually been rising steadily since late last year. Together with improved corporate profitability and rising consumer confidence, firms could start investing, stimulating the economy. As inflation excluding the impact of the tax hike slows, the Bank of Japan may ease monetary policy further.

Since the Quantitative Easing taper tantrum in mid-2013, **India's** current account deficit and inflation rates have both declined significantly, thanks in part to the fall in oil prices. This has provided room for a more accommodative monetary policy. On the fiscal front, the government is ramping up infrastructure spending, boosting aggregate demand in the near term and productive capacity in the long run. Together with other pro-business reforms, there is a good chance that this will "crowd in" private investment. Many observers rightly pointed out that land acquisition reforms remain a huge challenge and so infrastructure development will likely be hindered. However, the government seems to understand this. For instance, the rail budget, which increased by more than 50%, focused on improving existing networks instead of creating new ones.

After the low-hanging fruits are picked and deliver results, sensitive laws on land and labour will become easier to tackle.

The impending rate hike in the US poses the greatest risk to **Indonesia.** Weak commodity prices have hurt exports and slowed down economic expansion. This presents a dilemma to the central bank: while a 5.0% GDP growth rate in 2014 represents the slowest in five years, the large current account deficit makes it think twice before joining the flurry of rate cuts in the region. In fact, the central bank has been forced to shore Rupiah up; consequently, Indonesia's foreign exchange reserve saw the largest month-on-month drop in almost two years in March. In the political realm, infighting within the President's own party could hamper reform.

Australia is another country that has been bogged down by cheap commodities. With an even larger trade exposure to China and Japan than Indonesia, the year ahead will remain challenging. So far, rate cuts by the Reserve Bank to support the economy have spurred construction activities, as the residential market enjoyed a robust 17.5% capital appreciation in the two years to the end of 2014.

South Korea, Thailand and **Malaysia** share the same problem of high household debt of over 80% of GDP weighing on consumption. In Korea and Thailand, exports have also not been performing well, prompting both governments to step up fiscal stimulus and central banks to slash their policy rates to 1.75%, a record low for the former. The Bank of Korea also cut its growth forecast for 2015 twice so far this year. Interestingly, despite all these, the economy is showing resilience as the residential market continued to recover. Prospects are brighter in Thailand, as GDP growth is expected to bounce back off a low base. High hopes are pinned on public spending to mitigate the impact of low prices for agricultural products such as rice and rubber, and the termination of the rice pledging and first-time car buyer schemes. Although the investment contracts signed by state agencies in the first half of the current fiscal year missed the target by almost half, private investments that were granted promotional privileges in Q1 2015 jumped by more than five times year-on-year.

Despite the collapse in energy prices, including those of LNG and palm oil, Malaysia's current account balance has held up. However, confusion surrounding the recently implemented Goods and Services Tax (GST) and worries about the fiscal health due to lower oil prices have hurt both consumer and business sentiment recently.

Rising interest rates combined with a growing supply of newly completed residential units this year and next will likely create a drag on the **Singapore** economy due to higher debt burden and negative wealth effect. This is on top of the painful restructuring the country is undergoing. Ironically and worryingly, despite the push to enhance productivity, private investment has been sluggish.

*Written on 15 April 2015

"...a strengthening US economy coupled with an appreciating Dollar will lift external demand for the region's outputs..."

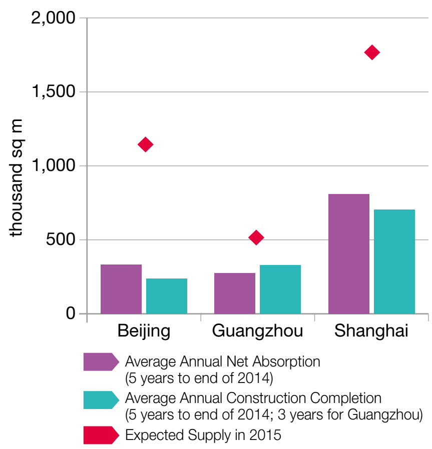
REAL ESTATE OCCUPIER MARKETS

Office | 2014 ended with vacancy rates achieving multi-year lows in several markets

In H2 2014, Shanghai was the bright spark among the top-tier cities in China. Helped by strong demand from the education and training sector, the vacancy rate dropped 0.9 percentage points to a historic low of 3.0%, while rents rose 0.8% over the six-month period. Meanwhile, Beijing saw weak take-up, at the same time when substantial office space was added; consequently, vacancy jumped by 1.7 percentage points while rents fell 1.6%. Moving forward, a massive supply pipeline will exert downward pressure on rents in Shanghai, Beijing as well as Guangzhou (see Figure 3).

FIGURE 3

Massive Supply Pipeline in Chinese Cities



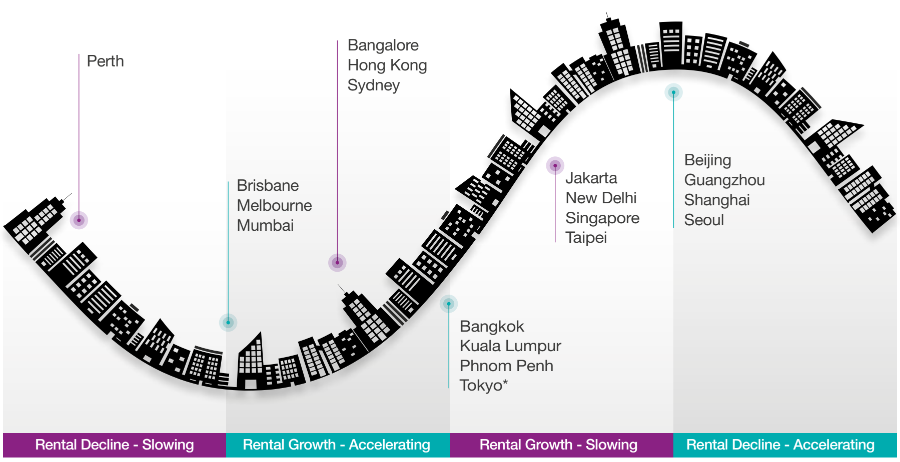
Source: Knight Frank Research

In contrast, given the tight supply of Grade-A offices in prime location and continued demand from the Mainland Chinese firms, we expect office rents in Hong Kong to inch upwards in 2015. In Taipei, net take-up surged by 56.5% in 2014, more than sufficient to absorb the huge amount of office space that came on-stream.

The vacancy rate in Tokyo fell to a six-year low of 4.0%, as domestic firms continued expanding while new supply remained relatively limited, pushing rents up by 7.3%, the fastest growth rate among the cities in our index. In nearby Seoul, although headline rents only declined marginally, we saw longer rent-free periods.

FIGURE 4

Asia-Pacific Prime Office Rental Cycle



Source: Knight Frank Research
The diagram does not constitute a forecast and is intended only as an indicative guide to current rental levels. Rents may not necessarily move through all stages of the cycle chronologically.

In Australia, performance continued to be mixed. Brisbane and Perth have been seeing negative net absorption since H1 2013 and H2 2012 respectively as the mining industry and the government pulled back demand. Melbourne and Sydney, on the other hand, enjoyed improved leasing activity.

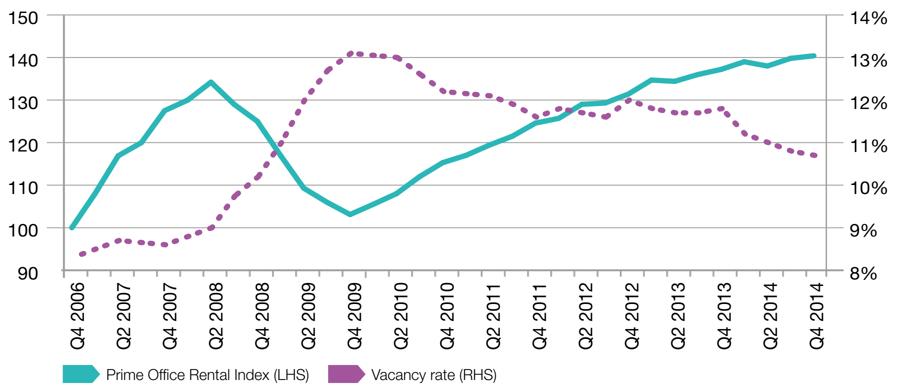
Little new supply has allowed rents in Singapore to continue increasing. Even though the addition of office space in 2015 will remain similarly modest, economic headwinds will limit future rental growth. Budget-conscious tenants are already exploring high-quality buildings outside the core CBD.

Elsewhere in Southeast Asia, rents in Phnom Penh increased by 3.1% on the back of steady demand from foreign companies seeking to capitalise on Cambodia's strong economic growth.

> "Moving forward, a massive supply pipeline will exert downward pressure on rents in Shanghai, Beijing as well as Guangzhou."

FIGURE 5

Asia-Pacific Prime Office Rental Index



Source: Knight Frank Research

FIGURE 6

Asia-Pacific Prime Office Rents

H2 2014

Increase / No Change / Decrease

City	Submarket	Prime Net Headline Rent	Local Measurement	6 mths % change	US$/sq m/ mth	Forecast next 12 mths
Brisbane	CBD	556.0	AUD/sq m/annum (Net Floor Area)	-0.4%	37.8	No Change
Melbourne	CBD	486.0	AUD/sq m/annum (Net Floor Area)	0.0%	33.0	No Change
Perth	CBD	650.0	AUD/sq m/annum (Net Floor Area)	-5.0%	44.2	Decrease
Sydney	CBD	783.0	AUD/sq m/annum (Net Floor Area)	0.9%	53.2	Increase
Phnom Penh	City Centre	22.0	USD/sq m/month (Net Floor Area)	3.1%	22.0	Increase
Beijing	Various	372.5	CNY/sq m/month (Gross Floor Area)	-1.6%	60.7	Decrease
Guangzhou	CBD	175.8	CNY/sq m/month (Gross Floor Area)	-1.1%	28.6	Decrease
Shanghai	Puxi, Pudong	272.9	CNY/sq m/month (Gross Floor Area)	0.8%	44.5	Decrease
Hong Kong	Central	120.8	HKD/sq ft/month (Net Floor Area)	0.6%	167.6	Increase
Bangalore	CBD	1,095.0	INR/sq ft/annum (Gross Floor Area)	1.4%	15.4	Increase
Mumbai	BKC	3,050.0	INR/sq ft/annum (Gross Floor Area)	1.7%	43.0	Increase
New Delhi	Connaught Place	3,210.0	INR/sq ft/annum (Gross Floor Area)	1.1%	45.3	No Change
Jakarta	CBD	6,688,524.0	IDR/sq m/annum (Semi-Gross Floor Area)	6.2%	44.9	Increase
Tokyo*	Central 3 Wards	30,573.0	JPY/Tsubo/month (Net Floor Area)	7.3%	77.1	Increase
Kuala Lumpur	City Centre	4.9	MYR/sq ft/month (Net Floor Area)	0.8%	15.1	No Change
Singapore	Raffles Place, Marina Bay	10.1	SGD/sq ft/month (Net Floor Area)	2.3%	81.9	Increase
Seoul	CBD	30,336.0	KRW/sq m/month (Gross Floor Area)	0.0%	27.7	Decrease
Taipei	Downtown	2,566.0	TWD/ping/month (Gross Floor Area)	0.6%	24.5	Increase
Bangkok	CBD	770.8	THB/sq m/month (Gross Floor Area)	3.5%	23.5	Increase

Source: Knight Frank Research / *Sanko Estate

> “The vacancy rate in Tokyo fell to a six-year low of 4.0%, as domestic firms continued expanding while new supply remained relatively limited, pushing rents up by 7.3%, the fastest growth rate among the cities in our index.”

Jakarta registered the second strongest rental growth of 6.2%, as vacancy dropped to the lowest rate of 4.2% in our records. It is followed by Bangkok, which experienced the lowest vacancy rate in eight years, as demand continued to outpace new supply. In neighbouring Kuala Lumpur, office rents barely moved.

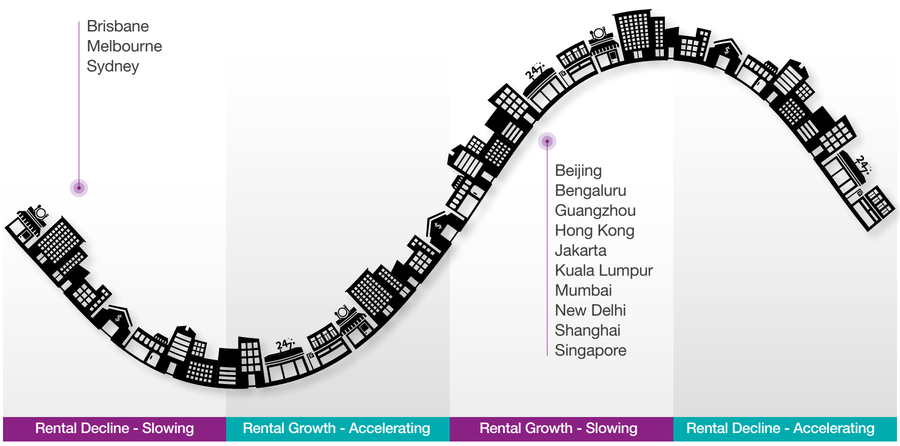
Continued demand for large office space from the Information Technology industry, along with demand from the rising e-commerce sector, has similarly driven the vacancy rate in Bengaluru to just below 10% for the first time in our database. Mumbai appears to be finally bottoming out, after years of stagnation, with improving demand from the financial services and consultancy sectors. Although India’s financial capital will see significant supply in 2015, the occupier market will likely be buoyed by a healthier economy. As such, we revised our projections and anticipate office rents in these cities to climb in 2015.

Retail | Slower rental growth in H2 2014

Knight Frank’s Prime Shopping Centre Index increased by 0.3% in the second half of 2014, the same rate as seen in the year-ago period. Compared to the preceding six months, however, this represents a slowdown in momentum from 1.5% growth.

2014 saw online retail sales surge by a spectacular 49.7% in China, accounting for 10.6% of total retail sales, forcing shopping centres to alter their tenant mix to enhance their food and beverages and entertainment offering. More recently, even Dalian Wanda, one of the largest developers in China, planned to close or restructure dozens of its department stores. It also teamed up with internet giants Baidu and Tencent to offer an online-to-offline retail platform in an attempt to drive traffic to its bricks-and-mortar malls. Together with the corruption crackdown hammering luxury retail sales, this has led prime retail rental growth in H2 2014 to soften in the major Chinese cities. Moving forward, a

FIGURE 7
Asia-Pacific Prime Shopping Centre Rental Cycle



Source: Knight Frank Research
The diagram does not constitute a forecast and is intended only as an indicative guide to current rental levels. Rents may not necessarily move through all stages of the cycle chronologically.

strong supply pipeline will further limit rental increments.

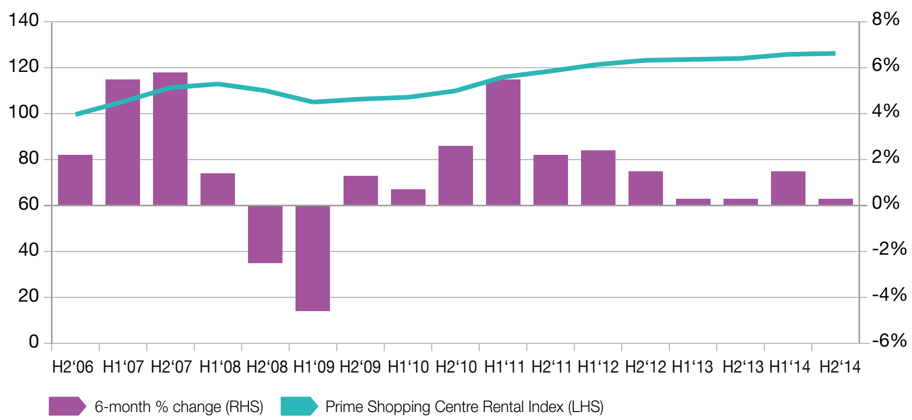
Similarly, shopping centres in India are being forced to rethink their retail formats following the rise of e-commerce. However, brighter economic prospects with rising consumer confidence bode well for the future of retail markets in India and this is reflected in the increasing rents experienced by major retail markets. Bengaluru, in particular, enjoyed a healthy 6.5% rental growth.

Although Kuala Lumpur witnessed substantial completion of retail space in H2 2014, retail rents grew decently as the regionally competitive rates continued to draw leasing demand from international brands.

In Singapore, sluggish retail sales (excluding motor vehicle sales) in H2 2014, due in part to a strong Singapore Dollar hurting tourist arrivals, coupled with a labour crunch as a result of the economic restructuring programme, presented strong headwinds to retailers. As a result, prime rents moved sideways.

In Australia, prime retail rents were mostly flat. Although deteriorating terms of trade imply higher import costs, international brands continued to show interest in Australia's prime retail space in central locations.

FIGURE 8
Asia-Pacific Prime Shopping Centre Rental Index



Source: Knight Frank Research

FIGURE 9
Asia-Pacific Prime Shopping Centre Rents
H2 2014

City	Prime net headline rent	Local measurement	6 mths % change	US$/sq m/mth
Brisbane	1,450	AUD/sq m/annum	0.0%	98.6
Melbourne	2,950	AUD/sq m/annum	0.0%	200.6
Sydney	3,075	AUD/sq m/annum	0.8%	209.1
Beijing	43	RMB/sq m/day	-0.1%	214.5
Guangzhou	19	RMB/sq m/day	0.1%	92.6
Shanghai	58	RMB/sq m/day	0.3%	288.4
Hong Kong	1,096	HKD/sq ft/month	1.7%	1,520.2
Bangalore	5,100	INR/sq ft/annum	6.5%	71.9
Mumbai	5,910	INR/sq ft/annum	0.2%	83.4
New Delhi	5,280	INR/sq ft/annum	-2.2%	74.5
Jakarta	8,068,035	IDR/sq m/annum	-6.8%	54.2
Kuala Lumpur	1,485	MYR/sq m/annum	3.6%	35.4
Singapore	32	SGD/sq m/month	0.0%	260.0

Source: Knight Frank Research

"… even Dalian Wanda, one of the largest developers in China, planned to close or restructure dozens of its department stores. It also teamed up with internet giants Baidu and Tencent to offer an online-to-offline retail platform in an attempt to drive traffic to its bricks-and-mortar malls."

REAL ESTATE INVESTMENT MARKETS

Prime yields in Australia and Japan continued to drop

Overall commercial real estate investment continued apace in the second half of 2014, with volumes (excluding land sales) hitting US$ 72 billion, only marginally below the US$ 74 billion high of H2 2007. A significant weight of capital continues to be concentrated on Japan and Australia, which together accounted for 42% of all transaction volumes in H2 2014, up from 40% in the same period of 2013. With prime yields in the two most traded markets continuing to compress, there is an increasing appetite for value-add opportunities or secondary assets, as investors move up the risk curve.

In **Japan,** the three largest deals of H2 2014 (excluding land) were completed in the Tokyo office market, with Pacific Century Place, Marunouchi purchased by GIC for US$ 1.7 billion, the Mizuho Bank Headquarters by the Mizuho Financial Group for US$ 1.4 billion and Meguro Gajoen by Mori Trust for US$ 1.3 billion. While concerns exist about the long-term potential of the Japanese market, Tokyo continues to benefit from declining vacancy rates and decent rental growth prospects. The weakened Yen and attractive spreads (Figure 11) have tempted increasing amounts of foreign capital, with Taiwanese groups especially active.

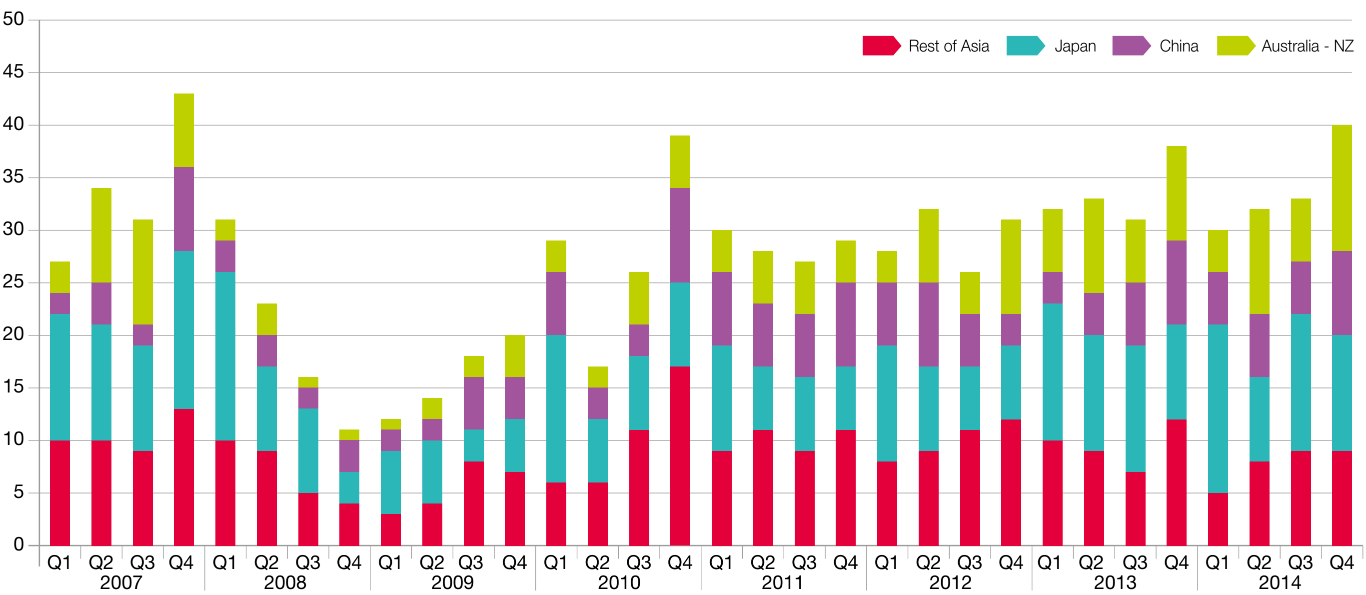
Australia recorded a significant 22.3% increase in investment volumes in the second half of 2014 compared to same period of 2013. Currency continues to be a significant driver, with the weaker Australia dollar encouraging interest from institutions and privates, especially from China and Southeast Asia who together invested US$ 6.6 billion (all asset classes) in the second half of the year.

The price correction in the **Singapore** residential market has presented investors with a window of opportunities. Most notably, Blackstone made two bulk purchases of apartments for a total of US$ 186 million. As the seven-year deadline to sell all units draws near for many foreign developers, we are likely to see more bulk transactions.

India saw investment activity pick up significantly in H2 2014, with volumes increasing by more than five times when compared to the same period in the previous year. Demand came from both local and foreign investors, who are seeking exposure to the anticipated acceleration in India's economic growth, which was forecast to overtake that of China this year (Figure 2).

FIGURE 10

Asia-Pacific Investment Volumes (US$ billion, excluding land sales)



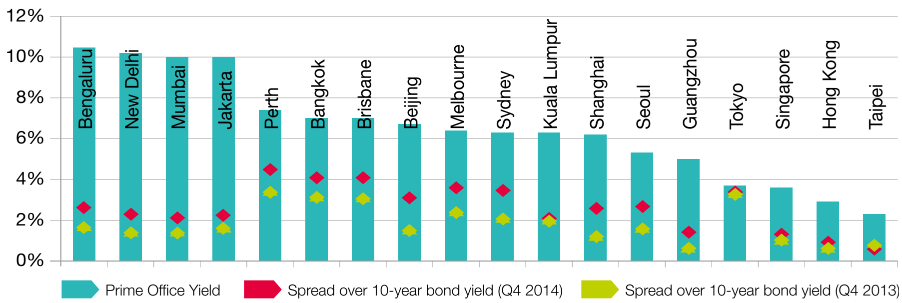
Source: Real Capital Analytics, Knight Frank Research

Investment volumes in **China,** on the other hand, slumped 16.9% year-on-year. Even domestic investors are increasingly going overseas. For example, having gained confidence investing offshore, Ping An and China Life recently adopted a more opportunistic strategy and looked beyond traditional markets by investing in a development project in Boston.

Yield spreads continued to increase

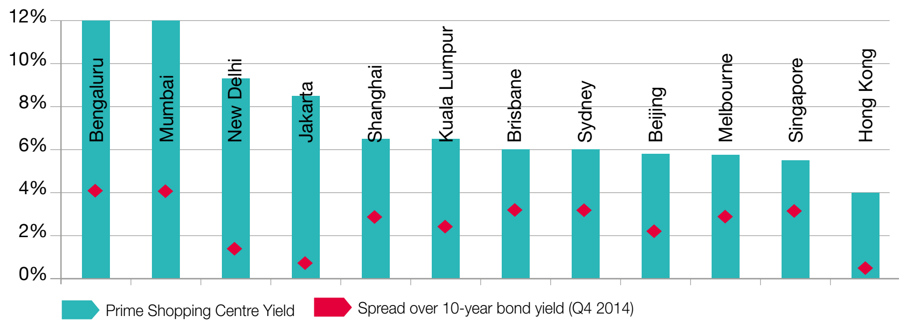
With the exception of Malaysia which saw the collapse in oil prices sparking worries about its fiscal health, 10-year government bond yields fell across the board in Asia-Pacific over 2014. Meanwhile, office and shopping centre yield movements were marginal as compared to the decline in bond yields. This is true even in Australia and Japan where the weight of capital has compressed prime office yields the most. The result is that yield spreads continued to widen, creating a substitution effect that draws more allocation of fund to commercial properties as an asset class.

FIGURE 11
Prime Office Yields and Spreads over 10-Year Bonds



Source: Knight Frank Research

FIGURE 12
Prime Shopping Centre Yields and Spreads over 10-Year Bonds



Source: Knight Frank Research

Indian REIT structures

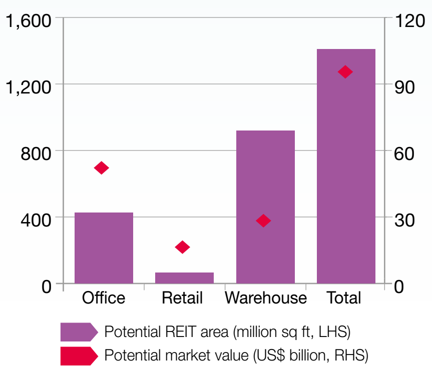
Hope that new vehicles will transform real estate sector, although challenges remain

In terms of liquidity and financing, the Indian commercial property investment market has been a consistent underperformer. However, hope is on the horizon, not only with the ongoing improving economic fortunes of the world's largest democracy, but also with the framework for Real Estate Investment Trusts (REITs), an investment vehicle that invests in rent-yielding completed real estate properties.

REITs certainly have the potential to transform the Indian real estate sector, helping to attract long-term financing from domestic as well as foreign sources (see Figure 14 for key foreign investors in India). For investors, REITs can provide a new investment vehicle with ongoing returns, elevated transparency and governance standards, while offering an exit opportunity to developers, enabling them to monetise their real estate. Mandatory listing of REITs on recognised stock exchanges will offer an easy entry and exit mechanism for investors. With respect to providing liquidity to the investors, REITs may be on par with equity shares trading on the exchange.

While no REIT has yet been listed, and there continues to be debate about some issues, most notably around tax, the potential impact of REITs on the Indian real estate landscape is significant.

FIGURE 13
REIT Market Potential in India



Source: Knight Frank Research

FIGURE 14
Key Foreign Investors in India

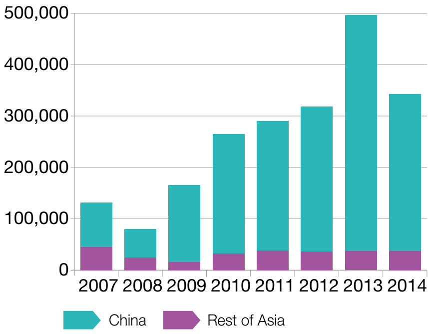
Global Investor	Invested / Committed Amount (US$ million)
Blackstone	1,750+
Brookfield	500+
ADIA	500+
APG	400+
CPPIB	750+
GIC	850+
QIA	500+

Source: Knight Frank Research

FIGURE 15

Land Investment Volumes in Asia

US$ million, development sites > US$ 10 million



Source: Knight Frank Research

Greater China land markets end 2014 on a brighter note

After languishing in the middle of 2014, the Chinese prime development land markets returned to life towards year end, after the government implemented a series of stimulus measures. As more monetary easing policies are rolled out, we expect the land markets to stay buoyant this year.

Although Knight Frank's Prime Asia Development Land Index continued to climb upwards, the sales volume in Asia tumbled by 31.0% in 2014 from an extraordinarily high base in the previous year (Figure 15). This is due to a 33.5% plunge in China, as the inventory of unsold houses swelled. In the meantime, the rest of Asia still saw volumes increase marginally. While Asian developers are making less cross-border acquisitions within the region, non-Asians pumped in 118.5% more investment. As the land markets in several major cities improve, we are sanguine about the prospects for increased sales this year.

FIGURE 16

Selection of Recent Major Transactions

H2 2014

Property name	Market	Type	Buyer	US$ million	Comments	Date
Lumley Centre	Auckland	Office	Deka Immobilien	129	Largest office sale in New Zealand since 2007. Net annual income exceeds NZ$ 10 million. 93% leased, with weighted average lease terms standing at eight years.	Sep-14
Plot 0110-663 (C2) and 0110-634 (R2), Xicheng District	Beijing	Dev Site	Beijing Huarong Infrastructure	1,213	US$58,683/sq m site area; US$10,302/sq m GFA.	Aug-14
Mt Ommaney Centre	Brisbane	Retail	Federation Centres, TH Real Estate OBO TIAA-CREF and Henderson Global	363	56,570 sq m. Managed by Federation Centres. Anchored by three supermarkets: Woolworths, Coles and Aldi.	Oct-14
BPTP Crest	Delhi	Industrial	Qatar Investment Authority and RMZ Corp	133	A 650,000 sq ft IT park. Tenants include Deloitte and Fidelity.	Sep-14
Plot AF040131, Liwan District	Guangzhou	Dev Site	Shenzhen Zhenye Group	330	US$11,582/sq m site area; US$2,970/sq m GFA.	Sep-14
Lippo Malls Kemang	Jakarta	Retail	LMIR Trust	277	93% occupancy rate.	Dec-14
Inland Lot No. 11237, Tsim Sha Tsui, Kowloon	Hong Kong	Dev Site	Henderson Land Development	605	US$229,990/sqm site area; US$19,151/sq m GFA.	Sep-14
CBW Complex	Melbourne	Mixed-use	GPT Group (GPT & GWOF)	568	Two towers with 76,000 sq m of office space and 5,300 sq m of retail component. Tenants include Ashurst and Deloitte.	Sep-14
KEPCO HQ	Seoul	Dev Site	Hyundai Motor Company, KIA Motors and Hyundai Mobis	9,852	To be demolished and developed into a business centre that includes a hotel, a convention centre, an auto theme park and Hyundai's headquarter.	Nov-14
Plot 616 and 735, Xiaodongmen Sub-district, Huangpu District	Shanghai	Dev Site	China Minsheng Investment, Shanghai Bund Investment Group and Shanghai Jiadu Real Estate	4,046	US$31,920/sq m site area; US$5,762/sq m GFA.	Nov-14
The Straits Trading Building	Singapore	Office	Sun Venture	360	159,000 sq ft of net lettable area with street retail component.	Sep-14
101 Miller Street & Greenwood Plaza	Sydney	Office	TH Real Estate OBO TIAA-CREF and Henderson Global	270	50% share purchased. 37,549 sq m of lettable office space and 8,777 sq m of lettable retail space.	Oct-14
Minan Sec 601-630	Taipei	Dev Site		313	Residential development	Nov-14
Pacific Century Place Marunouchi	Tokyo	Office	GIC	1,700	Office component from level 8 to 31	Oct-14

Source: Knight Frank Research

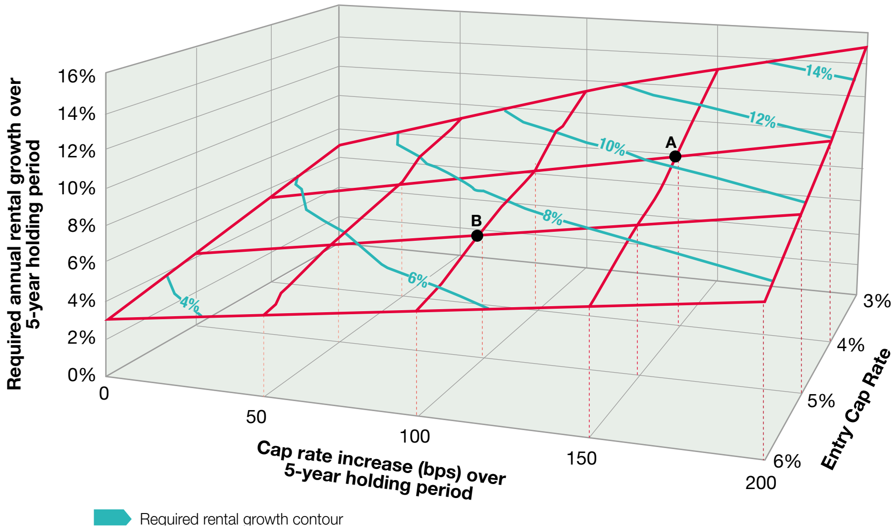
Cap rate decompression and required rental growth

While the timing and speed of interest rate rises in the US are still difficult to determine, there is little doubt that the Federal Reserve will start to move at some point in the second half of 2015. Despite the loosening of monetary policy in many markets in the Asia-Pacific region, ultimately higher global interest rates will begin to put upward pressure on cap rates as the cost of debt rises. While we have been seeing the sheer weight of capital compress prime yields in key cities, just what could be the impact of increasing cap rates over the coming years?

In this scenario, one important consideration is what rental growth an investor would have to receive to maintain a specific internal rate of return (IRR). Figure 17 illustrates this, showing the rental growth required to maintain an assumed IRR target of 10%, given various entry cap rates and a range of cap rate increases.

FIGURE 17

Required Annual Rental Growth over a 5-Year Holding Period to Maintain an IRR of 10%, Given Differing Cap Rate Decompression



Source: Knight Frank Research

Example A: If an investor purchased off a yield of 4% and the market sees a 150 basis points (bps) increase over a 5-year holding period, they would require an annual rental growth rate of just over 10% per annum (as shown by point A, just above the 10% rental growth contour) to maintain an unleveraged IRR of 10%.

Example B: If an investor purchased off a yield of 5% and the market sees a 100 bps increase over a 5-year holding period, they would require an annual rental growth rate of just over 7% per annum (as shown by point B, between the 6% and 8% rental growth contours) to maintain an unleveraged IRR of 10%.

RISKS	A prolonged or sharp slowdown in the Chinese economy would further weigh on the region, especially commodity exporters.
	The normalisation of interest rate in the US could lead to a correction in asset valuations.
OPPORTUNITIES	An economic recovery in the US and Eurozone would: - boost leasing demand for commercial properties in the West, with Germany in particular already attracting some investor interest; and - increase export demand for Asia-Pacific goods and services, thereby supporting corporate demand for commercial space here.
	Countries such as Australia and Japan are likely to ease their monetary policies further, creating opportunities for currency play to foreign investors.
	The booming e-commerce sector around the region, not just China, creates demand for prime logistics space.
	Reforms and infrastructure developments in India and Indonesia present opportunities for investors including developers.

Source: Knight Frank Research

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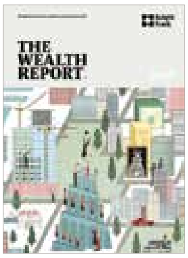

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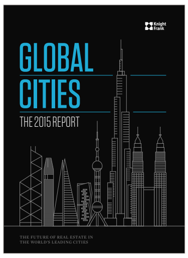

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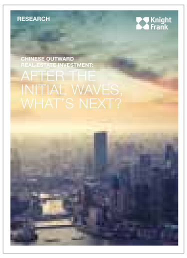

Chinese Outward Real Estate Investment

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