RESEARCH

Knight Frank

ASIA-PACIFIC CAPITAL MARKETS

SEPTEMBER 2013

- Growth prospects have weakened in Asia Pacific, as China's slowdown and talk of tapering QE3 in the US impact the region.
- Occupier markets remain active, although office markets have notably slowed for the first time since 2009.
- Investment volumes have remained steady, while prime yields have continued to compress across most markets, with significant buyer competition for prime assets.

01

ECONOMIC SNAPSHOT

A TOUGH REBALANCING ACT FOR CHINA AS TALK OF TAPERING QE3 LEADS TO CAPITAL OUTFLOWS IN EMERGING ASIA

While the Asia-Pacific economy continues to outpace other regions of the world, growth prospects have weakened over the first half of 2013. Notably with China's expansion rate dropping to 7.5% y-o-y at the end of Q2 2013 (from an average of over 10% over the last decade), there are concerns that growth could dip lower this year, although a hard landing is unlikely. Elsewhere, forecasts for growth in 2013/14 have been tempered somewhat, given the slowdown in emerging markets and the likely tapering of QE3 in the US. The rise in US bond rates has already led to an outflow of capital and a weakening of domestic currencies, most notably in India, Indonesia and Thailand.

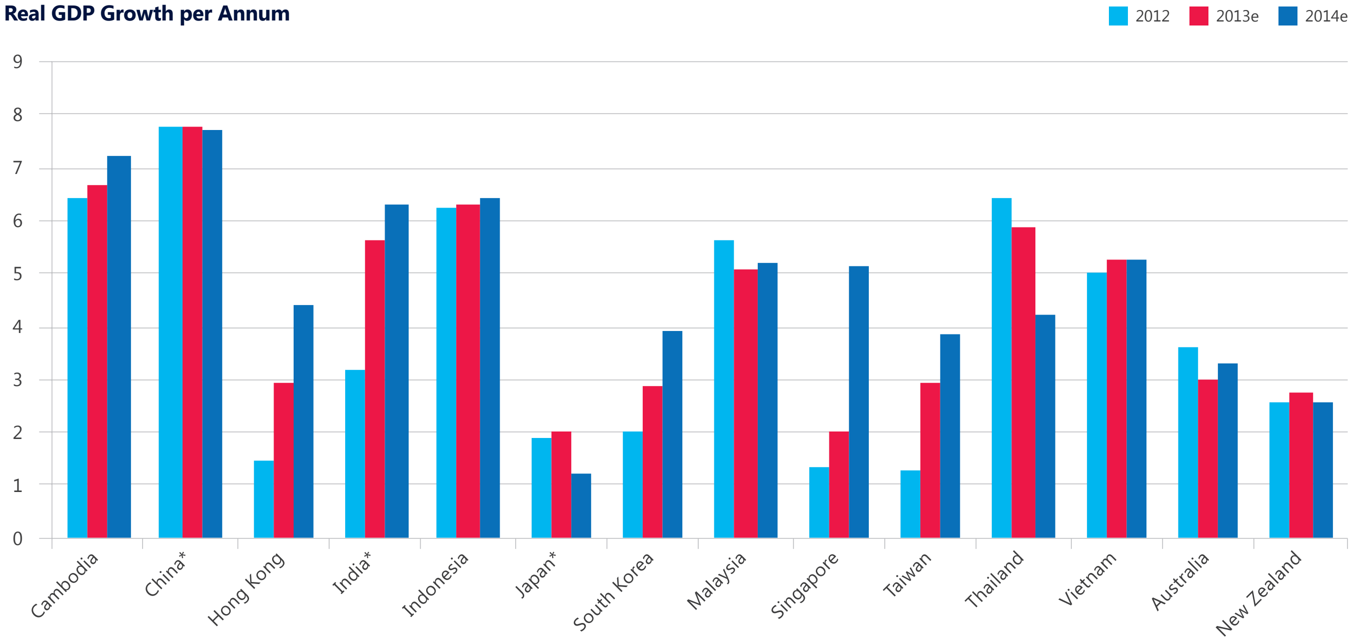
In China, credit conditions continue to be of some concern, with the largely unregulated shadow banking sector representing the largest credit growth in the economy. Further downside risks remain as external conditions continue to be weak and China's exports down in the first half of 2013 compared to 2012. Although policy makers have suggested that they will accept a slowdown in the economy as it rebalances away from export and overinvestment, they have introduced a number of minor policies to stimulate the economy, including tax breaks for small businesses, reduced fees for exporters and the opening up of railway construction.

With the regional economic role of China never more important than today, the knock-on effects of a slowdown in growth are likely be felt throughout the region. Australia, with its economy closely linked into the Chinese external demand for resources is seeing its growth prospects weaken. This has also been reflected in the Australian dollar which dropped by 13% against the US dollar over the first 6 months of the year, with the Reserve Bank of Australia cutting interest rates twice in an attempt to stimulate the economy.

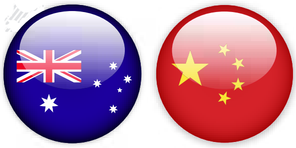
India's economy, which is running a current account deficit, has continued to suffer

Figure 1

Real GDP Growth per Annum



Source : IMF - World Economic Outlook April 2013 expect * World Economic Outlook Update July 2013, Knight Frank Research



INFLATION RISKS INCREASE WHILE FURTHER MONETARY EASING POSSIBLE IN AUSTRALIA AND CHINA

from capital flight and a depreciating rupee, leading to increasing inflationary pressure. The economy, which grew at 3.2% in 2012, is forecast to continue to see growth compromised in 2013. The newly appointed head of the Indian Central Bank is expected to prioritise stabilising prices and to continue championing structural reforms in the economy.

Of all the developed economies in the region, Japan is the odd one out, as its unprecedented stimulus measures have boosted growth prospects for 2013 and 2014. Although second quarter growth slowed from the rapid expansion seen at the advent of "Abenomics" in Q1 2013, hopes remain that the country's economy can be jolted out of its two "lost decades". The reality however is that demographics will continue to have the largest impact on the Japanese economy over the longer term horizon.

> "The knock-on effects of a slowdown in Chinese growth are likely be felt throughout the region."

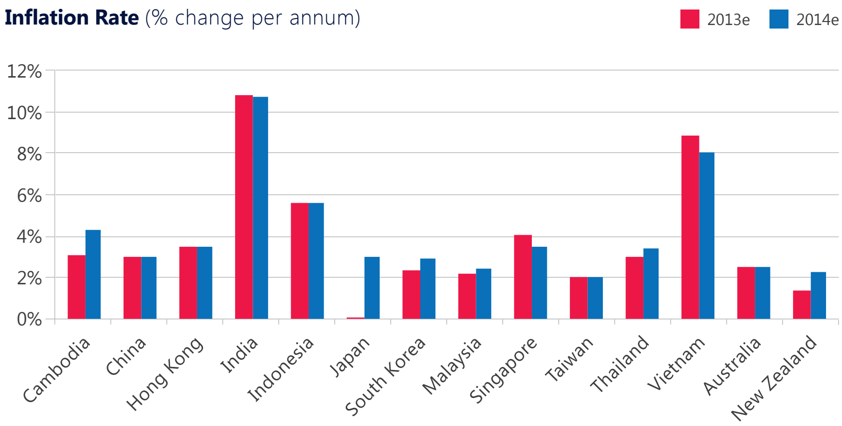
The adjustment of developing Asia currencies, notably in Indonesia, India, Thailand and Malaysia is likely to add some inflationary pressure. The one-off cutting of fuel subsidies in Indonesia has also significantly contributed to the country's inflation rate this year.

China has more room to manoeuvre, with inflation remaining under official targets. Although stimulating the slowing economy through monetary easing remains a possibility, all signs suggest that policy makers will favour structural reforms over the near term, as the economy continues to rebalance and some of the excess leverage is reigned in.

Japan, which has set itself a target inflation rate of 2%, has seen inflation hit 0.4%, its highest since 2008. The inflation is very much of a "cost push" variety, due to the weakened Yen importing inflation and a rise in electricity prices, rather than "demand pull" inflation in the real economy. The Prime Minister's decision on whether to raise consumption tax next year will impact headline inflation in 2014.

Figure 2

Inflation Rate (% change per annum)



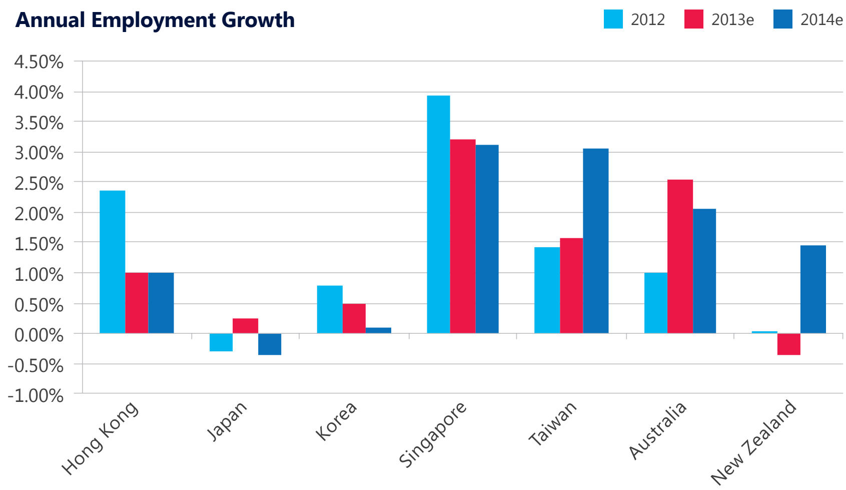
Source : IMF, Knight Frank Research

EMPLOYMENT GROWTH PROSPECTS POSITIVE

Growth in the Asia-Pacific economies continues to create employment across most sectors. In developed Asia Pacific, employment growth is forecast to remain positive in 2013 with the exception of New Zealand. The majority of new employment is expected to come from the services sector despite the recent cutbacks in the financial services and banking sectors. The major gateway cities, which are more connected into the economic recovery in the west will see employment growth closely linked to the performance of the US and Europe's economies.

Figure 3

Annual Employment Growth



Source : IMF, Knight Frank Research

02 REAL ESTATE OCCUPIER MARKETS

SLOWDOWN IN PRIME OFFICE OCCUPIER MARKETS

OFFICE

In China, the general slowdown of the economy has trickled down to the office market, where prime rents in Beijing, Guangzhou and Shanghai declined over the first half of 2013. The rebalancing of the economy that is currently underway has caused some uncertainty in the wider economy and this has impacted business expansions into new office space.

The recent change in government is expected to stimulate growth in Australia, although the Chinese slowdown has indirectly impacted office demand in H1 2013, demonstrated by all major city CBDs seeing negative absorption and declining effective rents.

In Japan, the prime office rental market actually edged down slightly in Q2 2013 following two quarters of strong rental growth. The ongoing impact of "Abenomics" and the continuing move towards prime, earthquake tolerant office accommodation however is likely to ensure solid prime rental growth over the next 12 months.

Similarly in India, while the struggling economy is growing at a faster rate than in 2012, and the office markets have shown solid net absorption, rents have moved sideways and are expected to continue this trend, given the significant new supply that is expected to come online over the next 36 months.

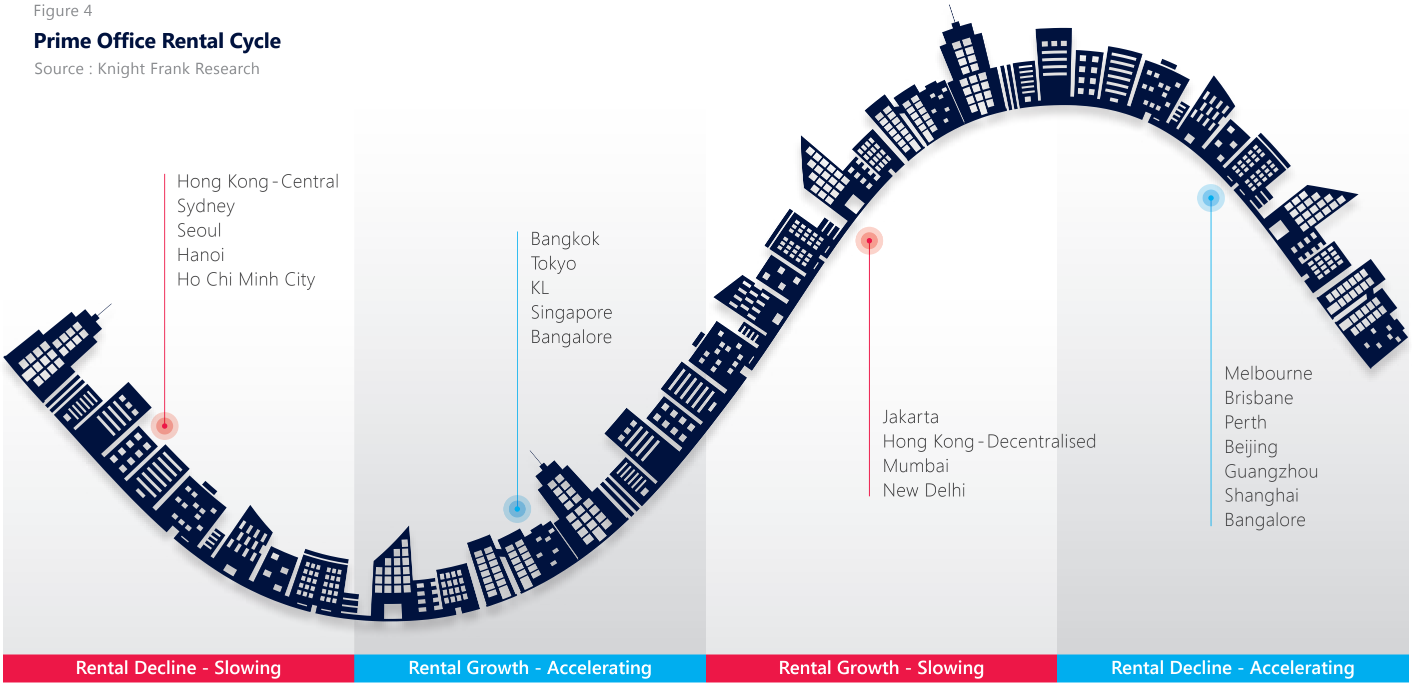
Elsewhere, prime rents remained stagnant in a number of major cities, with the expectation that markets are at the bottom of the rental cycle, most notably in Seoul, Singapore, Kuala Lumpur and Ho Chi Minh City (see figure 4).

In terms of markets that remain on the upward trajectory of the rental cycle; Bangkok continued to see increases in prime office rents, while Jakarta continued to be the stand out market, with rents increasing by 25.5% over the first six months of 2013. The Indonesian capital's prime office space is being driven by demand from international oil and gas, banking, finance and insurance sectors.

Figure 4

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.

Figure 5

Prime Office Rents

City	Submarket(s)	Prime Net Headline Rent	Local Measurement	USD/sq m/ month	6-month % change (Q4 2012-Q2 2013)
Brisbane	CBD	530.0	AUD/sq m/annum (Net Floor Area)	40.4	-5.86%
Melbourne	CBD	462.0	AUD/sq m/annum (Net Floor Area)	35.2	0.00%
Perth	CBD	760.0	AUD/sq m/annum (Net Floor Area)	57.9	-1.43%
Sydney	CBD	740.0	AUD/sq m/annum (Net Floor Area)	56.4	-0.27%
Beijing	Various	387.4	RMB/sq m/month (Gross Floor Area)	62.8	-2.11%
Guangzhou	CBD	176.8	RMB/sq m/month (Gross Floor Area)	28.6	-0.95%
Shanghai	Puxi, Pudong	274.8	RMB/sq m/month (Gross Floor Area)	44.5	-0.88%
Hong Kong	Central	119.1	HKD/sq ft/month (Net Floor Area)	165.4	2.36%
Bangalore	CBD	1,050.0	INR/sq ft/annum (Gross Floor Area)	15.8	-0.19%
Mumbai	BKC	3,300.0	INR/sq ft/annum (Gross Floor Area)	49.7	0.10%
New Delhi	Connaught Place	3,125.0	INR/sq ft/annum (Gross Floor Area)	47.0	0.16%
Jakarta	CBD	4,862,076.0	IDR/sq m/annum (Semi-Gross Floor Area)	40.9	25.46%
Tokyo*	Central 3 Wards	26,680.0	JPY/Tsubo/month (Net Floor Area)	81.4	11.31%
Kuala Lumpur	City Centre	4.7	MYR/sq ft/month (Net Floor Area)	16.1	0.00%
Singapore	Raffles Place, Marina Bay	9.1	SGD/sq ft/month (Net Floor Area)	77.4	-2.04%
Seoul	CBD	30,200.0	KRW/sq m/month (Gross Floor Area)	26.5	-4.09%
Bangkok	CBD	676.3	THB/sq m/month (Gross Floor Area)	21.8	3.66%
Hanoi	Hoan Kiem District	30.0	USD/sq m/month (Net Floor Area)	30.0	-3.23%
Ho Chi Minh City	District 1	31.0	USD/sq m/month (Net Floor Area)	31.0	0.00%

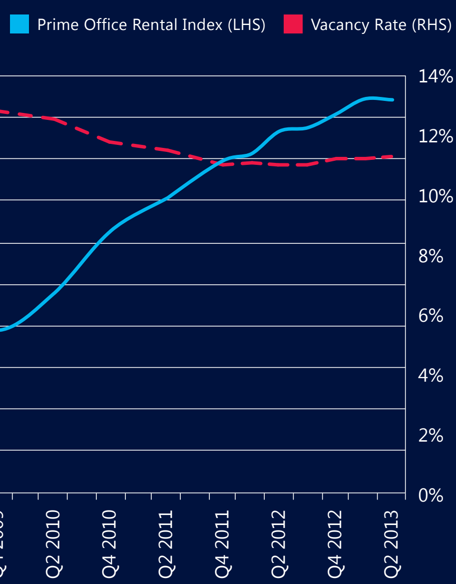
Source : Knight Frank Research * Sanko Estate

Although Knight Frank's Asia-Pacific Prime Office Index increased by 1.3% over the first half of the year, it dropped by 0.1% over second quarter (see figure 6). This was the first negative result for the index in 14 quarters. The stock weighted vacancy rate increased marginally from 11.20% to 11.27%, a result of the drop in demand being met with significant construction completions.

"The stock weighted vacancy rate increased marginally from 11.20% to 11.27%, a result of the drop in demand being met with significant construction completions."

Figure 6

Knight Frank Prime Office Rental Index



Source : Knight Frank Research

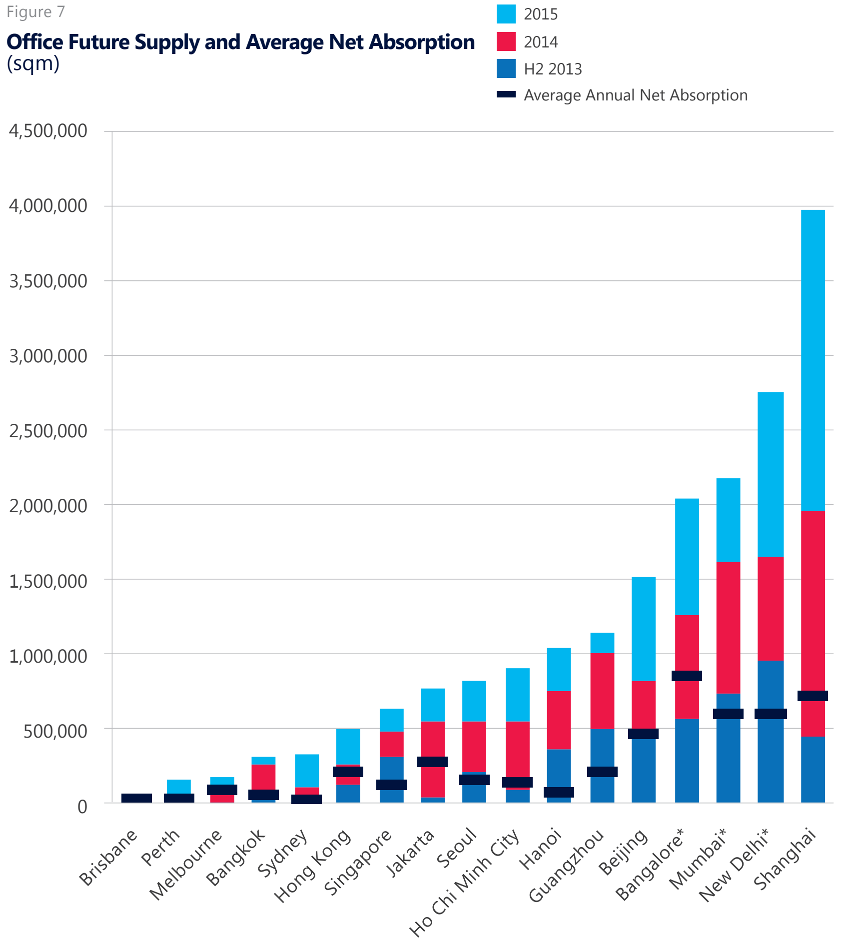
Overall activity across the region has been down in 2013: net absorption in the major cities of Asia Pacific in the first half of 2013 was 22.8% lower than the same period of last year and 13.9% lower than the second half of 2012, with a number of markets recording negative demand for the period.

The future supply pipeline varies significantly across the region, with the sophistication of development markets (developers and financers) to adapt and anticipate the cyclical nature of occupier demand differing in each country (see figure 7). Not surprisingly, the two giants of the region, China and India stand out with the largest future supply. While Shanghai has proven to be the largest market in terms of net absorption over the last decade, the significant supply pipeline raises questions as to the ability of developers to meet local demand without creating an oversupplied situation in specific localities.

“Net absorption in the major cities of Asia Pacific in the first half of 2013 was 22.8% lower than the same period of last year.”

Figure 7

Office Future Supply and Average Net Absorption (sqm)



Source : Knight Frank Research *Gross Absorption Figures

RETAIL

ASIA'S RISING MIDDLE CLASS UNDERPINS SOLID RETAIL PERFORMANCE

Figure 8

Prime Shopping Centre Rents*

City	Net Headline Rent	Local Measurement	USD/sq m/ month	6-month % change (Q4 2012-Q2 2013)
Brisbane	1,450	AUD/sq m/annum	110.5	-3.3%
Melbourne	2,950	AUD/sq m/annum	224.8	-1.7%
Sydney	3,050	AUD/sq m/annum	232.5	-1.6%
Beijing	45	USD/sq m/annum	221.7	-2.2%
Guangzhou	25	RMB/sq m/day	123.2	1.1%
Shanghai	69	RMB/sq m/day	342.3	1.6%
Hong Kong	1,000	HK$/sq ft/month	1,387.9	7.0%
Bangalore	4,780	INR/sq ft/annum	71.9	0.1%
Mumbai	5,940	INR/sq ft/annum	89.4	0.0%
New Delhi	5,400	INR/sq ft/annum	81.3	0.0%
Jakarta	7,440,504	IDR/sq m/annum	62.6	0.6%
Kuala Lumpur	1,424	MYR/sq m/annum	37.6	5.0%
Singapore	4,065	SGD/sq m/annum	267.4	2.0%
Ho Chi Minh City	60	USD/sq m/month	60.0	-3.2%

Source : Knight Frank Research
*Based on local market definition.

Figure 9

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.

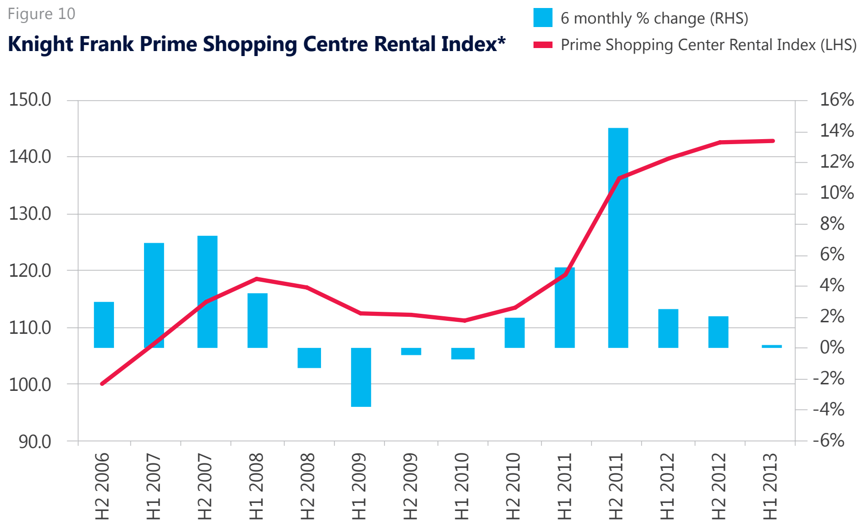
Knight Frank's Prime Shopping Centre Index increased by 0.2% over the first six months of 2013, down from 2.1% growth in the previous six months. The index has now increased over six consecutive half year periods. Steady rental growth across all of Asia continued, with the exception of Beijing, which saw rents soften slightly by 2.2% over the first two quarters of the year.

Kuala Lumpur and Hong Kong led rental growth over the first half of 2013, with 5.0% and 7.0% increases respectively. Kuala Lumpur, which is likely to welcome a significant amount of new retail supply over the next 12 months, is likely to see rents remain stable for the rest of the year. Prime retail rents in Hong Kong appeared to have peaked amid softening local consumption growth in the city - and while leading international brands' expansion slowed, domestic and Japanese retailers continued to increase their presence in both core and non-core retail districts.

While retail sales grew across all markets, driven by economic growth and a continued movement towards modern retail formats, uncertainty in the global economy is continuing to restrain consumer confidence. The continued growth of the middle classes in developing Asia however will underpin the increase in retail sales, including luxury goods, as increasing numbers of consumers orient themselves towards modern retailing formats and e-commerce. A recent study by the EIU forecasts that the number of households with annual incomes of over US$75,000 will increase nearly eight fold between now and 2030. (see figure 11)

Figure 10

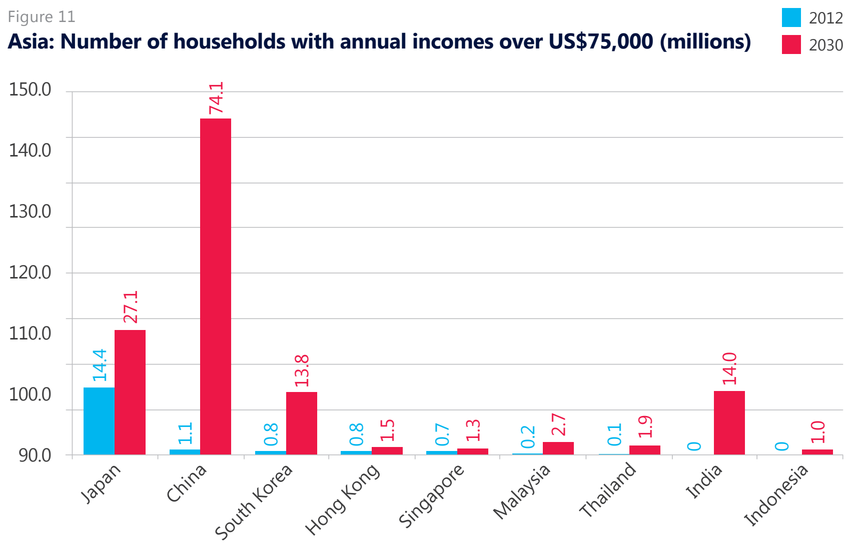
Knight Frank Prime Shopping Centre Rental Index*



Source : Knight Frank Research *Unweighted

Figure 11

Asia: Number of households with annual incomes over US$75,000 (millions)



Source : EIU, Knight Frank Research

03 REAL ESTATE INVESTMENT MARKETS

INVESTMENT VOLUMES HOLD STEADY WITH JAPAN LEADING THE WAY

Investment volumes recorded in the first half of 2013 stood at US$ 57.9 billion, down marginally 1.8% from the same period of last year, but up 9.6% from the second half of 2012. Japan has remained the most active market followed by Australia, Hong Kong, China, and South Korea.

In Japan, volumes are up 12.1% when compared to the same period last year. The positive sentiment brought about by the monetary and fiscal stimulus measures and the weakening Yen has encouraged offshore interest, with foreign investors such as AXA Real Estate, GE Capital, Goldman Sachs active purchasers over the last six months. As more capital has entered the market, prime office yields have compressed to 4.0%.

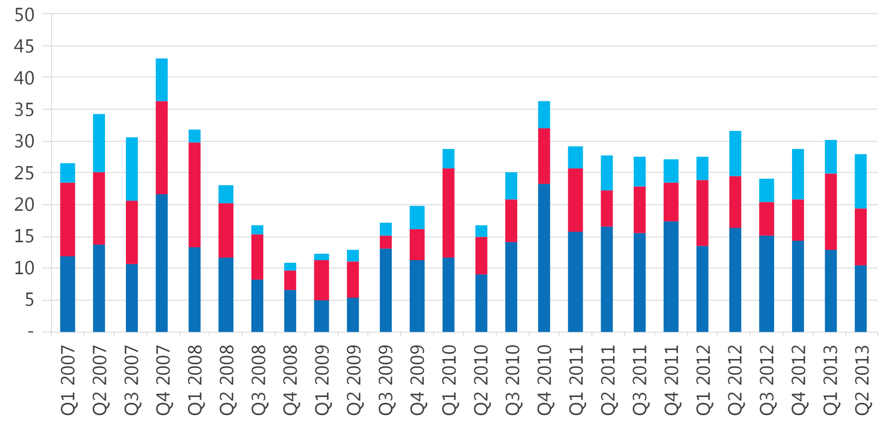
Australia saw activity increase significantly over the half, reaching US$13.2 billion, with Sydney continuing to be the most active market. Notable transfers included the NSW Government portfolio to Cromwell Property group for US$ 373 million and AAMI Building in North Sydney to Investa Office Fund for US$ 118 million.

The Hong Kong investment market remained quiet after the government successively imposed a series of cooling measures towards the end of 2012, with commercial investment volume dropping about 20% in the first half of 2013. Meanwhile, China saw investment sentiment warming up, with foreign funds returning to the country.

Some liquidity has returned to Vietnam, despite a continuing crisis in the banking sector, with the largest deal on record going through with the sale of Eden Center (Vincom Center A) to a local purchaser for US$ 470 million.

Figure 12

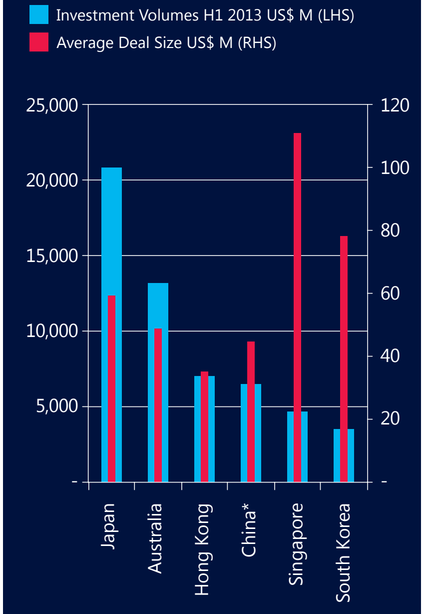
Investment Volumes Asia Pacific (US$Billion) (excluding land sales)



Source : Real Capital Analytics, Knight Frank Research

Figure 13

Volumes and Average Deal Size (deals>US$10m)



Source : Real Capital Analytics, Knight Frank Research

In terms of average deal size (for transactions over US$ 10m), Singapore stood out with average lot size of US$111 million, although this number does not take into account the numerous sub US$ 10 million deals, such as strata office, industrial and retail. The increase in retail investors purchasing smaller commercial real estate has been a direct consequence of cooling measures we have seen, most notably in China, Singapore and Hong Kong.

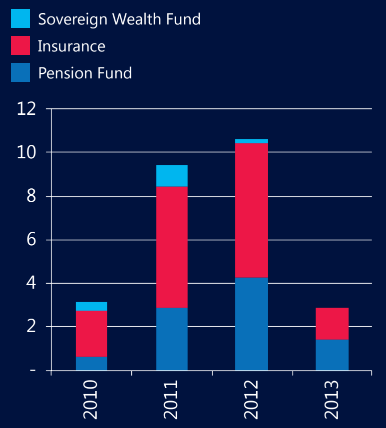
THE RISING PROMINENCE OF THE ASIAN INSTITUTIONAL INVESTOR

Changing regulations and the rise of welfare states in developing Asia are helping shape cross border property investment activity. The increasing exposure of many of these investors to alternative investment classes, including property is likely to continue as allocations edge towards levels seen in the west. Most notably, following the China Insurance Regulatory Commission (CIRC) regulatory clarification of October 2012, Chinese Insurers have started going offshore, with the notable purchase of Lloyds Building in London, by Ping An Insurance Group for £260 million. South Korea's insurance companies have also continued to be active in offshore investment with National Pension Service (NPS) buying a 50% stake in Erina Fair, regional Sydney and Central Plaza in Shanghai.

The increasing importance of state pension, insurance and sovereign wealth funds is apparent when looking at volumes invested within Asia Pacific by these institutions (see figure 14). These numbers do not take into account the amount invested in Europe and the Americas, where core well located prime assets in gateway cities are continuing to attract institutional capital from the region.

Figure 14

Key Institutional Buyers in Asia Pacific (US$Billion)



Source : Real Capital Analytics, Knight Frank Research

PRICING KEEN IN CORE MARKETS, WHILE INCREASE IN BOND YIELDS REDUCE SPREADS ACROSS THE REGION

Although bond yields remain at historic lows, they have moved out across most countries in Asia Pacific. This has reduced the spreads of property yields over the risk free rate. Property however continues to be attractive thanks to its income appeal and hedge against inflation. Prime yields have compressed across nearly all markets over the first six months of 2013, as significant capital is chasing limited stock. Secondary yields where tenancy risk is deemed more significant have remained stable in the majority of markets.

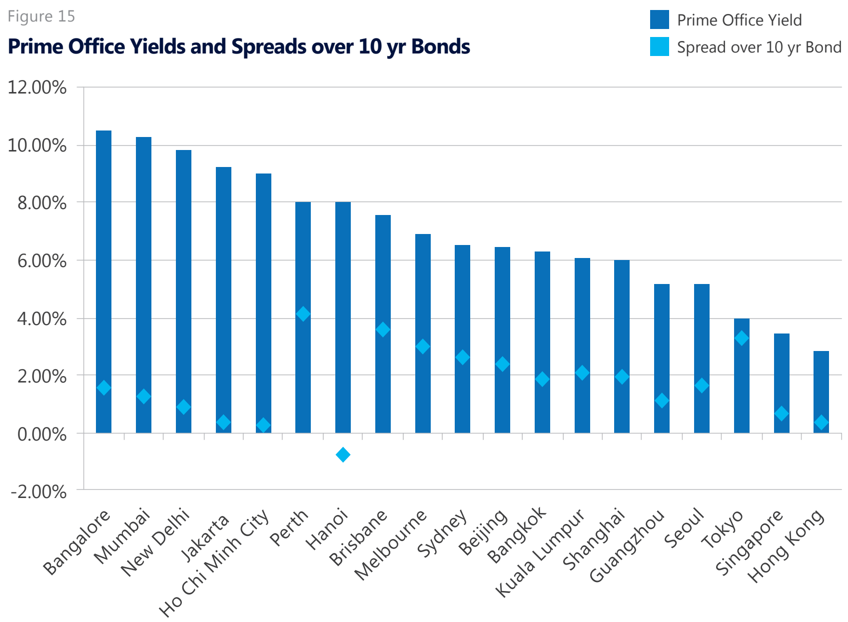
98

Basis Points

The amount prime office yields have compressed in Beijing over the last 12 months.

Figure 15

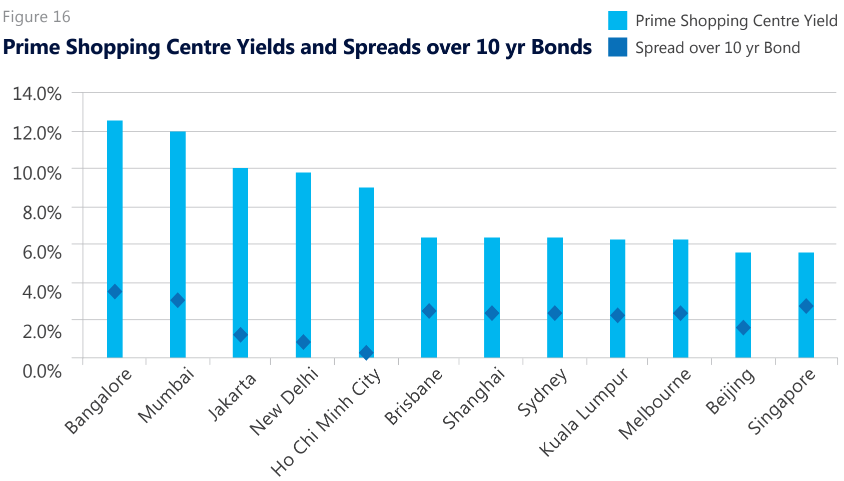
Prime Office Yields and Spreads over 10 yr Bonds



Source : Knight Frank Research

Figure 16

Prime Shopping Centre Yields and Spreads over 10 yr Bonds



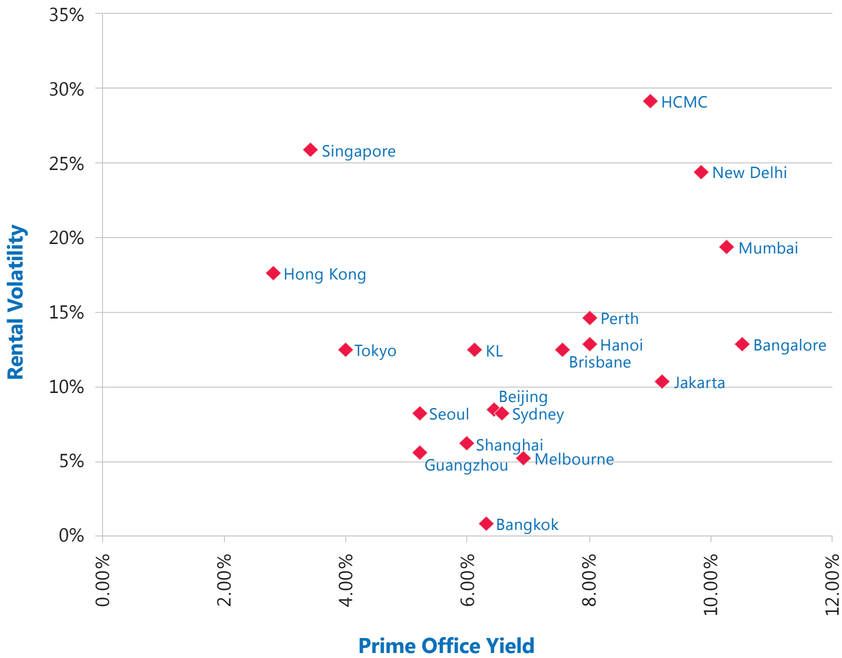
Source : Knight Frank Research

IS ANYWHERE REALLY A SAFE HAVEN?

While property assets in markets considered "safe havens" have been favoured in these times of uncertainty, some may be surprised when looking at the rental volatility of prime office rental markets across the region (see figure 17). Core markets such as Singapore and Hong Kong have proven to be two of the more volatile markets, although assets continue to trade at the lowest yields in the region. The sheer weight of capital, lack of opportunities and long term prospects for rental and capital growth will ensure that yields remain low, while the open nature of these economies will continue to mean that these markets are sensitive (both in the positive and negative sense) to events in the wider global economy.

Figure 17

Prime Office Rental Volatility and Prime Office Yields



Source : Knight Frank Research

RISKS AND OPPORTUNITIES

RISKS	A multispeed monetary and fiscal stimulus environment leading to increasing interest rates and uncertainty around economies in the region
	Rising bond yields have reduced the historically large spreads of property yields over 10 year government bonds
	The continued slowdown of the increasingly connected Chinese economy, impacting economies and real estate markets across the region
OPPORTUNITIES	A strengthening of the US economy to increase corporate appetite to invest into emerging Asia could boost demand for commercial real estate in the region
	A stabilising Chinese economy reorientating itself towards domestic consumption, boosting demand for retail and retail related logistics
	An adjustment in currencies across the region, most notably the Australian dollar and Japanese Yen providing attractive opportunities for offshore investors into prime real estate in these markets

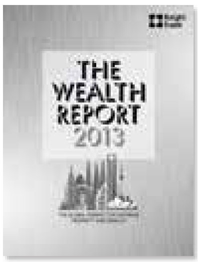
Figure 18

Selection of Recent Major Transactions

Property Name	Market	Type	Buyer	USD (m)	Comments	Date
GS Yeokjeon Tower	Seoul	Office	Angelo Gordon	160.0	Sale and leaseback through Vestas Asset Management.	April-13
Beijing Financial Center Bldg 4	Beijing	Office	China Merchants Bank	682.0	Forward purchase of property currently under construction, with delivery scheduled for 2015.	April-13
480 Queen Street	Brisbane	Office	DEXUS Property Group 50% / DWPF 50%	565.6	Fund through purchase of a 31 level premium grade office development 38% pre-leased. Completion of construction due 2016.	April-13
Erina Coast	Sydney	Retail	National Pension Service of South Korea	397.1	50% share in 113,500 sq m regional shopping centre which benefits from a 99.9% occupancy rate.	May-13
Central Plaza	Shanghai	Office	Carlyle Group OBO NPS of South Korea	266.7	19-storey grade A office tower located in the Shanghai CBD, 99% occupied.	May-13
Kamiyacho Central Place	Tokyo	Office	Hulic	514.0	CBD office property leased to Ford, Virtualex Consulting, Nomura, Dimension Data Japan.	May-13
Citibank Plaza Block A Citibank Tower	Hong Kong Central	Office	Shine Hill Deveopment Ltd	277.7	3rd - 6th floor with a GFA of 6,161 sq m.	May-13
Vincom Center A	Ho Chi Minh City	Retail/ Hotel	VIPD Group	470.0	Prime retail and hotel asset, representing the highest value property transaction in Vietnam to date.	June-13
NSW Portfolio	Sydney	Office	Cromwell Property Group	373.0	Seven office properties, including three CBD assets: Symantec House, McKell Building and Bligh House. 70% leased to the NSW government.	June-13
Raine Square	Perth	Mixed Use	Charter Hall	438.4	CBD mixed use property consisting of retail component, office (including Bankwest headquarters), and two hotels.	June-13
PoMo	Singapore	Office/ Retail	Enviro-Hub Holdings Ltd and BS Capital Group	265.8	Joint venture acquisition of office and retail asset located on Selegie Road.	June-13
Jinhan Building	Guangzhou	Mixed Use	Yuexiu Real Estate	135.3	Older generation mixed use property, sold to Yuexiu Group for redevelopment.	June-13
Greensborough Plaza	Melbourne	Retail	Blackstone	344.6	Shopping mall in Melbourne's north-east, with Harvey Norman, Coles, Aldi and Hoyts as key tenants.	June-13

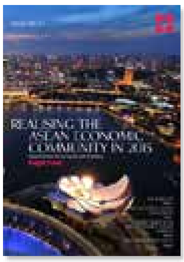
Source : Knight Frank Research

PUBLICATIONS

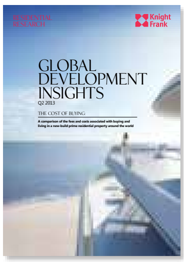


The Wealth Report 2013 - English

The Wealth Report 2013 - Chinese

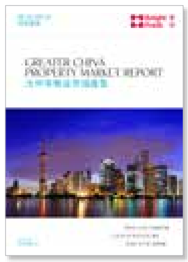


Realising the ASEAN Community in 2015



Global Development Insights Q2 2013


Asia Pacific Prime Office Index Q2 2013



Greater China Property Market Report Q2 2013

ASIA PACIFIC RESEARCH

Nicholas Holt
Asia Pacific, Head of Research
T +65 6429 3595
nicholas.holt@asia.knightfrank.com

GLOBAL CAPITAL MARKETS

Peter MacColl
Head of Global Capital Markets
T +44 20 7861 1211
peter.maccoll@knightfrank.com

ASIA PACIFIC CAPITAL MARKETS

Australia
James Parry
T +61 2 9036 6758
james.parry@au.knightfrank.com

China
Nick Cao
T +86 21 6032 1708
nick.cao@cn.knightfrank.com

Hong Kong
Henry Lam
T +852 2846 9568
henry.lam@hk.knightfrank.com

India
Shishir Baijal
T +91 22 6745 0101
shishir.baijal@in.knightfrank.com

Indonesia
Fakky Ismail Hidayat
T +62 21 570 7170 ext.400
fakky.hidayat@id.knightfrank.com

Japan
Daisuke Naoi
T +65 6429 3597
daisuke.naoi@asia.knightfrank.com

Korea
Yoona Choi
T +82 2 538 5360
yoona.choi@kr.knightfrank.com

Malaysia
Sarky Subramaniam
T +603 228 99 688
sarky.s@my.knightfrank.com

New Zealand
Layne Harwood
T +64 3 377 1460
layne.harwood@nz.knightfrank.com

Singapore
Ian Loh
T +65 6228 6823
ian.loh@sg.knightfrank.com

Thailand
Phanom Kanjanathiemthao
T +66 2 643 8223
phanom.kanjanathiemthao@th.knightfrank.com

KnightFrank.com