Knight Frank

OPPORTUNITIES IN THE INTEREST RATE CYCLE ENDGAME

Asia Pacific Cap Rate Summary Table (as of 1Q 2019)

Country	Sector	Cap Rate	12 Month Outlook	Current Yield Spread	10Y Average Spread
China Tier 1	Office	4.4%	Unfavourable	1.3%	2.3%
	Retail	4.7%	Unfavourable	1.6%	2.4%
	Industrial	5.5%	Stable	2.4%	2.5%
Seoul	Office	4.8%	Stable	2.9%	2.1%
Hong Kong	Office	2.3%	Stable	0.8%	1.1%
	Retail	2.6%	Stable	1.1%	1.0%
	Industrial	2.6%	Stable	1.1%	1.2%
Tokyo	Office	3.9%	Favourable	3.2%	2.9%
	Retail	4.1%	Stable	3.4%	2.9%
	Industrial	4.6%	Stable	3.4%	3.6%
Philippines	Office	5.9%	Favourable	0.3%	2.3%
	Retail	7.1%	Stable	1.5%	2.1%
Thailand	Office	7.0%	Stable	4.5%	3.7%
Malaysia	Office	6.5%	Unfavourable	2.7%	2.4%
	Retail	6.5%	Stable	2.7%	2.3%
	Industrial	6.8%	Favourable	3.0%	3.4%
Singapore	Office	4.1%	Stable	2.0%	1.5%
	Retail	4.7%	Stable	2.6%	3.0%
	Industrial	6.2%	Unfavourable	4.1%	4.3%
Indonesia	Office	6.5%	Unfavourable	-1.2%	0.2%
	Retail	8.0%	Stable	0.3%	1.9%
Sydney	Office	4.6%	Stable	2.8%	2.4%
	Industrial	5.8%	Favourable	4.0%	4.0%
Melbourne	Office	4.7%	Stable	2.9%	2.7%
	Industrial	6.2%	Favourable	4.4%	4.1%
Perth	Office	6.8%	Favourable	5.0%	4.1%
	Industrial	7.0%	Favourable	5.2%	4.3%
India	Office	8.8%	Favourable	1.5%	2.2%

Source: Knight Frank Research, Investing.com

TENSIONS PUTS BRAKE ON INTEREST RATE RISE

With ongoing trade tensions and heightened economic uncertainties, many Asia-Pacific central banks have opted for a more dovish stance on their monetary policies. As their own economies start decelerating, many have released diminished outlooks for the year. In the past six months alone, five Asia-Pacific central banks have cut their benchmark interest rates following weaker than expected economic readings.

Malaysia: Bank Negara Malaysia cut its overnight policy rate by 25bps to 3%, the first cut seen since July 2016, as the central bank forecasts the country's economy to expand 4.3% to 4.8% this year; lower compared to the government's previous 4.9% projection.

India: The Reserve Bank of India (RBI) has cut its benchmark interest rate by 75bps in 2019. With the latest cut of 25 bps in June 2019, the RBI reduced the benchmark rates to 5.75%, citing the slowdown with its economy and inflation being in the lower end RBI's target range. India's GDP growth fell sharply to 6.6% in Q4 2018, surprising the market following the 7.1% and 8.2% GDP growth recorded in the previous two quarters.

Philippines: The Philippine central bank cut its benchmark interest rate by 25bps to 4.5%, a sharp reversal of policy following the aggressive 175bps hike witnessed over the past twelve months; the hike is the first seen in over three years. The move came as inflation remained within the central bank's 2% to 4% range and the country's economic growth fell to a four-year low of 5.6% in Q1 2091. Aside from cutting interest rates further, the central bank is also considering easing the country's current 18% reserve rate ratio.

New Zealand: The Reserve Bank of New Zealand cut its benchmark interest rate by 25bps to 1.5% in early May, bringing rates to its lowest historical level. The move comes after a weak economic report card which showed Q1 2019 inflation falling to 1.5%, below the market's 1.7% expectation and reading of 1.9% in Q4 2018. The labor market has also been weak with Q4 2018 unemployment rising to 4.3%, lower than the market's 4.1% expectation and Q3 2018's 4%.

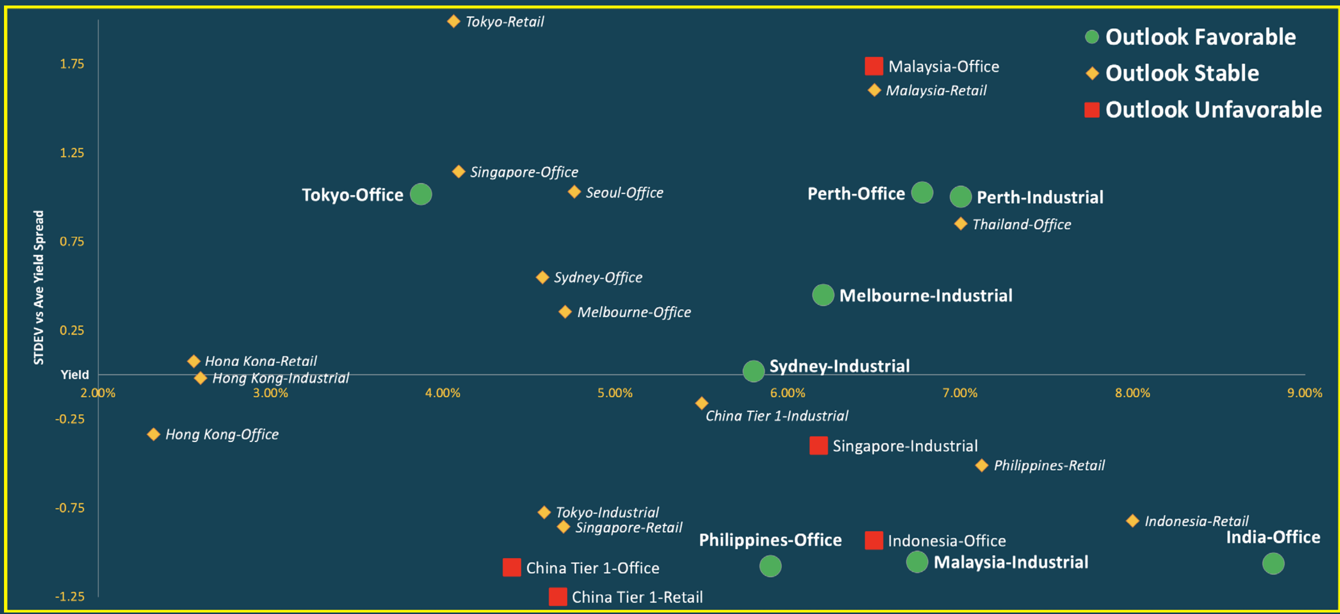
Australia: The Reserve Bank of Australia cut its benchmark interest rate by 25bps to 1.25% in early June in an effort to stimulate a slowing economy impacted by declining home prices and a slump in trade form China, its largest trading partner.

WHERE CAN INVESTORS NEXT UNCOVER OPPORTUNITIES?

While global interest rates are not expected to rise any further in the foreseeable future, investors should still consider hedging themselves from the risk of further hikes, given the late cycle environment, which will have an impact on their investment borrowing costs. One option for doing this is to seek out opportunities where current yield spreads* are trading at their widest compared to their historical averages. The chart (next page) plots the current Asia-Pacific property sector yields against the standard deviation of their yield spreads over the past 10 years along with their respective market outlooks.

**Defined as yield minus domestic 10Y bond yield; cost of borrowing proxy.*

ASIA-PACIFIC RELATIVE YIELD SPREADS



Source: Knight Frank Research, Investing.com

Perth – Office, Industrial: Across Australia's three major cities, Perth's commercial sector represents an opportunity for investors with office (5.0%) and industrial (5.2%) sector spreads currently trading at one standard deviation above their historical means. Followinng the bottoming of the commodity sector cycle, some shoots of recovery are emerging and will likely lead to improved organic growth prospects for both markets.

Singapore - Office: Singapore's office sector, which historically accounts for half of all commercial volumes, provides an attractive opportunity with its 2.0% current yield spread; slightly more than one standard deviation away from its 1.5% historical average. Coupled with positive rental growth expectations this year, investors have started to take more interest in the sector recording several large deals year-to-date including Manulife Centre (US$411 million), 77 Robinson Road (US$520 million) and Chevron House (US$760 million).

Kuala Lumpur - Retail: With its 6.5% yield, Kuala Lumpur's retail sector is trading at a 2.7% spread compared to its 2.3% historical average; roughly one and a half standard deviation from its historical mean. While consumers remain optimistic and with a stable medium-term outlook, the sector will face some near-term headwinds as supply is expected to outstrip demand in 1H 2019; this will likely impact less established and new shopping centers without high pre-committed rates.

Seoul - Office: Seoul's office sector currently trades at a 4.8% cap rate which is not only one standard deviation above its historical mean but also higher compared to the other major office markets within the region, for example Australia (4.7%), Singapore (4.1%), and China's Tier 1 cities (4.6%). The sector has seen strong interest year-to-date with the transaction volume for large (greater than US$100mn) CBD offices of US$4.1 billion, a 36% year-on-year growth.

Tokyo - Retail, Office: Tokyo's 23 ward commercial sectors are looking attractive with retail trading at a 4.1% cap which is two standard deviations above its historical mean and office at 3.9% at one standard deviation. Both sector fundamentals are attractive with retail driven by a growing tourism industry and office with its firm demand, low vacancy and lack of available upcoming supply.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

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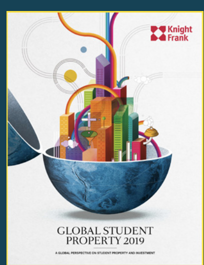
Singapore Investment Market – 2019

Australian Capital Markets Insight – June 2018



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