RESEARCH

CHINESE OUTWARD REAL ESTATE INVESTMENT GLOBALLY AND INTO AUSTRALIA

AUSTRALIAN MARKET INSIGHT APRIL 2015

HIGHLIGHTS

Softening of Chinese market conditions and government policy encouraging overseas investment by Chinese firms, has led to increasing investment levels in gateway markets globally, particularly in Australia.

The total value of Chinese outward real estate investment skyrocketed from US$0.6 billion in 2009 to US$16.9 billion in 2014. Already over US$5.5 billion has transacted in the first quarter of 2015.

The next wave of Chinese investors are diversifying more and broadening to areas such as Brisbane, Adelaide, Gold Coast, Perth and metropolitan suburbs of NSW and Victoria, which will all start to gain more traction.

“Chinese UHNWIs are getting comfortable with new worldwide markets. Outward real estate investment into the global market by the Chinese hit US$16.9 billion in 2014, 10% higher than 2013 and a substantial 205% increase from 2012.”

MATT WHITBY
Head of Research and Consulting

AFTER THE INITIAL WAVES

There has been a tremendous surge in Chinese outward investment in overseas real estate in recent years. What first started as sovereign funds making exploratory investments has proliferated into buying sprees by Chinese developers, banks, UHNWIs and institutional investors, such as insurance companies.

OPPORTUNITY

This surge has been fueled by a combination of push and pull factors, with a number of key domestic economic and policy variables contributing to this surge. One of the most powerful drivers has been the continued consolidation of China’s residential real estate market. Fierce domestic competition, combined with government curbs on home purchases and rising borrowing costs over the past two years, has led to developers’ actively looking elsewhere for new opportunities. Government incentives, such as the relaxation of real estate investment regulations for insurance companies, have also resulted in billions of dollars in extra funding for overseas investment.

Meanwhile, the attractiveness of mature gateway markets in the UK, US and Australia, is “pulling” capital out of China, providing quality products and higher yield returns with diversification benefits and assisting institutions and developers build their brand internationally.

MAP 1
Chinese UHNWI overseas investment destinations
Traditional vs. New or Emerging destinations

Source: Knight Frank

THE PUSH & PULL: CHINA'S DOMESTIC POLICY & ATTRACTIVENESS OF MATURE MARKETS DRIVES OUTWARD EXPANSION

THE PUSH: POLICY INDUCED UNCERTAINTY AND WEAKENING RESI MARKET

One of the push factors for outward investment comes from the slowing economic growth and consolidation of China's residential market. As China's residential market is policy driven, Government measures have been effective in mitigating external shocks on the one hand, but have caused market fluctuation and uncertainty on the other.

As a result of rampant construction, vacant residential floor space increased by over 80% since 2010. It is estimated that existing inventory nationwide will take at least two years to absorb. This oversupply has sparked cut-throat competition amongst developers, fuelling buyers' expectations of further price falls.

China property prices began falling during the second half of 2014 and the majority have continued to fall into 2015. In March 2015, all of the 70 major Chinese cities recorded annual house price falls, compared to March 2014 when only one city recorded an annual decline (see Figure 1). On a month-on-month basis, the downtrend has improved slightly, with 50 of the 70 cities recording a decline, compared to the worst point in October 2014, when 69 of the 70 cities recorded monthly house price declines, which was the highest percentage since 2010.

Recent cuts to lending rates and the Reserve Requirement Ratio (RRR), in addition to the Ministry of Housing and Urban-Rural Development relaxing mortgage down payments, are aimed at providing support to the economy and may help boost confidence in the equities and property markets. On the 19th April, the People's Bank of China (China's central bank) announced that it would lower the average RRR by 100bps (to 18%) for the whole banking sector, which is the biggest cut since December 2008.

Despite this, we expect property prices to remain under further pressure in 2015, as prices are unlikely to rebound while developers continue to clear inventory and pull back on new projects. While this remains the case, we believe this will impact on developers' future investment strategies, continuing to make offshore expansion a viable option over at least the short to medium term.

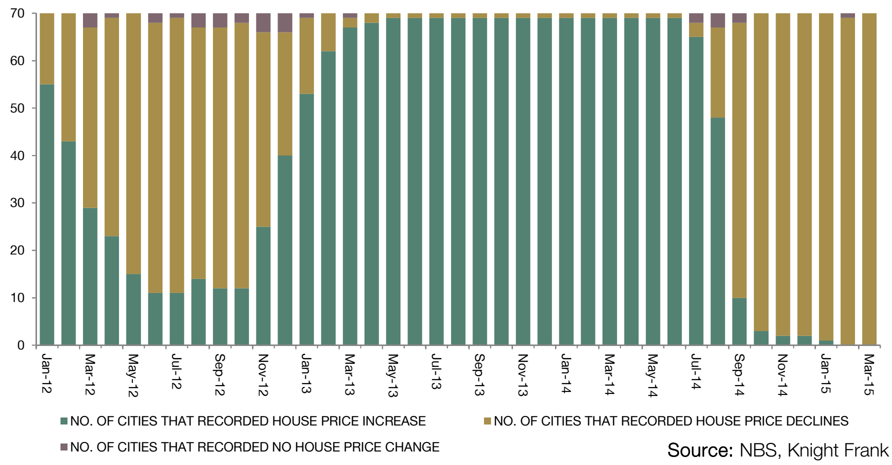
Investment policy

Another major push comes from some significant easing of overseas investment policies. For example, in late 2013 the outward investment approval threshold was raised from US$100 million to US$1 billion and in October 2014, the Ministry of Commerce removed prior approval for most foreign investment.

The total assets of China's insurance industry doubled over the past five years to RMB 9.6 trillion (US$1.6 trillion) as at October 2014. By 2020, authorities estimate that the Chinese insurance industry will accumulate a further RMB 20 trillion worth of premiums, tripling the current pool size.

Despite generous investment thresholds - insurance companies are allowed to invest up to 30% of their assets in real estate, with 15% of total investments allowed offshore - we expect Chinese insurance companies to adopt a prudent approach to real estate and cross-border investments. That said, the sheer size of this insurance pool means that even a small allocation offshore will result in significant deal flows. Insurance companies such as Sunshine, will be active in Australia over 2015 and 2016.

FIGURE 1
70 out of 70 cities recorded house price falls
Annual Growth—Major Chinese cities, newly constructed homes



Source: NBS, Knight Frank

THE PULL: THE ATTRACTIVENESS OF MATURE MARKETS SUCH AS AUSTRALIA

There are a number of pull factors at play fuelling investment in overseas markets:

- As these investors and developers already have extensive domestic exposure, offshore investments help them diversify risk into markets that offer better returns and lower funding costs. Funding costs in Shanghai and Beijing are very high, notwithstanding recent cuts, often at above 8%. In contrast, funding costs can be as low as 4% in Australia and an easing cycle is underway.
- Deep, liquid and transparent markets with scale – clarity of rules/regulations.
- The quality of life, weather, clean-air and world class education institutions all act as a magnet to Chinese developers and migrants alike.
- Overseas acquisitions help Chinese institutions and owner occupiers build their brand internationally.
- Owner occupiers (e.g. big banks) use investments to help manage their future occupation costs. Banks such as CCB, Bank of China, Agricultural Bank of China and ICBC have been active in the commercial market globally over the past year.

TABLE 1

Select recent Chinese buying activities in Australia 2014/15

Date	Purchaser	Property Name	Location	Property Type	Consideration (AUD$ million)
Jan 14	Fu Wah International	Park Hyatt	East Melbourne	Hotel	135.0
Jan 14	Bridgehill Group	52 Alfred St	Milsons Point, Sydney	Office/Dev Site	80.0
Mar 14	Greenland	Leichardt Green site	Leichhardt, Sydney	Dev site	47.1
Mar 14	Greenland	225-235 Pacific Hwy	North Sydney	Dev site	56.0
May 14	Aqualand	Melrose Park site	Melrose Park, Sydney	Dev site	135.0
May 14	Chinese Private	Campsie Centre	Campsie, Sydney	Retail	67.0
Jun 14	Chinese Private	299 Elizabeth St	Sydney CBD	Office	45.0
Aug 14	Dalian Wanda^	Jewel development project	Gold Coast	Hotel/Resi	c 300.0
Aug 14	Aqualand	CSIRO Site	North Ryde, Sydney	Office/Dev Site	170.0
Aug 14	Yuhu Group	221 Miller St	North Sydney	Office/Dev Site	56.0
Sep 14	Glorious Sun	231-235 Swanston St	Melbourne CBD	Office/Retail	25.3
Oct 14	3L Alliance	350 Queen St	Melbourne CBD	Office	130.0
Oct 14	Xiang Xing Developments	58-68 Dorcas St	Southbank, Melbourne	Office	35.0
Oct 14	Private Chinese Family	617-621 Pacific Hwy	St Leonards, Sydney	Dev site	c 40.0
Nov 14	Kingold Group	75 Elizabeth St	Sydney CBD	Office	67.0
Nov 14	Shimao Group	175 Liverpool St	Sydney CBD	Office	392.7
Nov 14	Chinese Private	695-699 George St	Sydney CBD	Office	41.0
Nov 14	Sunshine Insurance	Sheraton on the Park	Sydney CBD	Hotel	463.0
Nov 14	GH Properties	Ashmore/Mitchell Roads	Alexandria, Sydney	Dev Site	c 380.0
Nov 14	Guangzhou R&F Property Co.	1 Cordelia St	South Brisbane	Dev Site	46.0
Nov 14	Visionary Investment Group	233 Castlereagh St	Sydney CBD	Office	156.0
Dec 14	Visionary Investment Group	338 Pitt St	Sydney CBD	Office	102.0
Dec 14	China Poly Group	Cambridge Office Park	Epping, Sydney	Office/Dev Site	110.0
Dec 14	Wanda One (Dalian Wanda)	1 Alfred St	Sydney CBD	Office/Dev Site	425.0
Jan 15	Wanda One (Dalian Wanda)	Fairfax House	Sydney CBD	Office	73.0
Jan 15	Aqualand	168 Walker St	North Sydney	Office	157.5
Jan 15	Fosun International *	73 Miller St	North Sydney	Office	116.5
Jan 15	Lee Shing Hong Ltd	300 Adelaide St	Brisbane CBD	Office	47.5
Jan 15	Chiwayland	14-20 Parkes St	Parramatta, Sydney	Dev Site	27.0
Feb 15	Ryan Ouyang	Greenwood Business Park	Burwood, Melbourne	Office	69.5
Feb-15	Aoyuan Property>	130 Elizabeth St	Sydney CBD	Office/Dev Site	121.0
Feb-15	Jiyuan Li	Prince of Wales Hotel	St Kilda, Melbourne	Hotel/Dev Site	45.0
Mar-15	Huayu Group	Sofitel Broadbeach Hotel	Gold Coast	Hotel	62.0
Mar-15	Hengyi (Shandong HY Group)	170 Victoria Street	Melbourne CBD	Dev Site	64.8
Apr-15	Chinese Private	Compass Centre	Bankstown, Sydney	Office/Retail/Dev Site	45.0
Apr-15	Chinese Private	143 York Street	Sydney CBD	Office/Retail/Dev Site	21.3

* JV with local group Propertylink, ^ JV with existing owner of site Ridong Group, > JV with Ecove. NB. Many of the above have been purchased for potential residential development
NB. Figures rounded to one decimal place

Source: Knight Frank

CHINA'S OUTWARD INVESTMENT INTO REAL ESTATE

Targeting gateway cities in mature markets, such as Australia

As a result of the push and pull factors aforementioned, the total value of Chinese outward real estate investment (excluding residential and multi-family dwellings) skyrocketed from US$0.6 billion in 2009 to US$16.9 billion in 2014. Over US$5.5 billion has transacted in the first quarter of 2015, hence if this activity was to continue, 2015 is likely to be another record year for Chinese outward investment, both globally and into Australia, with the potential for more than US$20 billion transacting. So far the majority of the Chinese outward investment has been focused in gateway cities of Australia, the US and the UK.

"In 2014; Australia has seen the strongest growth in inbound real estate investment from China, with particular focus in Sydney and Melbourne (see Figure 2 on page 6).

Chinese high net worth investors and developers are looking to new destinations offering discounts on prime property such as Miami in the US and in Australia; Brisbane, Gold Coast, Adelaide, Perth and regional suburbs of NSW and Victoria will start to gain more traction.

MAP 2

Select Chinese Deals, Sydney CBD and North Sydney

Select Transactions since January 2014

Source: Knight Frank, Google Maps

Chinese real estate investment activity into Australia

The gateway cities of Australia, namely Sydney and Melbourne, have been the most active markets for Chinese investors. With their relative geographical proximity, relatively higher yields, market stability and liquidity, total Chinese real estate investment volume in these two cities outstripped both London and New York in 2014.

Australia has recorded exponential growth in investment over the past few years, culminating in just over $4 billion invested into the country by Chinese investors, across both commercial and development sites. This has exceeded the total Chinese inbound real estate investment which occurred over the prior five years combined (2009-2013).

Comparing these gateway cities in terms of cross border capital flows, it is clear that the Australian cities are attracting significant investment, relative to the size of their economies (see Figure 3). The economies of London and New York are much larger than the combined economy of Sydney and Melbourne, however they lag behind in attractiveness as a place to invest for the Chinese.

A further explanation for the intense attractiveness of Australia's gateway cities is that China and Australia signed a Declaration of Intent for a Free Trade Agreement (FTA) on 17 November 2014. This raised the threshold for private, non-state-owned investment from China in non-sensitive sectors (such as property) to go to the Foreign Investment Review Board from AU$248 million to AU$1.08 billion. The FTA, which is likely to be completed towards the end of 2015, is expected to accelerate the flow of Chinese investment funds into the Australian property market.

Somewhat dichotomously the Federal Government has proposed changes to the foreign investment framework in Australia, announced as part of an "options paper" released on 27 February 2015, which went out for community consultation (no formal announcement as yet). This may impact Chinese investment flows, albeit even if implemented in their entirety, it is unlikely to deter the large scale development and investment into commercial and residential development markets.

Developers targeting the wider local market

For many wealthy Chinese, the risk of buying property in unfamiliar overseas markets such as Australia can be offset by buying projects offered by Chinese developers. This provides a sense of both familiarity and pride. However, our recent conversations with several pioneering Chinese developers revealed that they are increasingly realising the need not just to cater for Chinese buyers, but to tailor project design elements and marketing strategies to the broader local markets.

They are no longer distinguishing buyers by nationality or relying primarily on demand from Chinese buyers. Robust local sales conditions have become one of their most commonly stated criteria for project screening. They aim to expand and leverage their brand identity overseas and to take advantage of this demand. Chinese developers, however, have the added advantage of being able to attract a significant pool of Chinese buyers, who often purchase off-plan, which helps to de-risk their development projects.

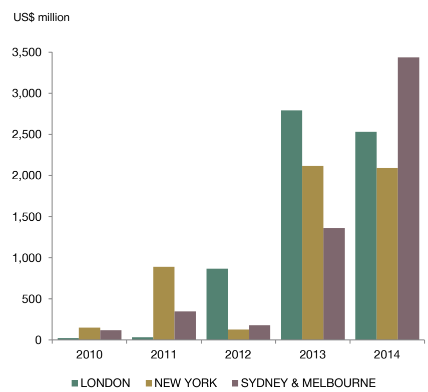
A few major Chinese developers have already begun aggressively expanding into Australia. For example, Greenland has invested heavily into Australian development projects, tapping predominately into cities such as Sydney and Melbourne. Dalian Wanda Group, one of the largest Chinese mixed-use developers, is developing major hotel and residential projects in Sydney and the Gold Coast.

Currency play and its impact on buying power

Since the end of 2007 and the onset of the GFC, the Renminbi (RMB) has appreciated considerably against a basket of major currencies, including 37% against the British Pound, 38% against the Euro, 15% against the US dollar and 26% against the Australian Dollar (AUD). This has largely strengthened the purchasing power of Chinese investors, as overseas investment has become relatively cheaper. Many Chinese investors see this as a good opportunity to acquire foreign assets.

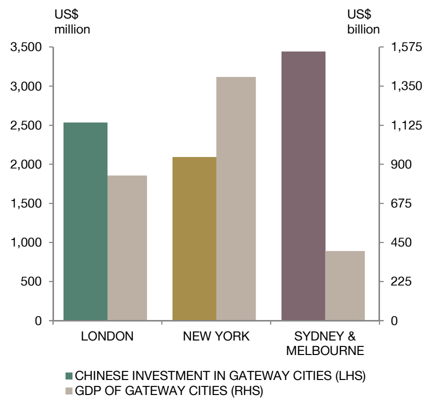
In the face of a cooling Chinese economy, RMB appreciation is expected to slow down in the coming years. Currency fluctuation is a double-edged sword for Chinese investors.

FIGURE 2
Chinese outward real estate investment in the gateway cities
Past 5 years



Source: Knight Frank, RCA
NB. Excluding residential and multi-family dwellings

FIGURE 3
Chinese outward real estate investment vs GDP
2014



Source: Knight Frank, RCA, Brookings Institute
NB. Excluding residential and multi-family dwellings

Since Greenland's acquisition of their Melbourne Flemington Racecourse site in October 2013, the AUD has depreciated roughly 18% against the Renminbi. On the flip side, this devaluation now favours any Chinese investors who buy into this and any other residential schemes.

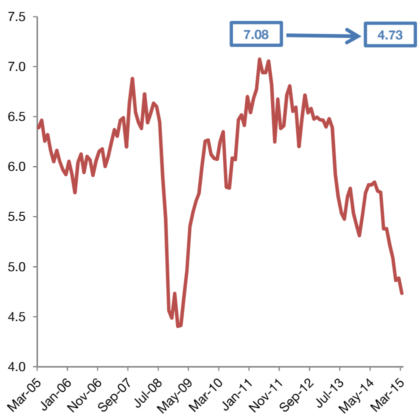
The stronger buying power of the Chinese and the weaker AUD will undoubtedly continue to support capital inflow. With an expectation of further interest rate cuts in Australia over the coming months, coupled with a seemingly more entrenched US recovery leading to interest rates rising there in H2 2015, the AUD will remain under downward pressure.

Occupier Markets

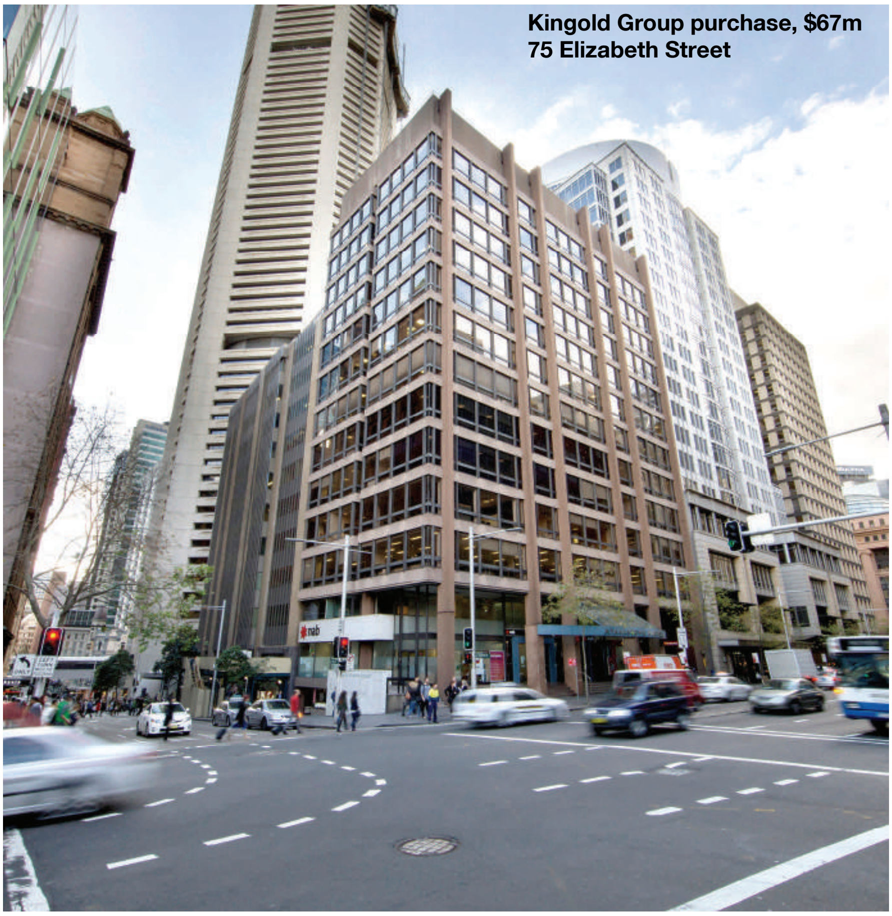
Alongside increasing capital flows and investment from China the commercial occupier market is also benefitting as Chinese developers, banks and fund managers go more global and develop and grow their global platforms. Enquiry and deal flow, across key Australian cities namely Sydney, Melbourne and Brisbane, has picked up over the past year for office space, albeit predominately smaller deals sub 1,000m².

Examples of deals in this market segment include Bank of Communications leasing 560m² of office space in Riparian Plaza, Brisbane,

FIGURE 4
AUD/RMB exchange rate
Last 10 years



Source: RBA, Knight Frank



**Kingold Group purchase, $67m
75 Elizabeth Street**

AXF Group leasing 550m² of office space on levels 16 and 17 of 1 Collins Street, Melbourne, and circa 1,000m² of office space leased at Gateway in Sydney to Kingold, Ruizean and Hailiang combined.

We expect even greater activity throughout 2015 and 2016, with banks, energy/mining, fund managers and developers taking space in predominantly Premium or A+ buildings with views, which should support greater demand in that segment of the market.

In addition to office leasing deals, we expect a trend, which has been witnessed in other gateway cities, to emerge in key Australian cities. Across London and Hong Kong there have been numerous Chinese banks acquiring buildings for owner occupation. CCB, Bank of China, Agricultural Bank of China and Industrial & Commercial Bank of China have all been active in the commercial acquisition market globally over the past year.

Going forward we expect a couple of owner occupiers or at least part owner occupier deals to transact over 2015 and 2016, as we have just started having some enquiry on sales listings in Sydney and Melbourne from Chinese banks.

> "Since April 2011 the Australian Dollar has depreciated by around 33% against the Chinese Renminbi, making opportunities and investment into Australia from China appear cheaper (see Figure 4)"

AFTER THE INITIAL WAVES: WHAT'S NEXT?

The emergence of a new fourth-wave of investors

The first wave of Chinese capital outflow saw sovereign wealth funds and private funds investing in core, trophy assets with examples including CIC and Bright Ruby Group acquiring core office assets in the Sydney CBD. Large developers followed, looking to diversify with an overseas presence. Currently, the third wave of equity investors and insurance firms are seeking core, value-add and yield-driven opportunities.

A new group of entities is quickly emerging as a fourth wave of capital outflow. This group constitutes not only big-name companies, but also UHNWIs, small- to mid-cap SOEs, and smaller, private developers. UHNWIs are exploring Australian investment opportunities mainly for secured income, capital appreciation, risk diversification, personal interest and to link with the strong education sector. Their investment strategies are far ranging, and they are open to different asset classes, with interests ranging from smaller shopping centres, such as the Campsie Centre, to offices such as 299 Elizabeth Street in the Sydney CBD, residential units and lifestyle properties.

The introduction of the Significant Investor Visa (SIV) scheme in late 2012 intended to target the migration of high net-worth individuals to Australia and required an investment of at least AU$5 million into complying investments in Australia for a minimum of four years before becoming eligible for a permanent visa. This has predominately been taken up by Chinese investors. This process was refined during 2014/15, with a Premium Investor Visa (PIV), offering a more expeditious, 12 month pathway to permanent residency for those meeting an AU$15 million threshold and will be formally introduced on 1 July 2015. This will be another driver of increased capital flow into Australia more broadly from UHNWIs over the course of 2015/16.

Amongst the big-cap players, as Table 2 highlights, only four of the top 10 Chinese insurance companies have made offshore investments so far, although the remaining six are considering overseas expansion. Sunshine Insurance Group is the only one to invest in Australia, purchasing the Sheraton on the Park Hotel in Sydney for a record AU$463 million in November 2014, which was followed up by acquiring the Baccarat Hotel in Manhattan, New York for circa US$230 million.

Chinese developers, however, have been more aggressive, with eight of the top 10 players having already made offshore investments, seven of which have been active in Australia, and other developers are contemplating such a

TABLE 2

Major Chinese insurance companies and developers and their outward investment status

Rank	Insurance company	Premium income (US$ bn)	Already made investment into Australia	Already made investment offshore	Expressed interest to invest offshore
1	China Life	52.9		◆	
2	PICC	44.4			◆
3	Ping An	40.4		◆	
4	CPIC	26.3			◆
5	NCI	16.9			◆
6	China Taiping	13.9			◆
7	Taikang Life	10.1		◆	
8	Sunshine Insurance	5.7	◆	◆	
9	China Post Life	3.8			◆
10	Sino Life	3.5			◆

Rank	Developer	Total Assets (US$ bn)	Already made investment into Australia	Already made investment offshore	Expressed interest to invest offshore
1	Poly Real Estate	82.3	◆	◆	
2	Vanke Group	81.8	◆	◆	
3	Wanda Group	74.9	◆	◆	
4	Evergrande Group	68.7		◆	
5	Greenland Group	57.5	◆	◆	
6	CR Land	48.7			
7	China Overseas	42.6		◆	
8	Country Garden	39.5	◆	◆	
9	Shimao Property	32.4	◆	◆	
10	R&F Properties	27.1	◆	◆	

Source: Knight Frank
Note: Information for insurance companies as at end-2013 and developers 2014 YTD.

move. Greenland Group, one of Shanghai's largest state-owned enterprises, has purchased numerous development sites in Sydney's CBD and other metropolitan markets in Sydney and Melbourne. Other developers currently actively developing product include Country Garden, Starryland, Chiwayland, Bridgehill, Aqualand, Golden Age, JQZ, R&F Properties, Golden Horse and Dalian Wanda (Wanda One). We expect to see more debuts from these companies and other smaller private developers in the coming years.

Increasingly, we will also see small- to mid-cap SOEs and private developers actively seeking different options in small- to medium-scale development opportunities in core and non-core markets in Australia. Given their relative lack of international exposure, their efforts to evaluate their overseas strategy and growth targets will follow a steep learning curve. One of their challenges in gaining market entry is that they typically take a longer period to learn about the market and carry out due diligence, given their corporate structure and scale. Partnering with trusted property and tax/financial advisors, providing local expertise and long-term professional support is critical in the process.

Where to invest next?

After heavy investment in prime office buildings and subsequent yield compression in gateway cities, Chinese investors have begun to look increasingly at opportunities in other key cities and other property sectors, and importantly in suburban locations in metropolitan Sydney, Brisbane and Melbourne, not just within the CBD and fringe markets. Whereas investors traditionally targeted the core office and residential development sector, they are now also targeting a more diversified group of real estate assets, from hotels & leisure to industrial to student accommodation and mixed-use opportunities.

Brisbane and the Gold Coast have begun to capture more residential development interest from Chinese investors and developers. There has been increasing activity in non-core areas of Brisbane, such as Newstead, South Brisbane and Fortitude Valley, and this is expected to broaden to more metropolitan sites and to the Gold Coast, where Wanda has co-invested in an AU$1 billion beachfront site. These markets are underpriced relative to Sydney and Melbourne, and we expect Chinese developers to continue to seek entry to these markets.

Adelaide, Perth and more satellite or regional suburbs of NSW and Victoria will start to gain traction/interest from Chinese developers and we should see some stronger price growth occur also.

In the commercial sector, retail and hotels will start to garner more interest following relatively subdued activity over the past few years relative to office and residential development sites.

PUTTING CHINESE INVESTMENT INTO A GLOBAL CONTEXT

Wealth Trends

Immigration, a classic driver for international property investment, coupled with growing wealth creation, has led to an increasing number of buyers from an ever-widening list of countries buying property in a growing number of global hubs. Demand for entry into Australia has been boosted by strong inflows from across the Asia-Pacific region (China, Indonesia and India), underlining Australia's connection into the Asian region.

Over the last decade, it's estimated that a total 76,200 Chinese millionaires emigrated or acquired alternative citizenship. Wealthy Chinese are a significant force in Europe and dominate Asia-Pacific schemes. Since it was introduced in 2012, around 90% of applicants from Australia's Significant Investment Visa (SIV) scheme have been from China. On average, less than half of UHNWI respondents to Knight Frank's 2015 Global Attitudes Survey around the world said their clients were concerned about the impact of the Chinese economy slowing. However, not surprisingly, this rises to over 70% across Asia and 67% in neighbouring Australia.

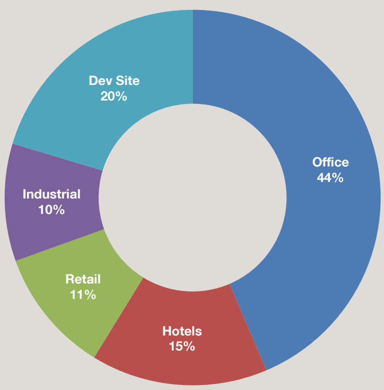
Within the Asia-Pacific region, Australians, along with Japanese, are least likely to emigrate, with only 5% of UHNWIs wanting to change their country of domicile; with China (23%), Hong Kong (17%) and Malaysia (10%) all recording double-digits. The top reasons for wanting to relocate are for a better quality of life and education – two major reasons why many consider Australia such a desirable location. The population of UHNWIs living in Australia is projected to grow by 23% over the next ten years.

In addition to those relocating to Australia, the number of Chinese tourists arriving in Australia has reached record levels, more than doubling in the four years to September 2014, growing from 347,600 to 801,500 (annually). Short term Chinese tourists are now second only to New Zealand, however, their average spend of AUD$7,460 is around 50% more than they spend in the UK. Increasing tourists numbers and rising average spend is due in part to the rise of the middle class and their associated wealth. By 2030 Asia will represent 66% of the global middle class, equivalent to growth of 3.1 billion people from 2009.

FIGURE 5

Capital into Australian property from Asia region - sector allocation

Past two CY (2013 & 2014)



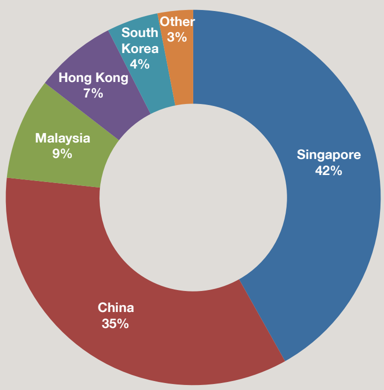
Source: Knight Frank, RCA

NB. Excluding residential and multi-family dwellings

FIGURE 6

Capital into Australian property from Asia region - country allocation

Past two CY (2013 & 2014)



Source: Knight Frank, RCA

NB. Excluding residential and multi-family dwellings

Global & Asian Capital Flows into Australia

Analysis compiled by Knight Frank Research on cross border investment activity over the past two years (2013 and 2014 calendar years) shows that offshore purchasers have invested over $29 billion into the Australian property market, with $16.1 billion invested in the office sector alone, making up 55% of the total activity, followed by the retail sector (11.5%) and hotels (10.9%).

While investment from offshore buyers has reached record levels, foreign capital inflows will continue as a result of regulatory restrictions abroad and as a wealth preservation measure for many global HNWI and developers, who are actively seeking safe haven investment markets such as Australia. Analysing the destination of global capital into Australia across all property assets classes, investors were still largely focused on Sydney and Melbourne, accounting for 48% and 26% respectively of all offshore purchases.

A large proportion of property acquisitions has stemmed from Asian based investors, accounting for 55% of all global purchases into Australia over the past two years. Asian capital inflows have been just over $16 billion, with office and hotels highly sought after, but "development site" activity has picked up strongly over the past 12-18 months, now making up 20% of Asian capital flows into Australia. The major sources of this Asian capital by country are Singapore (42%), China (35%), Malaysia (9%), Hong Kong (7%) and South Korea (4%) - see Figures 5 & 6.

RISKS?

Chinese market conditions

There is an expectation that Chinese investors and developers will continue to expand into real estate markets overseas. Australia's major gateway cities have been the greatest beneficiary of this over the past year. As the Chinese market continues to underperform, we expect to see active overseas expansion by these firms. Given the distinctive policy-driven nature of the Chinese market, however, we should equally be aware of the risk of policy reversals over time.

Despite China relaxing government restrictions and easing monetary policy, Chinese house prices have continued to slide, and an early rebound in the sector is unlikely. An accelerated worsening of the Chinese market may be a double-edged sword. While we may see more players in a relatively strong financial position sustain their overseas investments and in fact continue to seek safe-haven markets like Australia, we may also see some cash-strapped developers and investors finding it difficult to continue their expansion efforts, creating problems such as distressed properties in the host cities.

Australian policy intervention

In Australia, housing prices have risen by about 8% nationally in Australia over the past year and closer to 14% in Sydney, driven by rising investor demand. The Reserve Bank of Australia recently stressed the importance of maintaining rigorous standards on loans to property investors and flagged macro-prudential intervention. This is being watched closely, as will a formal policy on the foreign investment framework, where the "options paper" is currently out for community feedback.

KEY FINDINGS AND OUTLOOK FOR 2015

- The softening of Chinese market conditions (with its low yield, lack of investable stock and depressed residential markets) continue to impact Chinese investors and developers.
- With government policy encouraging firms to expand overseas, we continue to see active involvement by the Chinese institutional investors, developers and some of the big banks.
- The first wave of Chinese capital outflow saw sovereign wealth funds investing in trophy assets and banks acquiring property for owner occupation. Large developers followed, looking to diversify with an overseas presence, and Australia has been one of the major destinations for this capital.
- In this current third wave equity investors and insurance firms are seeking core and yield-driven opportunities. Sunshine Insurance Group is the only Insurance company to have invested in Australia, however there is an expectation that activity will increase during 2015 and 2016.
- We are now seeing the formation of a fourth wave of investors, consisting of ultra-high net worth Individuals (UHNWIs), small to mid -cap state-owned enterprises (SOEs), and private developers who are increasingly evaluating their overseas strategy and exploring overseas growth.
- Having invested heavily in gateway cities, such as Sydney and Melbourne, Chinese investors are looking to diversify geographically, moving from gateway locations to higher yielding leading provincial cities, such as the Gold Coast and Miami in the US.
- These investors will also diversify by broadening their sector allocation from core office and residential developments into hotels & leisure, student accommodation, industrial assets and mixed-use developments.
- Due to the policy-driven nature of the Chinese market, there remains a risk that China's outward investment could be impacted by policy adjustments.
- The proposed changes to the foreign investment framework in Australia, announced as part of an "options paper" released on 27 February 2015, may also impact Chinese investment flows, albeit even if implemented in their entirety, it is unlikely to deter the large scale development and investment into commercial and residential development markets.
- We expect 2015 will be another record year for Chinese outward investment, both globally and into Australia, with $20 billion worth of investments likely.

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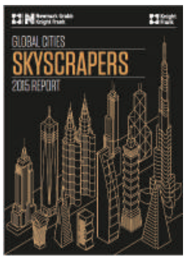

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