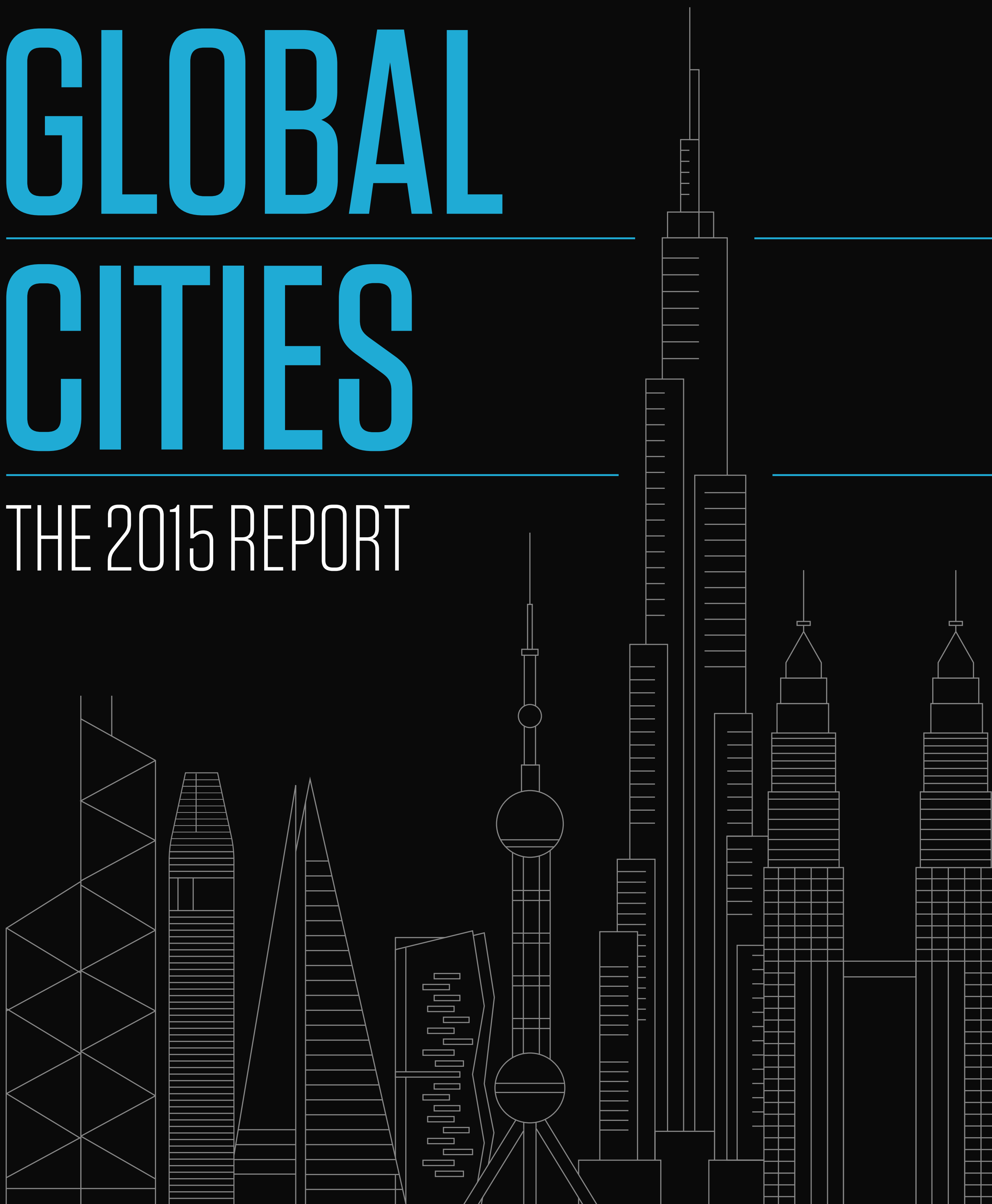
GLOBAL CITIES

THE 2015 REPORT



THE FUTURE OF REAL ESTATE IN
THE WORLD'S LEADING CITIES

1.1 BILLION

THE NUMBER OF NEW CITY DWELLERS GLOBALLY IN THE NEXT 15 YEARS. NEARLY THE EQUIVALENT OF THE POPULATION OF INDIA.

CONTENTS

Hangzhou, China

NAVIGATING THE GLOBAL CITIES

A global recovery creates challenges and opportunities in real estate.

INTRODUCTION BY — JOHN SNOW
Head of Commercial, Knight Frank

Recent years have seen a renaissance for what this report calls the Global Cities. These are the cities major airlines consider it essential to offer flights to, Fortune 500 companies will definitely have an office, and famous hotel groups invariably have a five star property. This makes them target locations for global property investors and occupiers.

This report is intended to help you with planning your future business strategy, by highlighting the future trends in real estate. I consider the following to be the key points:

1. Rapid technology change is reshaping the city economy, and buildings must match these changes to be fit for purpose. The report identifies super prime offices, nano-cores, skyscrapers, and all-in offices as the real estate best placed for future growth. These are described in *The Super Cities* (p.09).

2. Increasingly the workplace is about staff retention, and today the best and brightest want to be in the trendy part of town. Consequently, firms are moving their offices to edge-of-CBD locations, creating new office hubs, and homes and shops are following. This is discussed in *Rise of the New Districts* (p.21).

3. The roller coaster economy of the last five years has flushed huge sums of money into residential markets. A world returning to normality means investors will need to be more selective where they develop homes, and potential future hot-spots are highlighted in *Cities of Opportunity* (p.33).

4. European commercial real estate markets are seeing a multi-speed recovery, presenting different challenges and opportunities. Key for investors is timing when to move up the risk curve – see *Rising from the Ashes* (p.43).

5. North America is leading the global recovery, thanks to the rapid expansion of the technology and energy sectors. Cities not previously considered 'tech' have experienced a surge in start-ups, and the effect is broadening, as discussed in *The Americas* (p.57).

6. Across the globe, the rise of Asia-Pacific is becoming a major influence on real estate markets – outside investors want in, while Asian money is stepping on to the world stage. Within the region, Australia is seen as both a safe haven and an opportunity. This is examined in *Opportunities in the Asian Century* (p.67), and *Australian Outlook* (p.77).

By attracting the most productive workers, the Global Cities draw the great name companies, high flying financial firms, and the start-ups that become tomorrow's star tech firms. This makes property in these cities sought after investments.

Essential to success for both investors and occupiers is good timing, careful selection of location, and delivering the right building to match a fast changing business world. This report will inform your future real estate decisions, and I would be interested to hear your views on its conclusions.

THE SUPER CITIES

Real estate markets in the Global Cities are enjoying a renaissance, and a new economic paradigm of creativity is about to spur demand.

AUTHOR – JAMES ROBERTS
Head of Commercial Research

IN THIS CHAPTER

- **The Global Cities increasingly rely on high value, knowledge workers to drive economic growth.**
- **This has drawn investment into edge-of-CBD districts, expanding the definition of what is 'core'.**
- **We expect fast-paced technology change to create a new wave of hybrid industries, driving demand for CBD real estate.**
- **To meet demand, more skyscrapers will be built, and existing land maximised through nano-cores.**

In the next 15 years the world is forecast to add another 1.1 billion city dwellers, nearly the equivalent of the population of India[1]. Across the planet developing more offices, shops, homes, and distribution centres will be critical to house this urban explosion.

Premium pricing for real estate is found in cities with the most high-value knowledge workers, which attract the world's leading corporations. These are the Global Cities, and shaping their future is:

1. The growing centrality of knowledge workers, which is influencing the location and design of modern offices.
2. The transformation of former-industrial areas into new districts, bringing offices, leisure and homes closer together.
3. Investors seeking higher returns on their money, offering a pool of funds to back future urban development.

Encouraging these trends is essential in order to accommodate the new workers and firms the Global Cities are expected to attract.

It is little surprise that cities are expanding. The workers of the Global Cities are among the most productive in the world, typically outperforming their host countries. Asia's cities have powered ahead, with Singapore's GDP (PPP) per capita overtaking the USA in 2005, while Hong Kong surpassed Switzerland in 2006.

Firms want to capitalise on this success, and governments need the tax revenue. So cities will be encouraged to achieve their potential, resulting in a new wave of development. Micro-cities will be built within cities, ranging from Barangaroo in Sydney to Nine Elms in London.

The Global Cities are set for further expansion, thanks to a digital revolution that is unfolding around us. Rapid technological change is an established reality, and the pace is accelerating.

Ahead is a future where hedge funds use cheap satellites and drones to assess harvests in the field, informing their commodity investments. Smart fridges will monitor eating habits and order new food, while office maintenance robots inform HR if we work too many late nights. With so much machine data being generated, it will require software to draw the attention of humans to the relevant trends.

We expect the resulting surge in economic opportunities arising from ubiquitous technology to create many more jobs, most of them in occupations that presently do not exist, and energise demand for real estate.

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TALENT MAGNETS

Firms today are scrambling to secure the knowledge workers who can place them ahead of these trends. The resounding message from around the world is that such workers want the lifestyle that is afforded by the big cities, which has turned them into talent magnets, and consequently multi-national corporations feel it is essential to locate in the Global Cities. They also benefit from the critical mass and market efficiencies that arise from creating industry clusters, as shown by the tech hub in Silicon Valley, and the Lloyd's insurance cluster in London.

The industry cluster that was leading the charge ten years ago was the financial district, but in recent years we have seen the rise of the 'Creative Halo'. This has typically been a former-industrial district, on the edges of the CBD, drawing in technology and creative industries.

141 US$bn
Global semiconductor sales in 2002

306 US$bn
Global semiconductor sales in 2013

Source: The Semiconductor Industry Association

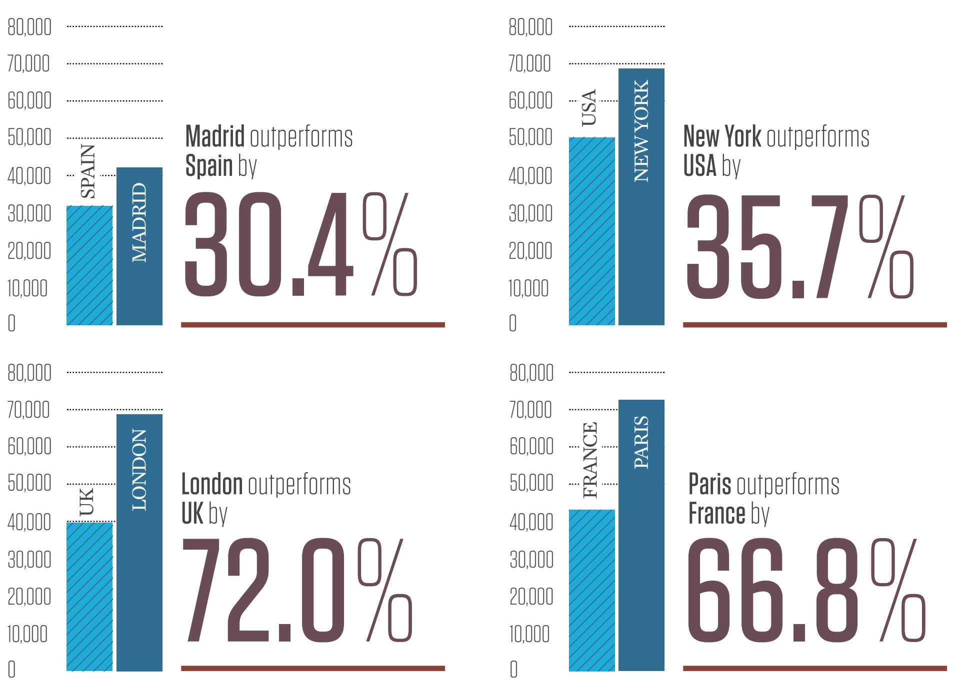
The Creative Halo has transformed edge-of-CBD areas from cheap rent backwaters into the driving force of the post-Lehman city economy. Cafés, shops, bars, and street markets have followed the offices, leading to a surge in property demand in places like London's Shoreditch, New York's Brooklyn, and San Francisco's SOMA district. While the trend began in the west, it is spreading to emerging market cities, like Beijing (see page 26).

Normally a new property market cycle starts in the core areas and spreads to the fringes. However, in London since 2010, the City Core financial district has seen 9% rental growth, Shoreditch in the Creative Halo has seen rents grow by 54%, and the real estate industry has dropped the term 'fringe'.

CITIES OUTPERFORM THEIR NATIONAL ECONOMY

GDP PER CAPITA (US$)

Source: Eurostat, International Monetary Fund, US Bureau of Economic Analysis



CREATIVE-LED ECONOMY

The switch from the Finance-led city economy to the Creative-led economy has required industries to adapt. Financial and professional firms are rethinking office layouts now they are competing with tech firms for the best graduates. Break-out areas and brainstorming rooms are migrating from trendy ad agencies to law firms and banks.

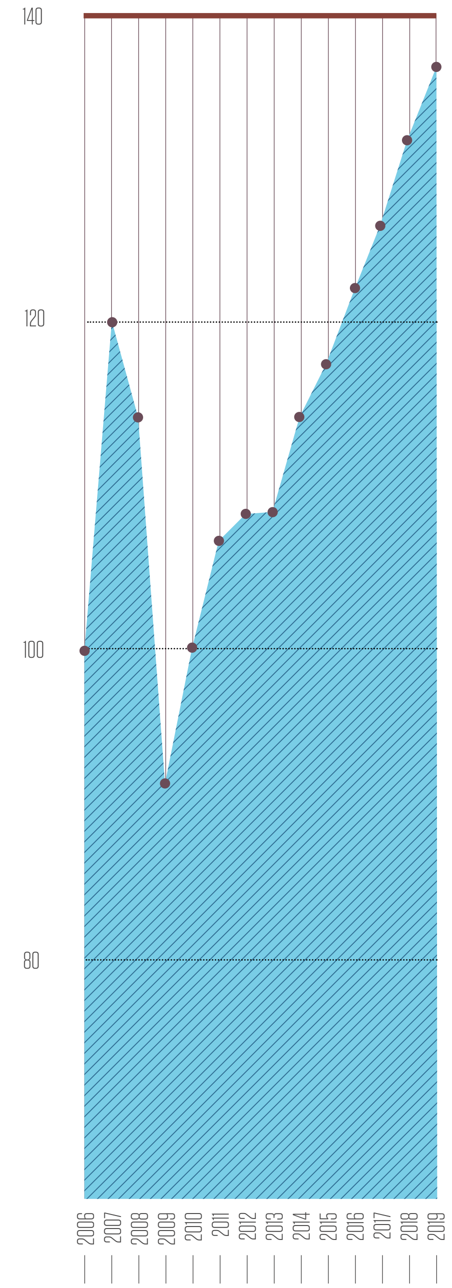
We are now seeing more office demand from financial and professional industries. This has been largely prompted by upcoming lease expiries, although headcount is growing again for financial firms, with many adding compliance staff. A subdued start to the new economic cycle from finance is to be expected, but nevertheless, this previously embattled industry appears to have normalised.

However, in a world set to be transformed by the 'internet of things', robotics, and driverless cars, tech is at the thin end of the wedge. Non-tech industries also want to raise the creative bar, and arranging workers in rows of desks is seen as a barrier to achieving this. The creative era is entrenched and has many years to run, and real estate must adapt to its needs.

Offices where desks are intermingled with different work areas are now almost the norm, so it is more a question of how far away from the desk a company is prepared to move. Wearable technology, like Google's Glass, will make more firms comfortable with workers who spend less time at desks, with the future office assuming a forum role.

The trailblazers of the new economy are also faced with big changes ahead, as the tech and creative firms are reconsidering what sort of offices they occupy in order to keep growing.

KNIGHT FRANK GLOBAL CITIES INDEX - PRIME OFFICE RENTS IN THE WORLD'S LEADING CITIES



Note: 2014 is a year end estimate, 2015 to 2019 are forecasts

Source: Knight Frank Research / Newmark Grubb Knight Frank

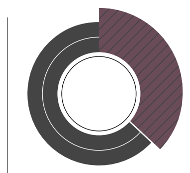
Generation Y's preference for living close to the CBD – cycling distance to the office is growing rapidly as a criteria – is keeping firms focussed on city centres. However, being the first industries out of the 'Great Recession' means the locations favoured by the tech and creative firms have seen supply of office space quickly come under pressure.

Supply of the converted warehouses favoured as offices by tech and creative firms is dwindling. They are turning instead to modern buildings out of necessity, in some cases moving into districts that are associated with traditional city core industries, like law and finance. Salesforce.com, for instance, is building up a London office in a district historically associated with finance and insurance. In San Francisco, we are seeing a different approach with finance district-type buildings being constructed in the tech quarter, SOMA.

BARRIERS CRUMBLE

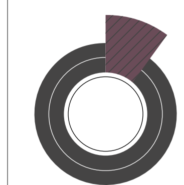
This marks the transition to the next phase for the city centre economy, which matches our forecast period of 2015 to 2019. Going forward, we expect to see the 'Creative economy' become a general reality across cities. In London the barriers are already crumbling as Amazon and Skype have taken new HQs in a district traditionally associated with law firms called Holborn, while in New York the Empire State Building is developing a reputation as a tech hub.

In the coming years we expect to see a cross over between technology and other industries. This will increase the paradigm dominance of creativity in tomorrow's economy, as mergers or technology change cause tech and other industries to intermingle, in turn creating new office clusters.



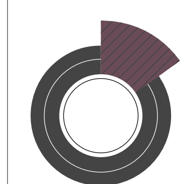
San Francisco rental growth in the last five years

37%



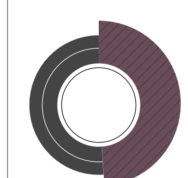
Houston's employment today is above its last peak by

10%



Mumbai's forecast rental growth to 2019

15%



Shangai is forecast to see net absorption in 2015 rise

49%

Worldpay, a digital payments firm, taking space in The Walbrook building in London – a short walk from the Bank of England, and near where Bloomberg is building a new HQ – is an example of an intermingled financial and tech cluster. It reflects the rise of a new hybrid industry known as Fin-Tech, and we believe more occupier demand will arise from other tech hybrids in the coming years. Cars, for instance, are seen as a new frontier for tech firms, as shown by Google's driverless car.

> "IN SAN FRANCISCO, WE ARE SEEING FINANCE DISTRICT-TYPE BUILDINGS BEING CONSTRUCTED IN THE TECH QUARTER, SOMA"

This will begin to level the playing field for CBD rents. Instead of the escalator of rents that started high in the most exclusive districts, and stepped incrementally lower as one looked gradually further afield, we see office accommodation (and consequently rents) falling into four categories in the future:

1. SUPER-PRIME

A luxury market of small 'c-suite' or 'hedge fund' offices in the most exclusive buildings, achieving headline grabbing high rents. A driving force will be a shift of high-margin financial activities from mega banks to specialist boutiques, which face less regulation by only servicing a high-flying clientele. It is the quality of that clientele that necessitates the luxury of the offices.

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2 NANO CORES

These are master planned clusters of buildings that are maintained as an estate with their own branding, 24/7 security and maintenance, retail and gym elements, and integrated features (such as cultural events in public areas). Particularly on the edge of CBDs we expect mixed commercial and residential Nano Cores emerging.

3 GENERAL CBD

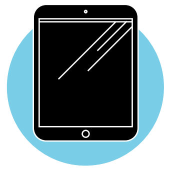
With most companies in the future seeing little difference between a high specification building in core or edge of CBD location, rents for grade A will converge as occupiers focus on the quality of the offices. Within the CBD, sudden drops in rent once one crosses a certain street will become rarer.

4 ALL-IN OFFICES

These will be a mix of serviced office and tech incubator, whereby small firms pay an all-inclusive rent, and collocate with other firms. Being surrounded by other entrepreneurs is valued by the tenant as replicating the collegiate atmosphere found in a typical office, as even in the start-up world working alone in a garage is not for everyone.

The General CBD will accommodate the majority of occupier demand, with Nano Cores providing their main source of competition.

In the face of competition from the higher priced but tailored Nano Cores, we see landlords in the general CBD responding by banding together to introduce initiatives to give local districts an 'estate' feel. We already see an element of this with the Business Improvement Districts in London, some of whom have introduced bowler hatted 'street ambassadors' who answer questions from the public and inform the borough council of any local problems.



225m

The number of iPads sold since launch in 2010, which is more than...

201m

The population of Brazil

INVESTING IN TOMORROW'S CITY

This offers significant challenges and opportunities for property investors and developers.

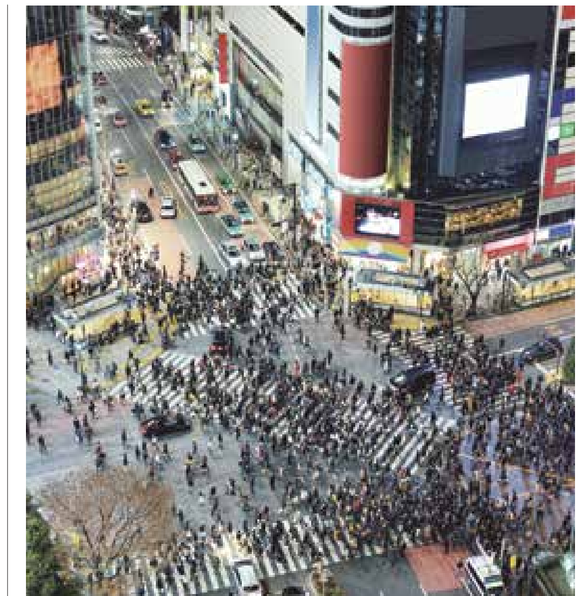
With the Creative Halo not the traditional Cores leading the new cycle, investors are familiarising themselves with the geography of districts that were previously the domain of specialist developers. New infrastructure projects, like the Grand Paris Express, are similarly causing investors to look widely for opportunities. Demand for mixed-use real estate in the Creative Halo is enhancing potential value, and reducing risk through diversification.

Another influence on today's investment market relates to changes in the bond market. 1994 to 2007 was a period of long-term decline for government bond yields, to the backdrop of general confidence in state covenants.

Hong Kong

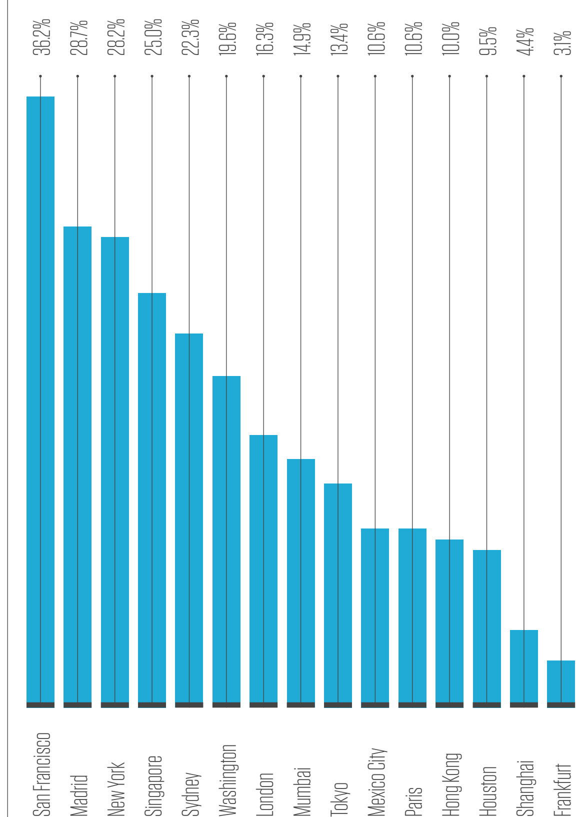
Paris from Montmartre

Williamsburg, NYC



Tokyo

OFFICE RENTS FORECAST: THE NEXT FIVE YEARS
PERCENTAGE CHANGE - 2014 TO 2019



Note: London is the West End

Source: Knight Frank Research / Newmark Grubb Knight Frank

Consequently, some investors were happy to pick-up yield compression in the 'risk free' investment of government bonds rather than ride the cycles of property.

Today, bond yields in many cases are trading above their 2011-2012 lows, while government covenants have lost their shine. The USA, France and UK have faced credit rating downgrades in recent years, while the previous cheerleading over the BRICs has faded. However, property values look re-priced and competitive, while a recovery in occupier market demand means that property yields can increase in a good way, through rental growth.

Due to the relative sizes of the markets, a small re-allocation away from bonds and towards property can have a significant 'weight of money' effect on real estate. Global property investment volume totalled US$559 bn in 2013, whereas the market for issued UK government bonds alone is US$2.3 trn[ii].

EYE ON THE CYCLE

Cycle expectations have encouraged investors to buy real estate. This reflects the view that even if there are further road bumps ahead, the worst of the downturn has been ridden out, and property today could look a canny investment when reviewed in five years' time.

Events in the occupier market add weight to this cyclical view. Many occupiers during the downturn years who were faced with a lease expiry opted to extend that lease rather than relocate during a time of uncertainty. Many are now contemplating that delayed lease expiry in the coming years, with the added twist that

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the development pipeline has dwindled post-2007. This offers opportunities for investors in the development sites market.

A feature of the new real estate landscape is the internationalisation of the investment market. Foreign buyers have accounted for the majority of investment volume in London for seven of the last ten years. Most of the other Global Cities have seen a notable rise in foreign investment, buoyed by new money from emerging markets. For new comers, buying in core locations is tempting, but that is not necessarily where the best opportunities are.

Emerging markets investors have proved quick to acknowledge this, as shown by Chinese money targeting up-and-coming Brooklyn, and a Malaysian consortium backing the regeneration of the Battersea Power Station site in London. We believe the next few years will see more joint venture development between international investors and local property companies. Or in some cases we may see large sovereign wealth or pension funds recruit in local talent and establish themselves on the ground in leading Global Cities.

We believe the larger institutional global investors will see the Nano Cores as an opportunity, as a way to develop in scale in order to deploy large volumes of funds. This issue of scale is very important to the big, global funds.

We also see skyscrapers as being in demand with investors. They offer an efficient means to quickly respond to the shortage of development pipeline post-2007, thus exploiting the anticipated rise in pre-let demand. There is also the option of tapping into growing demand for luxury high-rise residential by including apartments in the mix of uses.

202 US$bn

Global commercial real estate investment in 2009, compared to

606 US$bn

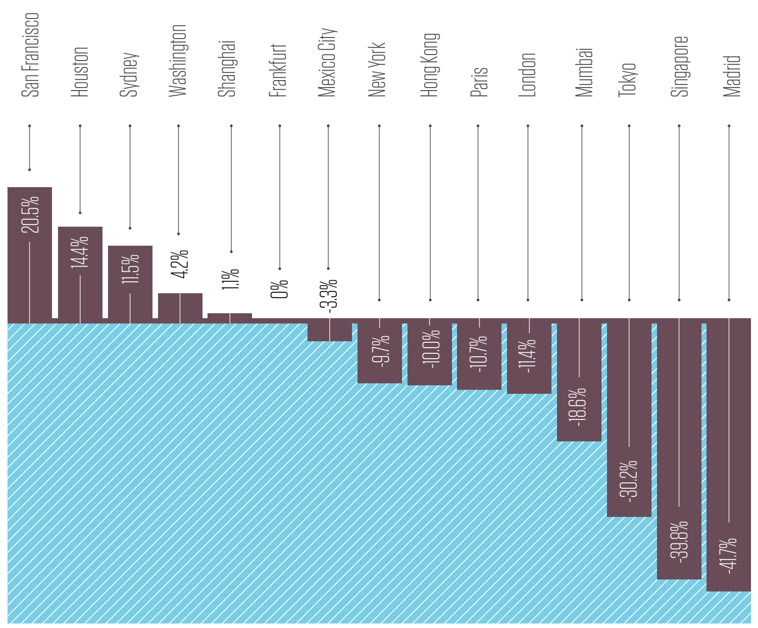
Forecast Global commercial investment for 2015

Source: Real Capital Analytics / Knight Frank

OFFICE RENT % CHANGE 2008 TO 2013

(BASED ON LOCAL CURRENCY)

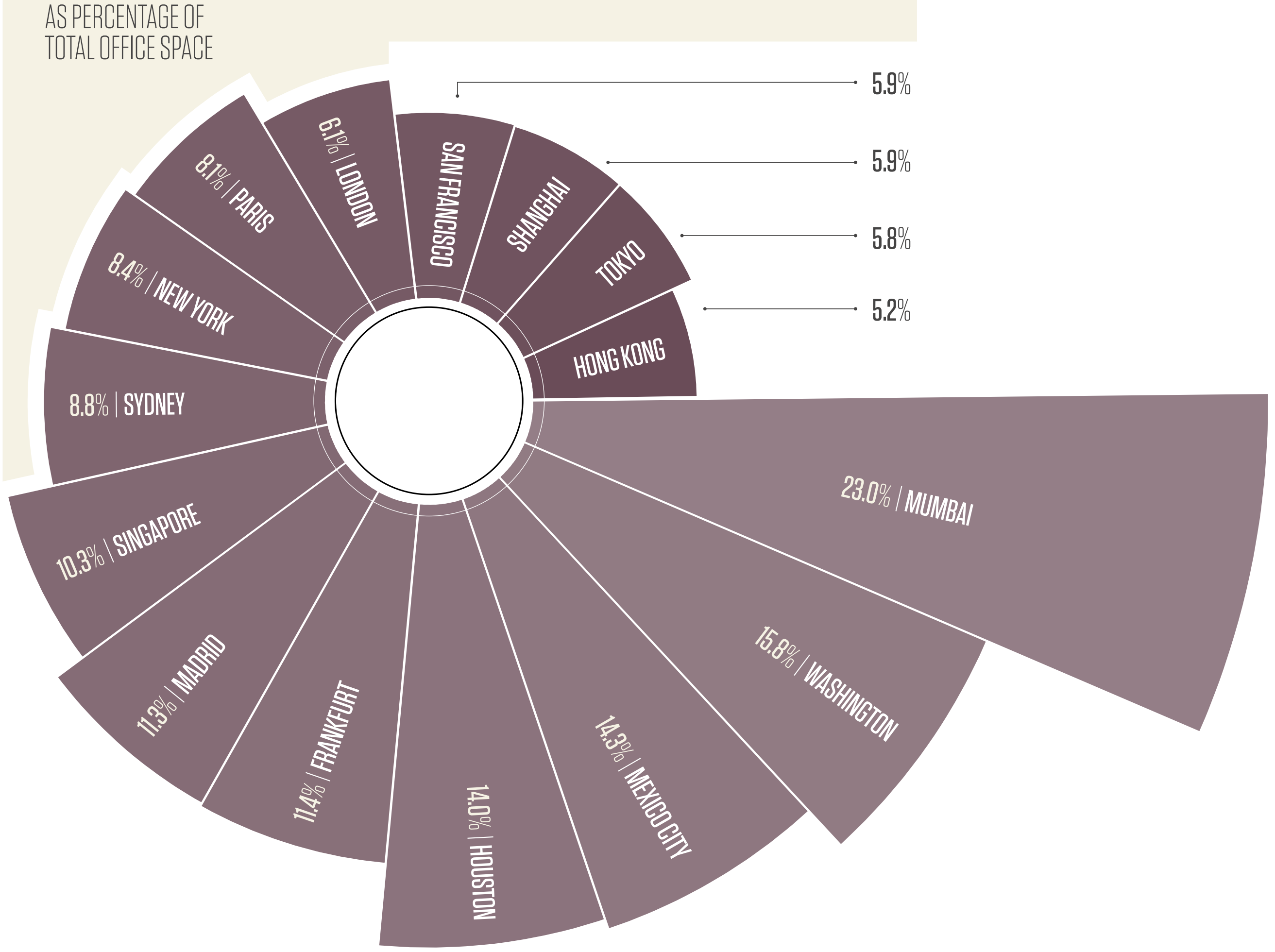
Source: Knight Frank Research / Newmark Grubb Knight Frank



VACANT OFFICE SPACE BY CITY - 2014 YEAR END (EST)

AS PERCENTAGE OF TOTAL OFFICE SPACE

Source: Knight Frank Research / Newmark Grubb Knight Frank



This offers opportunities for property investors and developers, who are in a position to exploit the growing trend of urban living across the globe. The rise of Creative Halo areas was phase one of the 21st century's property renaissance. Investing in its phase two, which will be fired by hybrid tech industries and the general acceptance of creativity as the dominant economic paradigm, is the new frontier for real estate.

City Hall, London

Another point to consider is the growing importance of airports in shaping real estate investment. Direct flights from the Middle East to Birmingham and Manchester have put these UK regional cities on the interest list of investors from the region. Dubai's growing popularity as aviation hub has supported the city's rise as a staging post for international real estate investment. Also, port facilities are being expanded around the world, such as Singapore's Tuas Mega Port scheme, which will create opportunities for property investors.

NEW FRONTIERS

While the Global Cities will in our view lead the new cycle, thanks to their large pools of knowledge workers, a long term question for investors is: when should we target the next wave of emerging market cities? Africa, South America, and developing Asia can be complicated propositions for investors, as there are issues of currency fluctuation, political instability, and poor market transparency.

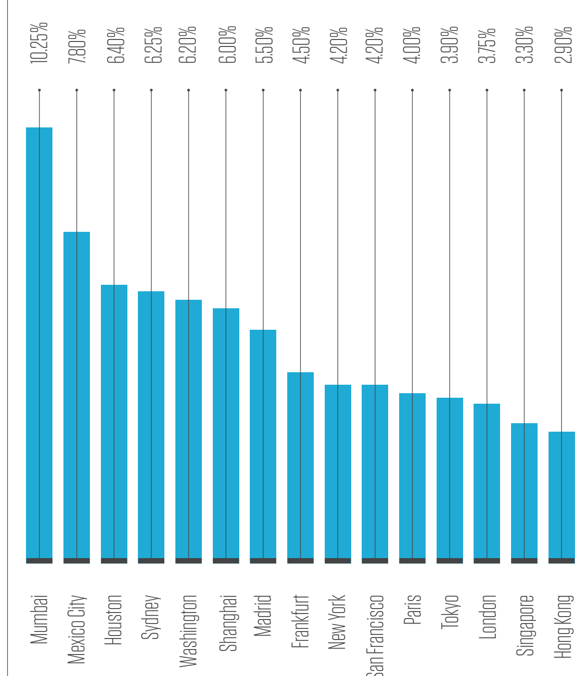
Consequently, we expect investors to target Africa's mature markets of Kenya, South Africa, Botswana, and Nigeria. Nairobi in particular has grown rapidly as a regional centre due to oil discoveries, the rise of the telecoms industry, and many global firms deciding that a regional base in east Africa is necessary to truly operate a pan-African business. Cape Town, Johannesburg and Lagos are also strategic hubs, and Dubai services a growing flow of African investment capital.

PROPERTY RENAISSANCE

The picture emerging is one of an accelerating pace of change. A new world of technology revolution, with humans providing the creative impetus, is generating a renaissance in the commercial property world. Offices are thriving as the ideal forum for idea generation, retail is shifting from shopping to leisure and 'destination' experience, while work and home are drawing closer now so many of us want to live near the bright lights.

PRIME OFFICE YIELDS - 2014 YEAR END (EST)

Source: Knight Frank Research / Newmark Grubb Knight Frank



[i] Source: The United Nations, World Urbanisation Prospects, 2011.

[ii] Sources: Real Capital Analytics, UK Debt Management Office.

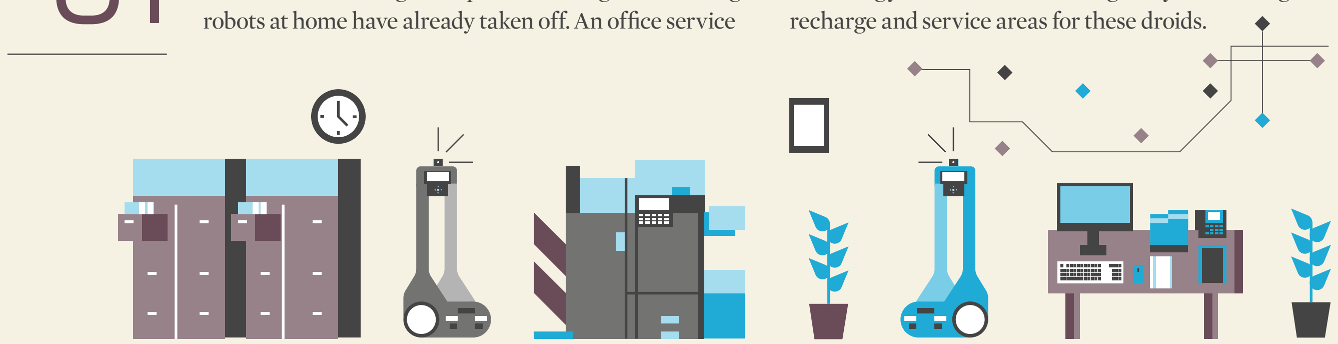
5 TECHNOLOGIES THAT WILL CHANGE PROPERTY

It is remarkable to think that just five years ago no one owned an iPad (launched in April 2010) illustrating how quickly new technology becomes taken for granted today. This is an example of a technological advance that has accelerated changes in how we work, shop and spend leisure time, with implications for commercial real estate. Some people who previously shopped regularly for books, CDs, DVDs, and video games, now access all these products through their tablet computer. This has contributed to a reshaping of retail property, and sparked a wave of office-based start-ups that produce apps. Similarly, the popularity of e-shopping has buoyed demand for warehouses. New technology undoubtedly impacts the property market, raising the question, where will change come from next?

HERE IS OUR SELECTION OF UPCOMING TECHNOLOGIES THAT WE SEE CHANGING PROPERTY.

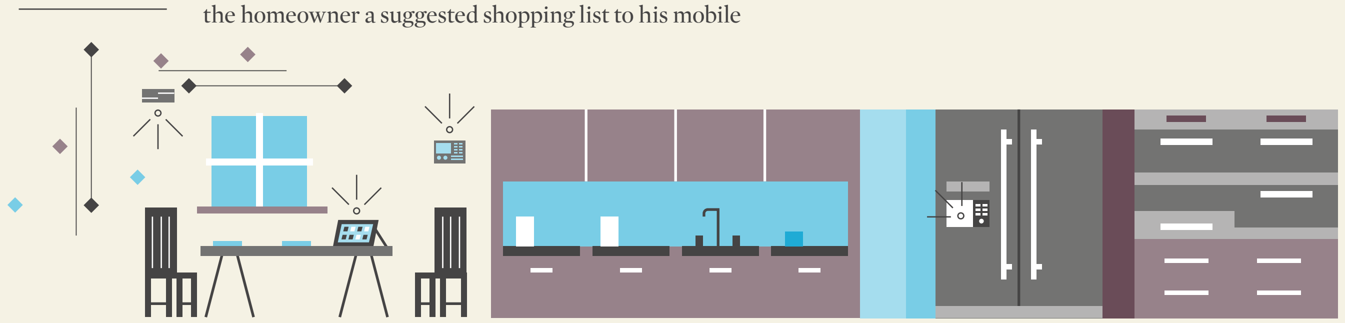
01 OFFICE ROBOTS

Development has begun on telepresence robots, whereby a remote worker can log into a droid, traverse the office, see what is occurring, and speak to colleagues. Cleaning robots at home have already taken off. An office service robot that cleans, reloads printers, and performs basic security duties, could be a future extension of this technology. Future office buildings may need storage, recharge and service areas for these droids.



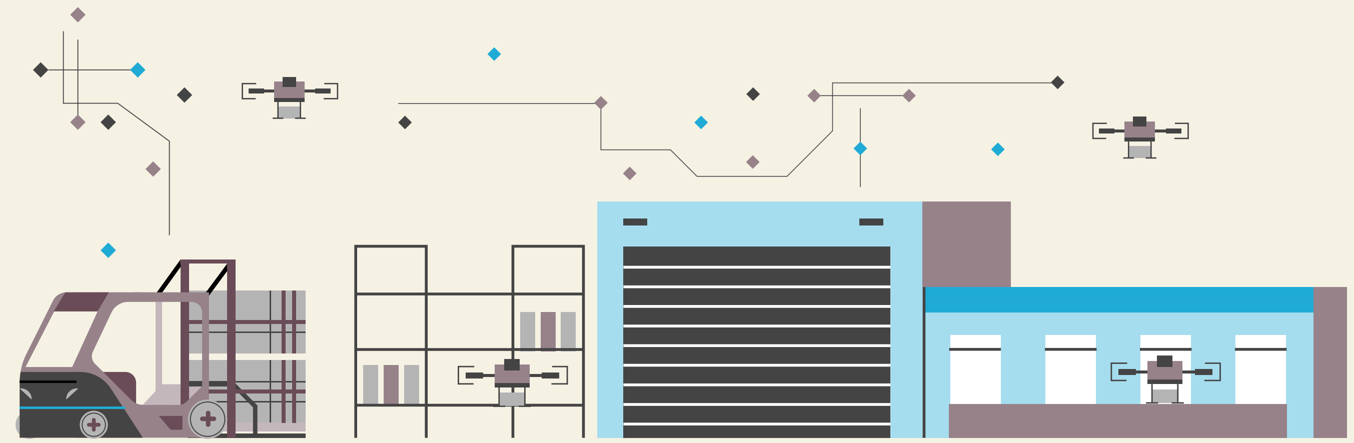
02 THE INTERNET OF THINGS

This is where everyday appliances are connected to the internet, so they can be controlled remotely or intelligently monitor how we use the device. For instance, a fridge could monitor its contents, and send the homeowner a suggested shopping list to his mobile phone with a 'buy' button. This would add momentum to the rise of e-retail, increasing demand for logistics property. Internet-linked machinery could also result in smart office buildings that partially manage themselves.



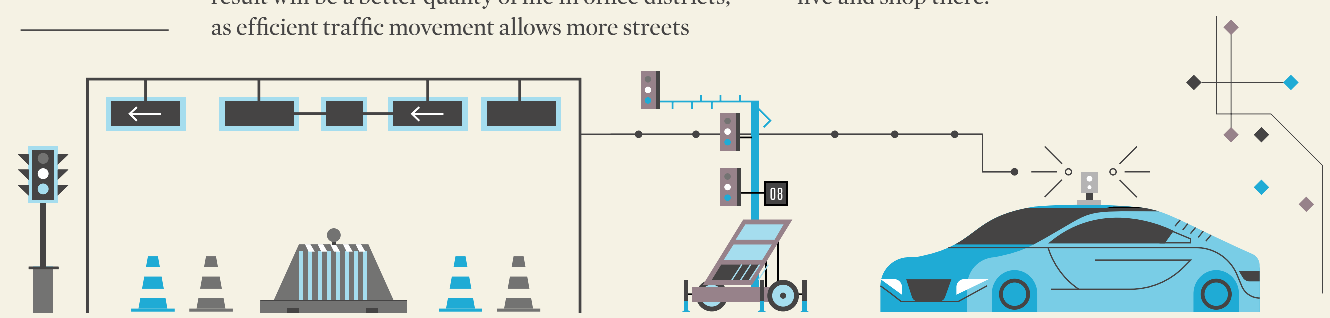
03 DRONES

When Amazon rolled out plans to deliver small goods by drone helicopters there was initially a sceptical reaction. However, other firms quickly announced they too were testing drone delivery. In the future, logistics properties may come to resemble mini-airports, as drones come and go. EasyJet, the airline, has plans for its maintenance crews to use drones for aircraft inspection. Similarly, the property industry could use drones to inspect buildings.



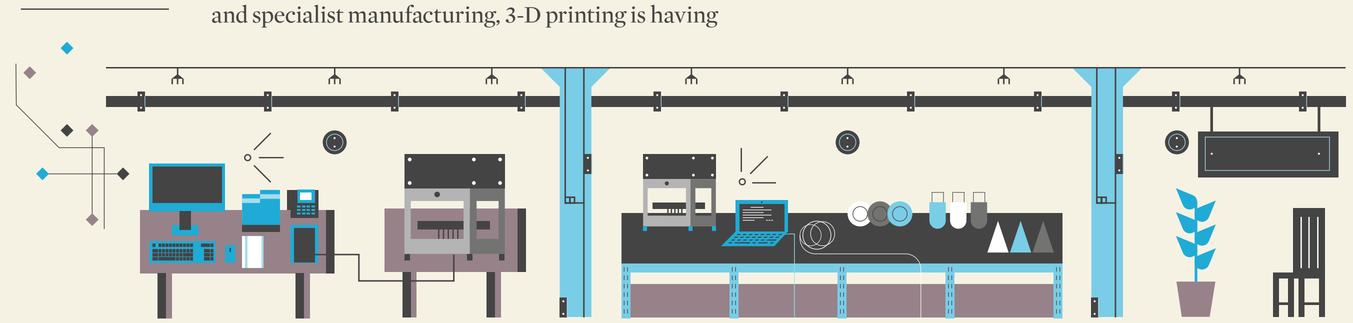
04 DRIVERLESS CARS

A computer driven car, using wifi to communicate with other vehicles and receive traffic reports, should improve traffic flow and speed up commuting. The result will be a better quality of life in office districts, as efficient traffic movement allows more streets to be pedestrianized, improving public areas and passing trade for retailers. The city will become a more pleasurable experience encouraging people to work, live and shop there.



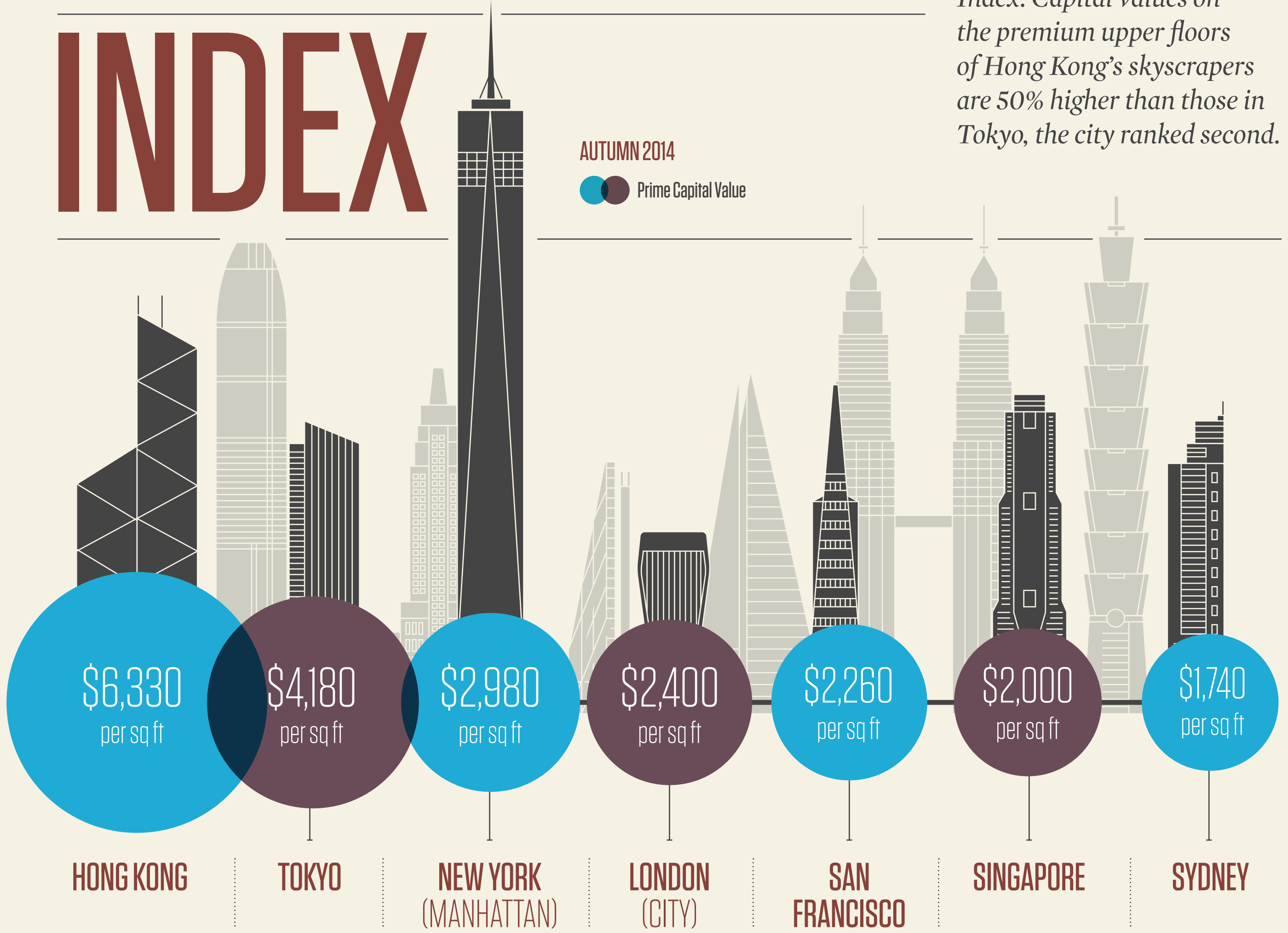
05 3-D PRINTING

3-D printers are being used more often for producing components, but those parts then need to be assembled into a working product, which will require quality control testing. This requires a factory. However, in R&D and specialist manufacturing, 3-D printing is having an impact, bringing down costs on short production runs. Consequently, we could see a wave of 'start-up' manufacturers offering bespoke or specialist goods, generating more demand for light industrial units.



SKYSCRAPER INDEX

Hong Kong office towers remain the most expensive commercial real estate in the world, according to the latest Knight Frank Skyscraper Index. Capital values on the premium upper floors of Hong Kong's skyscrapers are 50% higher than those in Tokyo, the city ranked second.

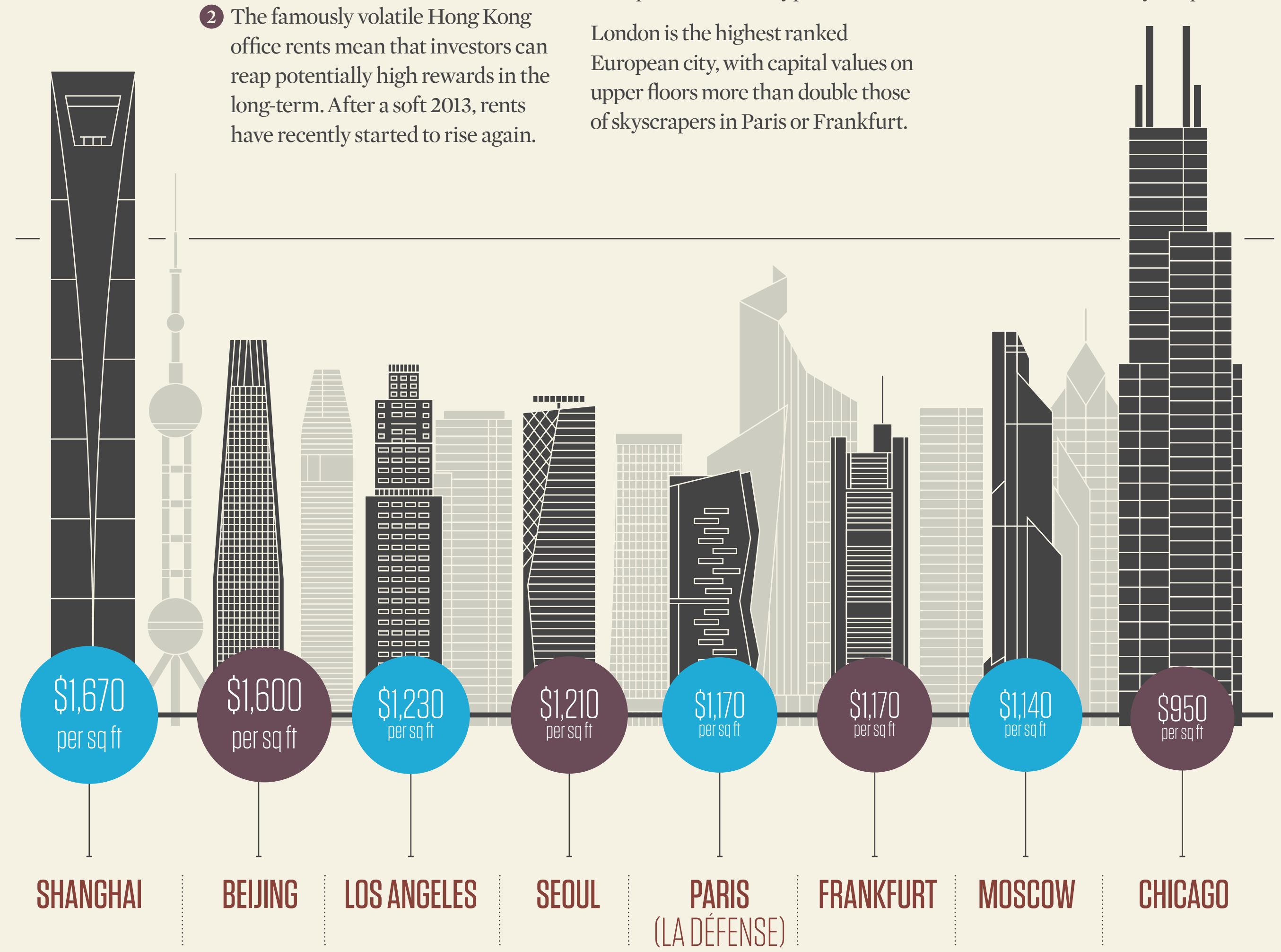


Hong Kong's commanding lead reflects three factors:

1. A restricted geographic area, which creates the logic of building upwards, and effectively converting air into 'land'.
2. The famously volatile Hong Kong office rents mean that investors can reap potentially high rewards in the long-term. After a soft 2013, rents have recently started to rise again.
3. The 'ego' appeal of the upper floors, with the panoramic views, delivers higher rents compared to the wider market. In Hong Kong and London, upper floors in skyscrapers can command a 15-20% premium over typical rents.

London is the highest ranked European city, with capital values on upper floors more than double those of skyscrapers in Paris or Frankfurt.

Worth noting is that San Francisco's towers have leapfrogged over four Asia cities, rising from ninth place last spring to rank number five today. The rapid growth of California's technology sector is driving demand for San Francisco's skyscrapers.



Source: Knight Frank Research / Newmark Grubb Knight Frank

FUTURE SKYSCRAPERS

WWW.KNIGHTFRANK.COM/GLOBAL-CITIES-INDEX-2015/SKYSCRAPER-INDEX

100 BISHOPSGATE, LONDON, UK

100 Bishopsgate in the City of London will provide a 900,000 sq ft of office, retail and restaurant space. The scheme consists of a five storey podium, and 40 storey signature tower. It is set in London's skyscraper cluster, and close to the transport hub at Liverpool Street station.

SHANGHAI TOWER, CHINA

The Shanghai Tower is being constructed beside the Jin Mao Tower and Shanghai World Financial Center in Pudong's Lujiazui Financial District. At 121 storeys, with a total floor area of 4.4 m sq ft, this will be the second tallest building in the world and the tallest in China.

10 HUDSON YARDS, MANHATTAN, NEW YORK

The 52-storey, 1.7 m sq ft tower is due to open in late 2015, and is 80% pre-leased to tenants Coach, SAP and L'Oreal. The location lies on the west side of Manhattan, in an area that has primarily contained warehouses as well as the rail yards serving Pennsylvania Station.

SALESFORCE TOWER, SAN FRANCISCO, CALIFORNIA

Scheduled for 2017 completion, this 61-storey, 1.4 m sq ft building is being developed in the SOMA district, which is popular with tech firms. Formerly known as the Transbay Tower, it has taken the name of its newly signed anchor tenant, Salesforce.com, which has leased 714,000 sq ft.

OASIS TOWER, MUMBAI, INDIA

The Oasis Tower will be 372 metres (1,220 ft) high, making it the second tallest building in India on completion in 2016. The scheme consists of 85 floors, of which 53 will house a hotel, office and retail space. The remaining floors will be apartments.

THE CITY TOWER, VAUXHALL, LONDON, UK

This 60-storey skyscraper will have 267 private apartments ranging from studios to penthouses, and 51 affordable homes at the base. There will also be a neighbouring 45-storey residential block, with a five star hotel and offices, with a linking walkway to The City Tower. The expected completion date is 2017.

RISE OF THE NEW DISTRICTS

The geography of our cities is changing and so is the way we live and work, so what are the implications for the future?

AUTHOR – PATRICK SCANLON
Partner, Commercial Research

IN THIS CHAPTER

- **New districts around the world: what has prompted the emergence of new districts in London, San Francisco, New York and Beijing?**
- **Future of work: both employers and staff are rethinking the traditional relationship between work life and home life.**
- **Cost of living index: young professionals are increasingly seeking to live closer to work but many are being priced out. Our index ranks the affordability of 20 global cities for the average graduate.**
- **Financial pioneers: lower rents and competition for young staff with tech firms is encouraging more financial firms to look at new districts.**

Gentrification is not new, and in many of the Global Cities it has roots back to the early 1980s. However, the last decade has seen it reach a new peak, stepping beyond young professionals moving into up-and-coming areas. Today gentrification is a broad-based economic phenomenon, where a wide range of business activities are relocating into previously neglected fringe areas. Offices, homes, and shops are being developed in large scale in former industrial districts, effectively building new cities within the world's leading property markets.

During the 1960s and 1970s, many of the Global Cities experienced a partial exodus, leaving large swathes of vacant properties. Factory districts were hit by deindustrialisation, while inner city dock areas were left redundant by the introduction of container ports. Tenements and terrace houses where industrial workers had lived became run-down, and rising crime added to the sense of decline.

KNOWLEDGE WORKERS

However, an initial wave of young financial and professional knowledge workers – the Yuppies – began the rebirth of these districts as places to live in the 1980s. The 1990s saw early examples of large scale office development, sometimes with financial firms as anchor tenants; a trend that gained momentum around the turn of the millennium.

A mushrooming digital economy in recent years has moved the new districts towards centre stage in the modern city economy. The ascendance of tech areas like London's Shoreditch and New York's Midtown South occurred mostly to the backdrop of the Global Financial Crisis, which demonstrates the momentum behind their rise. Unsurprisingly, the real estate world is hurrying to capitalise on opportunities.

Today these former-industrial districts are among the fastest rising office, residential, shopping and leisure locations in the Global Cities. Companies are moving into these areas to bring the workplace closer to where their younger staff live and socialise; as employee retention and satisfaction rises up the corporate agenda. Those employees live in the new districts as this is where new homes can be built en-masse to match population growth.

The new districts are of increasing significance within the Global Cities. This chapter looks at some of the leading examples, and considers what has led to their success.

01 SAN FRANCISCO

The Santa Clara Valley in the South Bay area of San Francisco, nicknamed Silicon Valley, has enjoyed a long association with the technology sector. Having grown around Stanford University, it remains the location of choice for some of the world's largest and most successful tech firms, accommodating offices and research & development (R&D) facilities.

A recent report by PwC and the National Venture Capital Association found that venture capital investments into software companies in the first quarter of 2014 totalled US$4 billion, three times higher than biotechnology, which came in second place. This continued focus from venture capitalists has ensured that demand for commercial space in Silicon Valley has remained strong.

57%

rise in tech jobs in San Francisco between 2010 and 2013

However, demand for space in San Francisco has been booming. Between 2010 and 2013 there has been a 57% rise in tech jobs compared to 14% in Silicon Valley, with a particular focus on the area South of Market Street, nicknamed SOMA. Twitter, Pinterest, Dropbox and Yammer are among the companies who have moved their California offices to the former industrial district. Salesforce and LinkedIn have just committed to new office space of 710,000 sq ft and 450,000 sq ft respectively; both buildings are currently under construction. What has been driving this interest?

Market Street in San Francisco

Despite the relatively high cost of living, young tech workers have long-favoured life in the city over settling in the suburban towns in Silicon Valley. San Francisco is seen as more vibrant and fashionable than its neighbouring towns to the south, and of all its districts, SOMA has the reputation for being the most edgy and hip.

RECRUITING THE BEST

The presence of young, affluent tech workers is not a new phenomenon; many of the major tech firms in Silicon Valley provide commuter buses for San Francisco-based employees. However, firms have become increasingly competitive in attracting the brightest talent, and have recognised that a SOMA address can give them a recruiting edge.

Additionally, government initiatives to promote regeneration in the area have meant that tax incentives have been available for firms to relocate their businesses to SOMA. Inevitably, this increase in demand has driven rents upwards. The Class A asking rent in SOMA is now US$64.00 per sq ft, significantly higher than the nearby financial district.

Rents for residential accommodation have also risen, which has led to anger amongst long-term SOMA residents towards what they perceive as tech-fuelled gentrification. Indeed, there are examples of commuter buses being surrounded and prevented from leaving the area.

Despite this, SOMA's rise as one of San Francisco's most important new districts appears assured. The office accommodation that the area offers is perfect for the tech innovators moving there, many of whom do not require large R&D units and have a preference for the stripped-back look of the redeveloped warehouses.

Looking forward, improvements in infrastructure and amenity will attract not only more tech firms, but associated service providers and workers, making SOMA an integrated part of San Francisco's expanding CBD.

02 NEW YORK CITY

New York City has long been famed for its status as a financial powerhouse. Manhattan is home to the headquarters of many of the world's largest financial institutions as well as the New York Stock Exchange and the Federal Reserve. In total, the securities sector employs 165,000 people in New York City proper (just 5% of total private sector jobs yet 22% of the wages). The entire financial sector employs 439,000 people in NYC.

However, the tech sector has seen an unprecedented surge in growth. Recent data suggests that tech now employs 150,000 people in the city, an increase of 21% since 2006. This growth is likely to continue for some time to come, as more venture capital funding poured in to New York's tech sector in the last year than any time since 2001.

In recent times Midtown South, an area more traditionally associated with fashion and entertainment, has been the focus of tech sector demand. Google, Twitter, Apple and Facebook have all opened offices in the area, and such is the demand for office space that the vacancy rate is significantly lower than the other Manhattan submarkets at 5.9%.

DUMBO FLIES

While both large established and small start-up tech occupiers have colonised Midtown South, other districts are also attracting significant tech demand. DUMBO*, Downtown Brooklyn and the Brooklyn Navy Yard, known as the Brooklyn Tech Triangle, have become significant tech hubs within the city; DUMBO has the highest concentration of tech firms of any neighbourhood in New York City. The area is home to 500 tech and creative firms employing over 10,000 workers, all in just a 10-block radius.

The largest recent deal was Etsy, the online shopping site, leasing 200,000 sq ft in the renovated buildings known as Dumbo Heights. Etsy will relocate there from an 80,000 sq ft office. Its head count is expected to jump from the current 350 to 750 within five years.

Tech growth in the area may have been organic, but there are plans to further encourage the new wave of firms. The Brooklyn Tech Triangle Strategic Plan is an initiative led by a coalition of tech leaders, government, and the real estate industry, which aims to provide the environment and office space for tech firms to prosper. The area has traditionally been associated with the arts and creative industries, and the warehouse-type post-industrial buildings lend themselves well to the requirements of young tech firms.

500 The number of tech firms in DUMBO, who employ **10,000** people

To accommodate future growth, the plans for the area include the improvement of transportation and pedestrian access, and the addition of cycle paths and green areas. Also, there are proposals to open up new office space by converting buildings currently used by the NYC Department of Transportation, municipal buildings in Downtown Brooklyn, and around 700,000 sq ft of space currently used for warehousing.

Forecasts suggest that net new requirements for office space in the Brooklyn Tech Triangle could grow by 900,000 sq ft to 2.2 million sq ft by 2015. Brooklyn's transformation is in its early days, with more opportunities for developers ahead.

Brooklyn

*DUMBO is the acronym given to the area Down Under the Manhattan Bridge Overpass.

London's office market has traditionally been concentrated around the core areas of the West End and City; the spiritual home of the capital's corporates, specialist financials, banks, accountants and insurers. While these remain leading business districts, over the last few years new markets outside the traditional core have emerged creating new business clusters, employment opportunities, and property value growth for offices, retail and residential.

New business locations have fared well in London; Canary Wharf, More London, Regent's Place and Paddington are all examples of successful new markets. These areas have succeeded not just because of their lower occupational costs, but also because of the flexibility occupiers can enjoy by moving to a managed estate.

The next 10 years will see the emergence of more new markets as occupier demand strengthens and working practices evolve. London is expected to become the UK's first megacity (population in excess of 10 million) by 2025, bringing the need for more real estate and improved infrastructure.

The redevelopment of the former railway land at King's Cross is some way from completion, yet has secured commitments on more than 1.8 million sq ft from tenants including Google and BNP Paribas. The land between Battersea Bridge and Vauxhall station, is undergoing substantial redevelopment and has attracted foreign missions including the United States and the Netherlands, with the Chinese Embassy believed to be following suit. The redevelopment of the iconic Battersea Power Station will provide a focus point for the area. These areas offer more than simply an office location; their mix of commercial, residential

Village Underground in Shoreditch London is a social enterprise project offering a warehouse and affordable studio space for people in creative industries

03 LONDON

and retail uses make them a destination and a place for working and living.

EMERGING MARKETS

London's emerging markets are not just found in large estates. Planning permission is in place for numerous commercial and residential schemes in Shoreditch and the northern City fringe, driven by the prospect of increased demand from London's growing creative industries including media and technology.

15

companies thought to have made up the Tech City cluster in 2008, compared to today's estimated

1,300

The growth in Shoreditch has been organic. The area has long been associated with art and fashion, and has traditionally been a mix of small businesses and residential accommodation, all within a stone's throw of the financial powerhouse that is the City. Tech entrepreneurs recognised the advantages of being in a creative environment, with relatively low accommodation costs and easy access to potential clients, and began to cluster around the Old Street Roundabout. In 2008 it was estimated that the Tech City cluster comprised 15 companies; today there are more than 1,300, reflecting the success and popularity of the area.

However, the area's growth has not been without issue. While many welcome the investment the area has attracted, others warn of gentrification changing the essence of what attracted the initial tech businesses: vibrancy, charm and affordability. Many tech start-ups now complain that owning an apartment or renting an office have become unachievable for individuals with little capital and businesses with no covenant.

London is a constantly evolving and expanding city, no more so than in its real estate markets. The emergence of these new districts has prompted improvements in local infrastructure and attracted new business, which will be at the heart of London's ongoing growth.

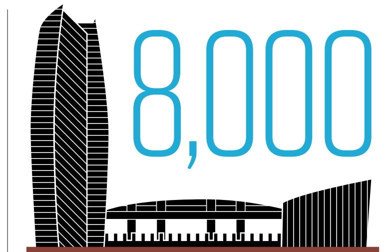
04 BEIJING

Beijing has embraced its growing technology sector. The Zhongguancun Science & Technology Zone is an area primarily occupied by technology firms in the Haidian district of Beijing. The area came to prominence in the 1980s and was established through government-backed development as Beijing's version of California's Silicon Valley.

Like Silicon Valley, development grew up in the area surrounding one of the country's top universities, and it is home to some of the world's largest technology companies. Google, Intel, Oracle, and Sony all have offices there. The Zhongguancun Scientific & Technological Park has more than 8,000 hi-tech enterprises.

NEW WAVE FIRMS

To date Beijing's tech sector has been dominated by the more traditional and established technology businesses. However, there has been a noticeable increase in the development of social media platforms similar to those which have led to the growth of the new wave of tech firms in San Francisco's SOMA, New York's Brooklyn Triangle and London's Tech City. Many of these new techs are developing smartphone apps.



8,000

hi-tech enterprises can be found in the Zhongguancun Scientific & Technological Park

While the continuing growth of Zhongguancun is not in question, the growing popularity of start-ups focusing on social media platforms raises the possibility of less corporate, more creative districts benefiting from increased demand for office space.

VIBRANT URBAN LIFESTYLE

One possible benefactor of this demand is the Dashanzi Art District in Beijing's Chaoyang district. Centred on the 798 factory, the area is characterised by a number of Bauhaus-style decommissioned military buildings designed by East German architects and constructed in the 1950s, and has become Beijing's artistic hub. It is home to galleries, design studios, fashion houses, restaurants and bars, and small publishing firms.

The 798 Space Gallery hosts galleries and exhibition space

The area is named after the former 798 factory which sits at its heart

The area shares many of the ingredients which have attracted young tech firms in other major global cities. Should tech start-ups base themselves here, it is likely that the initial growth will be organic as the young entrepreneurs look to immerse themselves in a creative environment.

While western cities have dominated discussion on new districts, Beijing's new tech and creative hubs show this is a global phenomenon.

THE FUTURE OF WORK

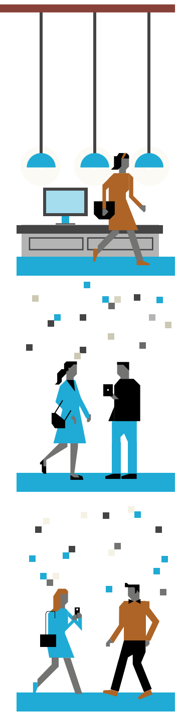
As work and home draw closer, both the office and workers are adapting.

The 21st century has experienced seismic shifts in the way business is conducted, particularly in the relationship between work and home. This has put the office at the forefront of today's city economy, and led to its transformation as a place to work. Similarly life beyond the office is shaped by the realities of working in a city.

When considering the success of the city and the office in recent years, it is worth considering that this is at odds with what pundits were predicting decades ago. During the 1970s, cities were viewed as in decline in favour of suburban towns. In the 1990s, the arrival of the internet prompted forecasts that working from home would negate the need for offices.

Understanding why these predictions were wrong is key to gauging what is behind a successful city office today, as increasingly the workplace is all about people.

Cities defied predictions of demise because they offer two pools – one of talent, the other of opportunity – which play off each other, and are able to achieve huge scale in a conurbation. This is because:



1. Cities can accommodate lots of people and many companies, by providing high density living and working accommodation.

2. People can then be efficiently and en-masse moved around the city's micro-economy by a complex transport system.

3. This environment of lots of people interacting, and easy transit, creates a dynamic place to live, which attracts large numbers of talented people.

4. Companies follow the talent into the cities; the crowd effect of their competitors and clients doing the same creates efficient business hubs.

Effectively, cities have achieved for centuries what the tech world calls crowd sourcing.

Turning to why the office survived (indeed prospered) through the rise of the internet; again we come back to people, their happiness and their relationship with their employer.

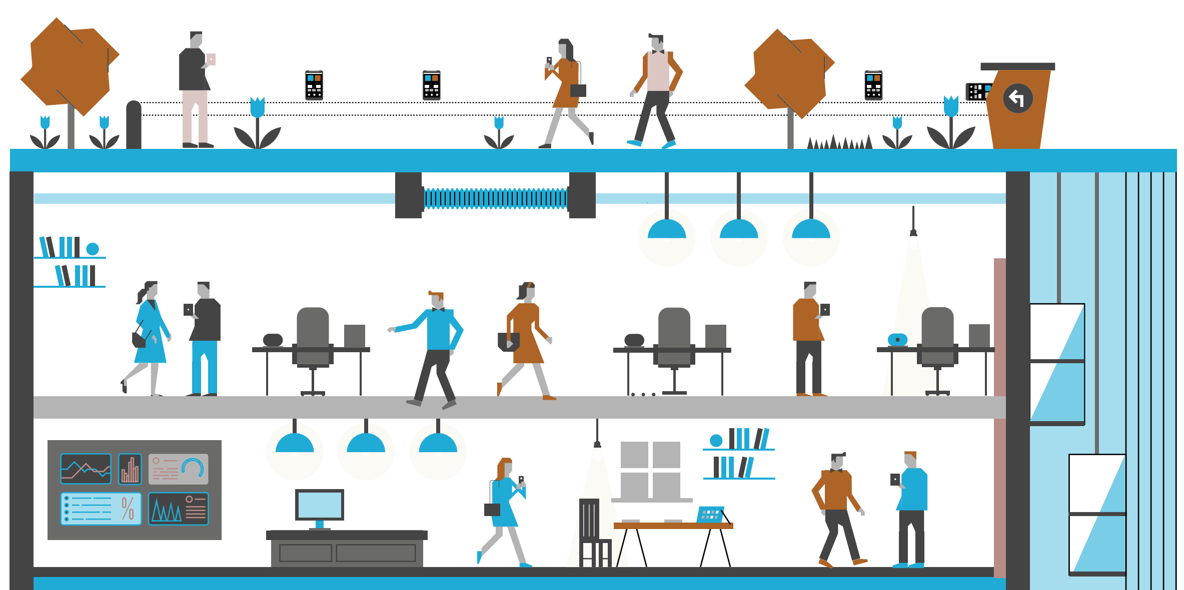
The modern city is a knowledge economy, driven by interaction of employees, which increases idea generation and exchange of information. Consequently, employers want their staff to be on site, while workers are conscious of how isolated they become working from home. Today's office, which is built around interaction, has spawned new work areas (team space, cafés, exercise areas) which are displacing desks.

The war for talent means the balance of power in the modern workplace has shifted towards the employee; thus companies locate where staff want to be. Once relocated from anonymous CBDs to areas with shops, cafés and leisure, more workers choose to live close to the office, which benefits the firm who want staff to work long hours.

> "EMPLOYERS WANT THEIR STAFF TO BE ON SITE, WHILE WORKERS ARE CONSCIOUS OF HOW ISOLATED THEY BECOME WORKING FROM HOME"

As a result, inner city homes are heavily in demand, often in areas where office supply is falling. This is driving up house prices, with knock-on pressure on the incomes of young workers (See Generation Y Cost of Living Index, p.93).

The loss of older offices to redevelopment as homes, in order to house the influx of workers, is placing further pressure on supply of business accommodation, and pushing up rents. The challenge for the Global Cities is balancing the conflicting demands of accommodating the new wave of firms, and their workers, in the same highly sought-after districts.



FINANCIAL PIONEERS

Recruitment and cost issues will draw finance to the new districts.

Shoreditch, London

Discussion of new districts usually focuses on office demand from technology firms. However, financial firms have a track record for opening up new areas. The type of young, ambitious graduates they target places finance in competition with techs for staff, increasing the need to be in an office location attractive to Generation Y. Lower rents and brownfield sites increase the draw of new districts to financial companies.

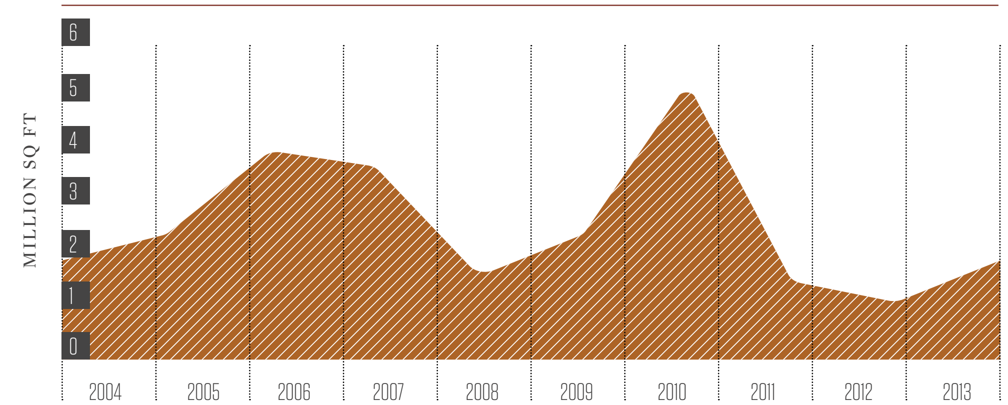
Presently, financial occupier demand is improving but patchy. HSBC has pre-let 285,000 sq ft of offices in Sydney's Barangaroo, although elsewhere in the world banks are consolidating offices in order to reduce their overall occupation. In some cases new districts are benefiting, such as JP Morgan Chase moving jobs to Brooklyn. There has also been a shift in activity in some financial districts towards insurers and fund managers, as shown by recent deals in London and Singapore.

> "THERE HAS BEEN A SHIFT IN ACTIVITY IN SOME FINANCIAL DISTRICTS TOWARDS INSURERS AND FUND MANAGERS"

However, there is reason to expect demand to improve going forward. A global economy requires a complex financial system, while more money is pouring into pension, hedge, and sovereign wealth funds. Digital commerce has created a wave of 'fin-tech' firms, who bridge the worlds of tech and finance.

ROLLERCOASTER RIDE - OFFICE TAKE-UP BY FINANCIAL FIRMS IN LONDON

Source: Knight Frank Research



In some cities, financial and creative hubs are found in close proximity. Many of the younger bankers in London's Broadgate drink and socialise in trendy Shoreditch, meeting up with friends who work in tech firms. Financial institutions eager to attract the best graduates must now think about providing a working environment that makes them competitive vis-à-vis tech firms, while matching the needs of financial trading.

Australian banks have been trailblazers, proving both requirements can be met via innovative fit out. Hong Kong is keen to leverage this synergy between social and work life with plans to build a 'Cultural City' in Kowloon West, a new district drawing in banks. Lower rents on high quality offices are part of the draw of Kowloon West, and reduced profit margins could encourage more banks look at developments in edge-of-CBD areas in other Global Cities.

Financial firms in the core CBD are increasingly specialised and high margin, and restrictions on banks operating in high risk businesses suggest we will see more of these 'boutique' financials. This will provide demand for quality CBD offices, whether in ultra-exclusive districts, or upper floors in skyscrapers.

TEN TOP OFFICES

PARIS

Pons & Huot, 5 Place de la Bataille, Paris 10ème

This former 19th century industrial hall was restored to provide 5,800 sq ft of HQ office space. The main office floor is a 72ft solid oak unit, into which the work stations and walkways have been carved. Underneath the oak unit sits 646 cubic feet of soil which acts as the bed for the eight Ficus Panda Trees.

LONDON

Innocent, 'Fruit Towers', 342 Ladbroke Grove, London, W10

The drinks manufacturer acquired this 24,270 sq ft building in 2010 after expanding its workforce from three to 250 in just two years. The offices reflect the brand's friendly nature, having opened up the mezzanine level to improve communication between floors.

SYDNEY

Fujitsu, 118 Talavera Road, North Ryde, Sydney

Japanese multinational information technology, equipment and services company, Fujitsu, leased this 98,000 sq ft office in North Ryde, a business district to the north-west of Sydney. The space is Fujitsu's Australian HQ and represents the firm's first 'agile' work environment – a cutting edge activity-based workplace, in which nobody has an allocated permanent workstation.

LONDON

Google, Central St Giles, London, WC2

One of Google's three London offices, sustainability is a key priority. There is an allotment space for staff, and high volumes of reclaimed materials such as second-hand furniture and a jet fighter canopy have been utilised. The fitout adheres to Google's 'Red List' of products that are free of known toxins.

SAN FRANCISCO

Pinterest, 808 Brannan Street, CA 94103

Pinterest recently relocated from Palo Alto to this 55,000 sq ft renovated warehouse in SOMA. The space has been left intentionally unfinished so it can be adapted as the company changes over time, and is designed to encourage community and creativity, while actively avoiding any suggestion of decadence or success.

SINGAPORE

Reed Smith, Ocean Financial Centre, SIngapore

Elegant, refined and contemporary are the three words used to describe the international law firm's offices globally. The new office provides streamlined solutions, caters for growth and highlights innovation through materials. With a green initiative, and eventual Green Mark Gold certification, the office features a green wall at reception and green certified furniture and finishes, with the result being a calming and soothing aesthetic.

AMSTERDAM

Microsoft, Evert van de Beekstraat 354, 1118 CZ Schiphol

Employees at Microsoft's Amsterdam office have no allocated desks, and are encouraged to locate themselves in the building according to the task they are working on at any given time. Staff are also encouraged to work from home where appropriate resulting in a 50% reduction in floorspace from the company's previous office.

BANGKOK

DTAC, 319 Chamchuri Square Building, Phayathai Road, Pathumwan, Bangkok

Having acquired in excess of 300,000 sq ft over 20 floors in downtown Bangkok, the telecoms provider focused on its tagline of 'feel good wherever you are' for its fitout. The space was designed to stimulate ideas, communication, creativity and staff wellbeing. One of the prominent features is the 'fun floor' where work-related activities are strictly off-limits.

MEXICO CITY

Oro Negro, Mexico City

The headquarters of oil & gas company Oro Negro has been designed to have an ageless feel and convey a message of strength and solidity. The pattern of the Iranian Travertine marble which forms the walls was chosen to represent layers of sediment.

LONDON

Splunk, 3 Sheldon Square, W2l

The US tech firm asked Morgan Lovell to create space reflecting its brand values of innovation, disruption, openness and fun, while referencing the location of the office, adjacent to Paddington station. The open plan office has phone booths, a Tardis-style demo room, and a Pullman carriage which acts as a meeting room.

CYCLING IN LONDON

Changes in the workplace are inextricably linked to shifting attitudes of workers to both their own wellbeing and that of the world in which they live. Also, the economic impact of living and working in a global city often prompts those many to modify their behaviour in order to ease the pressure on their finances.

In London, the growing resident and working population is placing increasing strain on the city's infrastructure, which has led to road congestion and overcrowded public transport. This has caused a boom in the number of Londoners cycling to work. Cyclists now comprise an estimated quarter of all rush hour road users, while the most recent data from Transport for London indicates that the capital's cyclists now make twice as many daily trips as in 2001.

To encourage commuters away from cars and public transport, a number of initiatives have been launched.

The most recent is the Cycle Superhighway scheme, which has provided cycle routes running from outer London into and across central London. However, the initiative with the biggest profile is the Barclays Cycle Hire scheme, known colloquially as 'Boris Bikes' after the Mayor of London during whose tenure the scheme was launched.

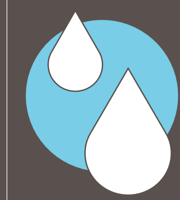
The scheme provides 10,000 bicycles located at 720 docking stations across the city, and has proved popular amongst residents and tourists. An analysis of nine million individual journeys between February 2012 and January 2013 shows the concentration of usage on certain routes; the thickness of the line on the map below shows the volume of cyclists taking that route.

While it is unsurprising that many of the most frequently used routes are between the main rail hubs and the business districts, there is considerable traffic from the east end of London, which is less well-served by public transport than other areas of London.

It could be said that the 'Boris Bike' scheme has opened up new districts in London by making them more accessible at a low cost. This accessibility can only benefit the growing markets around Shoreditch and Hackney as they expand to the east.

Cycle schemes have gained popularity in cities around the world as residents and tourists look for flexible and environmentally friendly travel options. In Europe, there are cycle schemes in cities such as Amsterdam, Barcelona, Berlin, Copenhagen, Lyon, Munich, Paris and Warsaw amongst others. In North America, Boston, Chicago, Denver, Miami, New York City and Washington have rolled out schemes, with plans afoot for schemes in a number of Californian cities. In China, the cities of Wuhan and Hangzhou have 150,000 bicycles between them, making them the largest schemes in the world.

As global cities grow and infrastructure strains to keep pace, cycle schemes offer a relatively cheap and efficient method to ease pressure on public transport, while also helping to protect the environment.



80%
drop in usage if there is rain

up to **3,000**
journeys can be happening simultaneously across the network on the busiest days

10,000
bicycles provided by the Barclays Cycle Hire scheme

720
bicycle stations located across the city

Up to **50,000**
journeys made per day

LONDON'S BUSIEST CYCLE ROUTES

BASED ON 9 MILLION JOURNEYS ON THE BARCLAYS CYCLE HIRE SCHEME (JAN-FEB 2013)

Source: Oliver O'brien, UCL CASA
Road data: OSM. Cycle data: TfL

CITIES OF OPPORTUNITY

The need for funds and institutions to focus on careful stock selection, as they appraise residential opportunities, will rise as competition increases and key stimuli for the sector are removed.

AUTHOR – LIAM BAILEY
Global Head of Research

IN THIS CHAPTER

- **We assess the residential market trends across the leading global cities to assess where investments have fared best**
- **From Political Intervention to Infrastructure; we map out the Top 5 Risks and Opportunities affecting residential property**
- **Wealth flows to global cities: our 2015 prime residential growth forecasts take the market's temperature**
- **New districts: the fast growth urban market neighbourhoods to watch**

Residential development and investment provides a high profile opportunity for property businesses to grow their brands globally. Significant investments during 2014 in Sydney, Los Angeles, New York, London and other key hubs, by some of the largest Chinese and Asian property companies, confirms the appetite for the sector.

This trend has coincided with a rapid expansion in cross-border demand for residential property from end purchasers. In most cases this demand has been led by an investment motivation, although lifestyle, safe-haven, education and other drivers have been common accompanying reasons.

With the macro-economic environment set for a shift away from stimulus measures in 2015 we believe a renewed focus on spotting micro-market opportunities is set to take centre stage.

Taking advantage of Knight Frank's Prime Global Cities Index, which benchmarks the price performance of over 30 cities, on a quarterly basis, in this chapter we provide a unique insight into the relative strengths and weaknesses of these bellwether markets.

In the year to the end of Q2 2014, our Prime Global Cities Index rose by 6% overall, up from 5% at the same point in 2013, pointing to a continuing upward trend for prime city prices.

This ongoing market strength is evidenced by the fact that the index was 36% higher than its post-Lehman low in Q2 2009, and perhaps more surprisingly 25% higher than its pre-crisis peak reached in Q2 2008.

We consider the key trends, risks and opportunities which will dictate the future performance of these critical urban markets.

Over recent years strong market performance within the world's leading city residential markets has come from all corners. Jakarta has featured prominently at the top of our growth rankings for several quarters, its growth is supported by the fact it remains one of the most affordably priced big city markets in the region.

Of all the recovery markets, Dublin has perhaps been the most obvious beneficiary of returning investor appetite. 2013 proved to be a notable turning point for Dublin's upmarket residential areas such as Dalkey and Ballsbridge. Since then luxury prices have risen strongly, by around 24%, although they still remain 35-45% below their pre-crisis peak.

RESIDENTIAL TRENDS

While the recent strength of key urban residential markets has been supported by safe-haven and wealth flows the story is much broader.

CONTINUED

Cooling measures in key Asian centres continue to weigh on prices and transactional activity, most obviously in Hong Kong and Singapore but also in Beijing and Shanghai.

Slightly over half our prime city markets, where we have the comparable data, show an outperformance in price growth over the five years to early 2014 compared to their wider national mainstream housing markets. Jakarta, Miami and London have led this outperformance.

While New York and Los Angeles appear to have had a weaker recovery compared to their national housing market, this appears to be related to the fact that the wider national house price series takes into account recent distressed sales which have unsurprisingly come from a very low base.

Street corner in Brooklyn, NYC

Skyscrapers in Dubai

36%

Prime global city price growth from market trough (Q2 2009 to Q2 2014)

25%

Prime global city price growth from pre-crisis peak (Q2 2008 to Q2 2014)

Source: Knight Frank Prime Global Cities Index

The Eastern Columbia Building Downtown Los Angeles

Pangu Plaza, Beijing's most expensive luxury apartment, Beijing, China

Similarly, while locations like Beijing and Shanghai, with 84% and 65% growth over our five year period, can hardly be regarded as slackers, even this level of growth has been insufficient to keep pace with strengthening prices at a national level.

FUTURE THINKING

Looking into 2015 and beyond, there is no doubt that a number of key market supports, which have helped to drive prices higher over the past five years, will be removed.

Investors and developers will have to accept that recent returns have been supercharged by government market support, and features like cheap finance, delivered through ultra-low interest rates, and the ability of quantitative easing to hold down the rate of alternative investment returns, will begin to be removed from 2015. Weak economic growth in Europe is likely to only delay, rather than stop, the inevitable shift to more normal economic conditions.

> "THE FACT REMAINS, THAT BY INTERNATIONAL STANDARDS, DUBAI'S PRIME RESIDENTIAL PROPERTY MARKET IS RELATIVELY INEXPENSIVE"

In short, the ability of investors and developers to enjoy healthy returns from the residential market from 2015 will require a greater investment in the search for outperformance. In lots of markets, which have prices well ahead of pre-crash peak levels, average returns will be less exciting in the next five years compared to the previous five.

How will investors secure outperformance in this new 'post-stimulus' world? There will be some opportunistic plays. For example, we believe Cape Town will be a market to watch in 2015. The weaker rand is attracting buyers from Europe and elsewhere in Africa, including wealthy Nigerians. Activity is strong on the Atlantic Seaboard and limited stock below US$470,000 is expected to lead to stronger price growth.

Economic growth will drive some markets. If we take Dubai as an example, the fact remains, that by international standards, Dubai's prime residential property market is relatively inexpensive. This, combined with the fact that the UAE economy and employment continues to grow strongly, suggests that the prime residential market in the Emirate is likely to see ongoing expansion despite new market controls, such as the doubling of transfer fees to 4% and newly introduced mortgage caps.

For other centres, the battle to secure investment returns will increasingly turn to micro-market outperformance.

While the removal of stimulus will take away a key support platform from global residential markets, our view is that in most centres the return of sustainable economic growth, especially in Europe, means the outlook for the key world centres for 2015 and beyond remains positive. Our forecast table (see left), which considers the prime city residential price outlook for 2015, identifies only Hong Kong as being at risk of a price decline next year - although several markets will be at risk of flat price growth.

Overall, key urban markets are set to weather changes to the macro-economic environment relatively well.

KNIGHT FRANK'S 2015 PRIME RESIDENTIAL PRICE GROWTH FORECAST

STRONG PRICE GROWTH
- Los Angeles
- New York
- Dublin
- Munich
- Nairobi
- Shanghai
- Bangkok

MODERATE PRICE GROWTH
- Vancouver
- Paris
- Madrid
- Monaco
- Cape Town
- St Petersburg
- Dubai
- Dehli
- Beijing
- Tokyo
- Mumbai
- Bengaluru
- Singapore
- Jakarta
- Sydney

FLAT PRICES
- London
- Rome
- Kuala Lumpur
- Geneva

MODERATE PRICE FALLS
- Hong Kong

Source: Knight Frank Research

5 TOP RISKS

1/5 REMOVAL OF GOVERNMENT STIMULI

The most obvious manifestation of this trend will be interest rate rises. It appears the UK and the US are likely to see the earliest moves in this direction; certainly the risk in Europe appears to have been pushed further down the track into 2016 or even beyond. Prime city markets are shielded to some extent by the fact they tend to be more equity rich than the mainstream national markets they sit within. The counter to this advantage is that as yields rise on alternative investments, low yielding residential property could begin to appear less attractive as interest rates begin to rise from historic lows. We expect to see a greater focus on income potential from pure-investor led projects in 2015, with increased interest in the sustainability of tenant demand.

2/5 CURRENCY INSTABILITY

There is no doubt that a weak pound was an important factor which supported London's prime market recovery in 2009, helping to deliver surprisingly strong price growth directly after the Lehman crisis.

Predicting the next currency movement to shift investor flows into international property is not an easy task. At the start of 2013, and again at the start of 2014, the widely-held view was that the dollar would strengthen throughout the year and outpace the euro. This eventuality didn't come to pass, however with the Federal Reserve likely to increase interest rates in 2015, and the ECB's move towards negative interest rates, the dollar is likely to rise – pointing to a stronger outlook for demand for prime residential property in the UK and Eurozone.

The Swiss franc's role as a safe haven during the recent crisis, goes some way to explaining the weaker demand and price growth in the Zurich and Geneva prime markets since 2012 – with increasing investment outflows, the currency could well decline in 2015, boosting inward investment in the prime city markets.

The most interesting development will be future movements in the yuan. The currency is still not fully exchangeable, but is likely to be in five years' time. Not all observers are expecting it to strengthen; there are a growing number of observers expecting a devaluation – which would dampen investment outflows into global residential property – especially property priced in currencies with a hard dollar link – Hong Kong in particular.

3/5 POLITICAL INTERVENTION

So far political interventions in the world's residential property markets, through cooling measures and limits to market access, have been concentrated in Asia, in particular Hong Kong, Singapore and China. The rising level of cross-border investment is likely to contribute to further debates in other parts of the world in 2015 on the impact of foreign buyers on local residential market affordability and stability. Changes to Canada's immigrant investor programme in 2014 could result in a slowdown in Asian buyers in particular which could impact on the prime Vancouver market; a similar debate in Australia could see a reduction in demand in key centres such as Sydney. Dubai has already seen a number of modest interventions aimed at reducing speculative purchases. The subject remains a live issue in the UK, although second-guessing the eventual direction of this debate is higher-risk than trying to forecast house prices movements.

4/5 ECONOMIC REVERSAL

While the immediate threat of a collapse of the euro has retreated, other risks have taken up the slack for those nervous of the economic underpinning of the world's key city housing markets.

With the target market for many prime residential developments becoming increasingly cross-border, a sharp reversal in the Chinese economy, probably one of the highest risk issues facing the market, threatens to undermine demand from these sources. However, do not underestimate the impact of economic uncertainty as a boost for safe-haven markets – as we note opposite in our opportunities section.

5/5 TAX

Taxation of residential property has become an increasingly live issue, especially in Europe, as governments have tried to shift the burden of taxation towards wealth and asset holdings rather than income. Ironically, taxation has also been used as a tool to reduce the impact of stimulus measures which have acted to push asset prices higher. The landscape in several countries for property taxation has undoubtedly become far less benign than it was pre-crisis, however outside of Hong Kong and Singapore; most changes have had a limited impact on demand.

FIVE TOP OPPORTUNITIES

1/5 NEW WEALTH CREATION IN EMERGING MARKETS

As we covered in-depth in the 2014 Wealth Report, the growth in global wealth, especially from emerging markets, is set to power demand for residential investment property in many key global cities. We reported that the growth in Ultra High Net Worth populations (investors with more than US$30m in investable assets) is set to rise from nearly 168,000 to over 215,000 in the decade to 2023. While the ever popular global hubs are set to take the lion's share of this investment, we also think 2015 will see a growing appetite for alternative markets and more speculative plays from investors – we note overleaf a number of 'next-neighbourhood' markets where some of this investment is likely to focus on.

MY.KNIGHTFRANK.CO.UK/RESEARCH-REPORTS/THE-WEALTH-REPORT.ASPX

2/5 IMPROVING ECONOMIC FORTUNES

The weakest spot of the world economy has, for several years, been Europe, however the tentative improvements in economic fortunes there has fed into a belief that prices for property have hit a low point, and investor appetite has returned (strongly in some markets).

Aside from Europe, there are other markets where improving sentiment and growth is helping to drive market performance – India is a notable example. The arrival of Narendra Modi's new government has led to an increase in business confidence. A focus on residential market affordability is likely to be a key plank of future policy development – creating significant opportunities for developers and funders.

MY.KNIGHTFRANK.COM/RESEARCH-REPORTS/INDIA-ECONOMIC-UPDATE.ASPX

3/5 CONTINUATION OF SAFE HAVEN TREND

Despite some easing of the crisis conditions facing the global economy in recent years, the flow of wealth from economic or political crisis locations into 'safe-haven' markets is continuing.

In markets like London, Sydney, New York, Miami and Vancouver these flows tend to reinforce demand for established market neighbourhoods, with buyers focusing on wealth preservation and looking for mature and stable markets. Even in these markets however there have been signs that safe-haven investors are willing to consider newer market opportunities – certainly Brooklyn's regeneration has been in part driven by wealthy investors looking for an alternative to rising Manhattan prices.

As prices have risen in some target markets, the opportunity for developers to attract buyers to alternative markets within the same cities, or even alternative city markets is a trend we expect to see expand in 2015.

4/5 PRICES EXPECTED TO REACH THEIR FLOOR, ATTRACTING NEW INVESTORS

Key European markets, notably Dublin, Madrid, Rome and even Paris, have experienced a long period of declining values and weak demand, as the global economic downturn was followed by the Eurozone crisis. We saw prices in the prime markets in Dublin turn up in 2012, followed by Madrid in 2013. Our forecast for 2015 confirms that there are still challenges in these markets, but there is a growing sense, certainly from investors, but also from developers, that prices are low by historical standards and that there is a considerable upside for investors moving into these markets.

We expect to see a greater focus on opportunities in markets like Paris and Rome, which thus far have been largely overlooked by investors, nervous of political uncertainty, but which are increasingly offering good value when compared to neighbouring alternatives.

5/5 INFRASTRUCTURE

So important is infrastructure that we examine it at length on p.47. For developers the issue is understanding at what point to move in the development cycle, something we have been monitoring closely in our series of reports on London's Crossrail project.

MY.KNIGHTFRANK.COM/RESEARCH-REPORTS/CROSSRAIL.ASPX

NEXT NEIGHBOURHOODS

TEN URBAN MARKETS TO WATCH

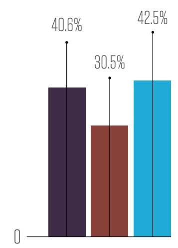
The relentless march of gentrification and upscaling of neighbourhoods in inner urban areas in the world's leading cities, offers opportunities to residents, who can access more affordable alternatives close to CBDs, but most obviously for developers and investors betting on the next new Shoreditch or Meat Packing District in which to invest.

To help you navigate the competing claims for future cool locations - Knight Frank has produced the following list of the best to watch.

PRIME CITY PRICE PERFORMANCE*, HOW YOUR INVESTMENT HAS FARED OVER THE PAST...

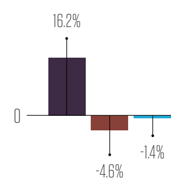
1 YEAR 2 YEARS 3 YEARS

Source: Knight Frank's Prime Global Cities Index
*Years to end of March 2014



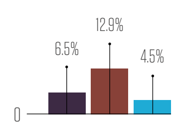
NEW YORK - WILLIAMSBURG (BROOKLYN)

While not a surprise 'tip', Williamsburg is after all the epitome of the gentrification model - a 20 year process starting with artist incomers, followed by musicians, then creative and now professional service residents. But the presence of high quality properties (lots of loft spaces), a strong lifestyle offer and convenient access to Wall Street means Williamsburg still has a long way to go.



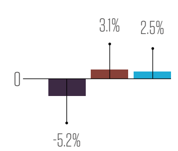
TOKYO TOYOSU - KACHIDOKI BAY-AREA

In a city as densely occupied as Tokyo, the presence of a large amount of vacant land, close to the CBD and adjacent to water means the Toyosu-Kachidoki bay-area is set to see substantial investment over the next few years. This is about as big an opportunity as you can find in Asia's most populous city.



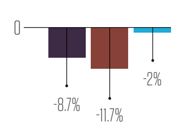
SYDNEY - BARANGAROO

Significant investment has expanded central Sydney's prime residential offer in recent years. Adjacent to the CBD, Barangaroo offers a new opportunity for growth. Its central location and waterfront views contribute to our positive view of this major dockside regeneration scheme. Over the next decade, approximately 1,000 apartments have been planned for the area, with prices averaging US$1,750 per sq ft.



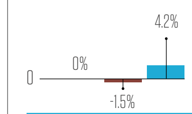
HONG KONG - KOWLOON WEST

Infrastructure investments are helping the emergence of this area as a new luxury residential area. A number of luxury residential developers will come on stream, including Grand Austin to be completed in 2015.



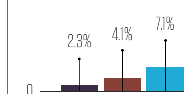
SINGAPORE - TIONG BAHRU

An old neighbourhood, which has retained more of its historic character than most of Singapore. The growth of high quality café and retail offering in recent years has helped lift values. Development opportunities are available but this is a sensitive urban area which will require skilful interventions.



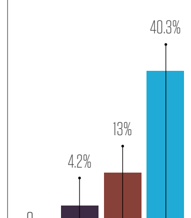
PARIS - 16TH ARRONDISSEMENT

Increasingly seen as more than just an upmarket residential area, the 16th is often compared to London's Borough of Kensington and Chelsea. Home to some of the best schools, museums, parks, and some of France's most prominent sporting hubs it is easy to see why the 16th retains its crown among the well-heeled. As a result prices have remained firm over the past five years, but importantly remain below the levels seen in the most established 6th, 7th and 8th arrondissements. If you want a safe but buzzing area this is it. Development opportunities are small scale and subject to intense competition.



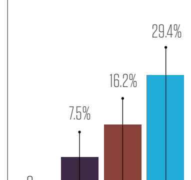
CAPE TOWN - CAPE TOWN CBD

Cape Town's CBD has seen considerable growth in both value and demand and has been a strong hot-spot in a South African context. Partially as a result of considerable residential and commercial development which has taken place already in the area, with the area's neighbourhood growing rapidly from less than 2,000 to nearly 5,000 in the past five years. New development opportunities are being released through change of use from commercial to residential.



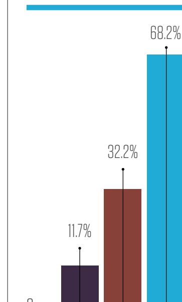
NAIROBI - RUNDA AND GIGIRI

Already affluent suburbs, these adjacent markets to the north of the CBD are seeing several development and infrastructure led improvements. The residential sector will be enhanced by several significant retail and leisure developments together with the continued expansion of the UN HQ for Sub Saharan Africa. These areas have relatively affordable values at present. These, together with room for expansion without physical challenges will offer opportunities for value growth.



LONDON - VICTORIA PARK

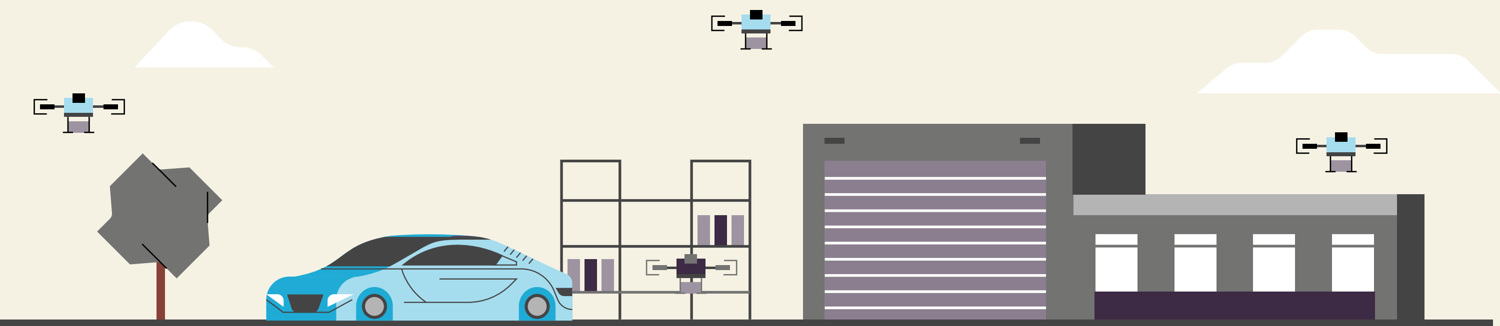
With a wealth of regeneration and gentrification stories across London, we could have equally listed Earl's Court, King's Cross or numerous significant development sites. Instead, it is Victoria Park, to the north-east of the City of London, that we settled for, with London's tech scene pushing demand and values from the south and with the Olympic Park legacy to the east, values have risen strongly in this area, but there is scope for further growth.

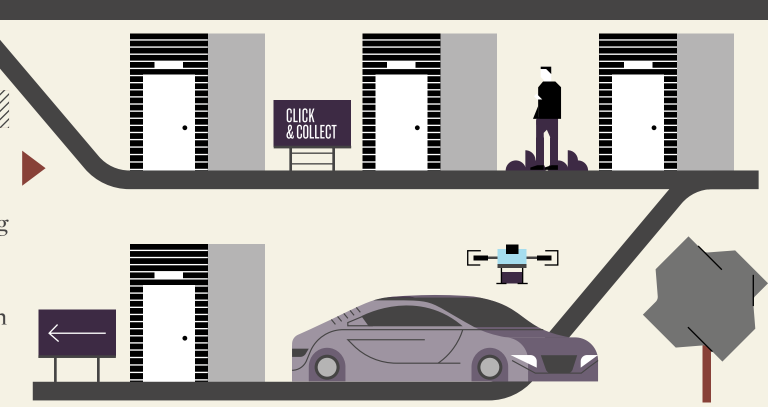


DUBAI - BUSINESS BAY

This area is close to Downtown (Burj Khalifa and Dubai Mall), with good connectivity to major arterial roads. This area is seeing a rising amount of investment with new residential and mixed used schemes currently under construction, there are projected to be upwards of 240 buildings once this area is completed. There are plans to link the sea with a canal going under Sheikh Zayed Road into the creek at Business Bay turning it into a more high-profile destination. With residential pricing starting at AED 1,200 per sq ft, the area is competitively priced compared to Downtown.

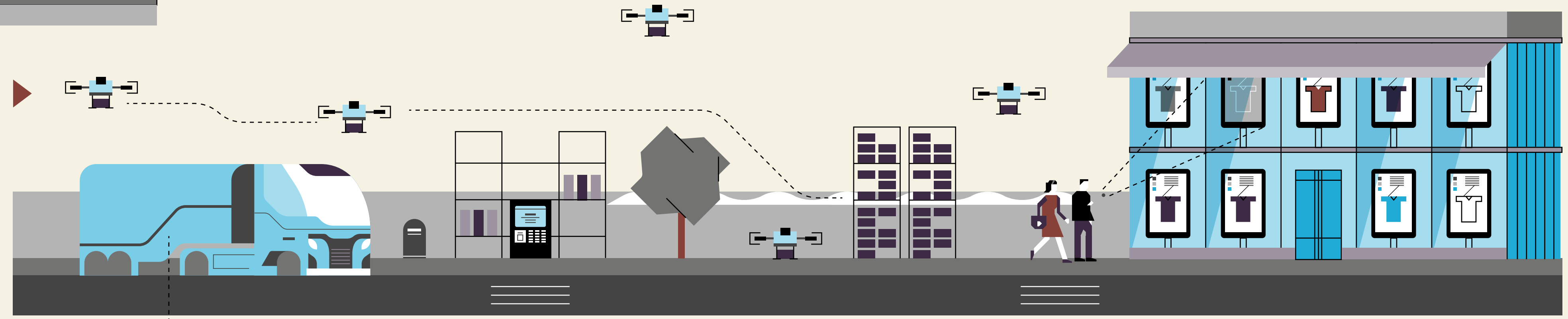
THE SHOP OF THE FUTURE





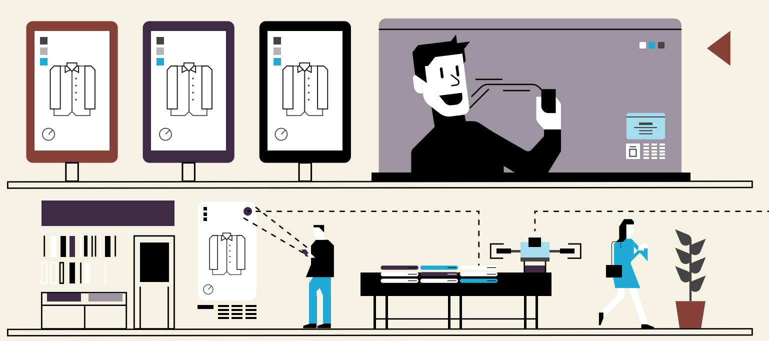
1 TRANSACTIONS

The move towards automated transactions and the 'cashless' society means that less space will be taken up by tills in store. Some companies have been installing more automated tills and touch screens as part of cost-cutting measures. Shop assistants will instead play a more 'advisory' role but will be able to process transactions from hand held devices.



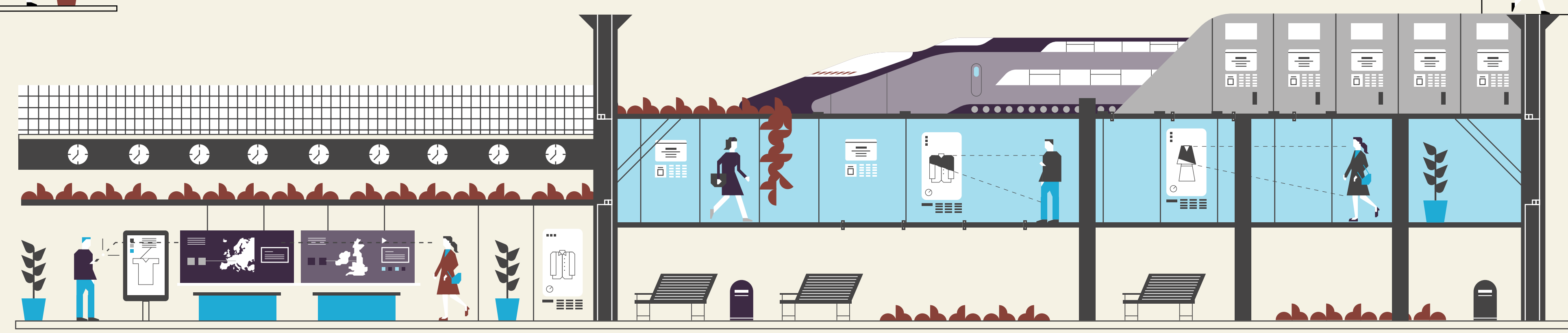
2 DRONES

Retailers will offer very quick delivery as standard, possibly the same day or even within an hour of goods being purchased, with robots or drones (as tested by Amazon) or even self-driving cars possibly being a key part of the process.



3 SHOWROOMS

More shops will function purely as showrooms rather than holding significant amounts of stock, enabling more space to be used as purely sales area. Customers will be able to buy in store and have the items sent directly to their homes.



4 EDUCATIONAL EXPERIENCE

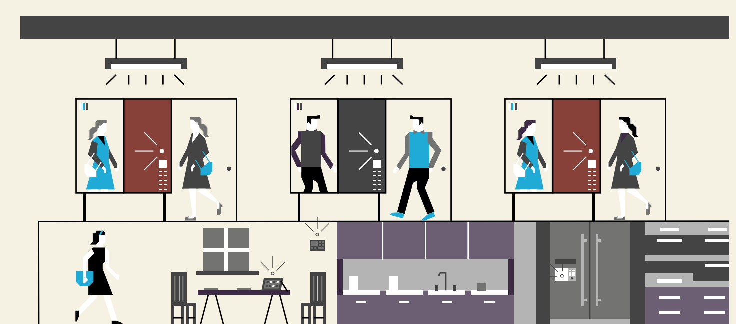
Stores will become places to inform and educate, rather than simply sales outlets. This will involve the provision of lots of information about products, how they are made and their social and environmental impact. Retailers will use high-tech gadgets and well-trained staff to educate customers.

5 CLICK AND COLLECT

Both Click 'n' Collect and Drive Thru are now established concepts but will become even more the norm in the coming years, with both offering potential growth avenues for retailers. Click 'n' Collect is likely to be the main way forward for grocery retailers, as high costs continue to weigh on home delivery operations.

6 DIGITAL SIGNAGE

High quality digital screens will increasingly replace physical store displays, so the old-style mannequins will begin to disappear. In addition, technology will allow signage to change so that advertisements can be targeted at individual customers, based on personal information given off by their smartphone as they pass by.



7 SMART CHANGING ROOMS

Customers will be able to stand in front of a smart mirror and see themselves wearing different products, from clothing to makeup.

8 BODY SCANNERS

Taking the 'augmented reality' theme a stage further, body scanners will allow shoppers to create their own personal profile and enable assistants to make recommendations.

RISING FROM THE ASHES – EUROPE ON THE WAY BACK

European real estate markets are drawing new investment, and seeing gradual improvement in occupier demand. However, the speed of recovery varies considerably across the continent.

AUTHOR – DARREN YATES
Partner, Head of Global Capital Markets Research

IN THIS CHAPTER

- **The end of uncertainty on the future of the Eurozone has drawn out property investors.**
- **The 'old continent' is seen as offering portfolio diversity and steady income by investors from emerging markets.**
- **Economic recovery already pushing up occupier demand in London and Paris, with others set to follow.**
- **Crossrail and the Grand Paris Express will create new business clusters in London and Paris.**

Europe has come a long way in the last six years – through a major recession, a short recovery, then a sovereign debt crisis. The good news is that Europe is now in recovery mode – albeit patchy – offering significant opportunities for occupiers, developers and investors.

Indeed, in June, the European Central Bank (ECB) reduced its main deposit rate to -0.1% to stimulate growth and encourage banks to lend more. The ECB will also offer cheap loans to banks at low rates until 2018, while the possibility of buying loans to small businesses in the form of bonds and quantitative easing remains open. With demand still fragile and annual inflation in the euro area currently below 1%, the measures were also designed to stave off a possible deflationary scenario and have been broadly welcomed.

However, there are reasons to be optimistic. The euro area has survived intact, despite many dire predictions of a messy break-up and peripheral bond yields are back to low levels following the unsustainable highs of 2012. Who would have thought even a year ago that Ireland and Portugal would have exited their respective bailouts, or that Greece would be back in the bond markets? While Europe is not yet completely out of the woods, things are nonetheless looking up. The key question now is can growth be sustained?

While Germany continues to be the main driver of the European economy, the encouraging trend is that growth is now more widespread across the Continent. In particular, Spain has bounced back strongly with several successive quarters of growth and, while Ireland recorded negative growth in Q4 2013, the country is seeing a better performance. The Italian economy remains weak but has stabilised and, while Portugal recorded negative growth in Q1, the country had been enjoying an export-led recovery for much of 2013. Unemployment remains a scourge across much of Europe, with youth unemployment stubbornly high, although the numbers are stabilising and are even falling in some cases.

The European property market has also seen something of a rebound – although the recovery has not been uniform across the Continent and the investment market has recovered faster than the occupational market. Prime yields for commercial property have hardened across most of Europe since the market low point in 2009. The strongest yield compression has been in core markets such as the UK and France and, while pricing has generally shown a modest rebound, prime yields in most markets remain comfortably above their market peaks. Yields for more secondary stock meanwhile have seen only a modest degree of compression.

THE RESURGENCE OF THE EUROPEAN PROPERTY MARKET

CONTINUED

European investment volumes for commercial property amounted to US$192.9bn in 2013 and we are forecasting US$215-220bn in 2014 – a rise of around 10%, which would be the best year since 2007. Volumes for all sectors have risen sharply, but most notably for industrial and hotels. One notable trend has been the acceleration in the disposal of distressed assets, with loan sales playing an increasingly important role, although the release of troubled assets on to the market has been more gradual than many predicted.

A wide variety of global investors are active in the European market, ranging from established US-based opportunistic players and North American pension funds to sovereign wealth funds from the Middle and Far East, as well as an increasing number of high net worth individuals.

US$ 103bn
European property investment in 2009

US$ 196bn
European property investment in 2013

Source: RCA

Of particular note, private Chinese capital is now emerging as a serious player on the global property investment stage, following the initial wave of investment by state-owned firms. There are also a growing number of examples of big global investors with abundant capital teaming up with domestic players who provide local expertise.

Investment bright spots in Europe have included the UK and Germany which continue to see a solid level of activity, with investor interest in the UK regions picking up markedly. The peripheral markets (notably Spain and, to a lesser extent, Italy) have continued to see greater interest from investors in search of value, albeit demand is focused keenly on prime assets let to strong covenants.

However, while the gateway cities of London, Paris and the top German cities continue to attract strong demand, cities such as Dublin, Edinburgh, Barcelona, Brussels, Rome and Milan are increasingly on the radar. Russia meanwhile has experienced a marked fall in deal volumes, with investors clearly taking a negative view of the crisis in Ukraine.

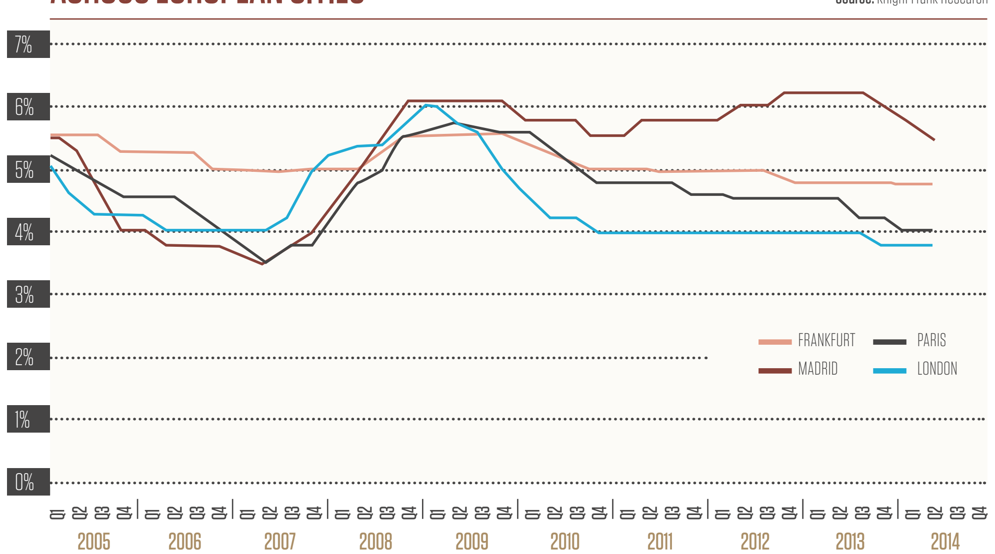
> "THE NEXT 6-12 MONTHS WILL BE TOUGH AND WE MAY SEE THE ODD CRISIS. BUT THE IMPORTANT THING IS THAT GROWTH HAS RE-EMERGED ACROSS MOST OF EUROPE"

While much of Europe continues to see high levels of unemployment and weak consumer spending, European retail's strong 2013 continued in to 2014. A number of significant shopping centre deals were concluded in the first half of the year, including Unibail-Rodamco's US$727.6m acquisition of a 50% stake in CentrO in Oberhausen and Intu's US$1.45bn purchase of Westfield Derby, Sprucefield Retail Park in Northern Ireland and a 50% stake in Merry Hill in Birmingham.

Occupier markets have been recovering at a slower pace than the investment market – as is normally the case - with trends generally mirroring the wider economic picture. Rental growth has been limited to date, with the exception of a handful of core markets. However, one encouraging trend has been in the periphery, notably Dublin, where rents have risen sharply, while rents in Madrid have reached their floor.

EUROPEAN PRIME OFFICE YIELDS ACROSS EUROPEAN CITIES

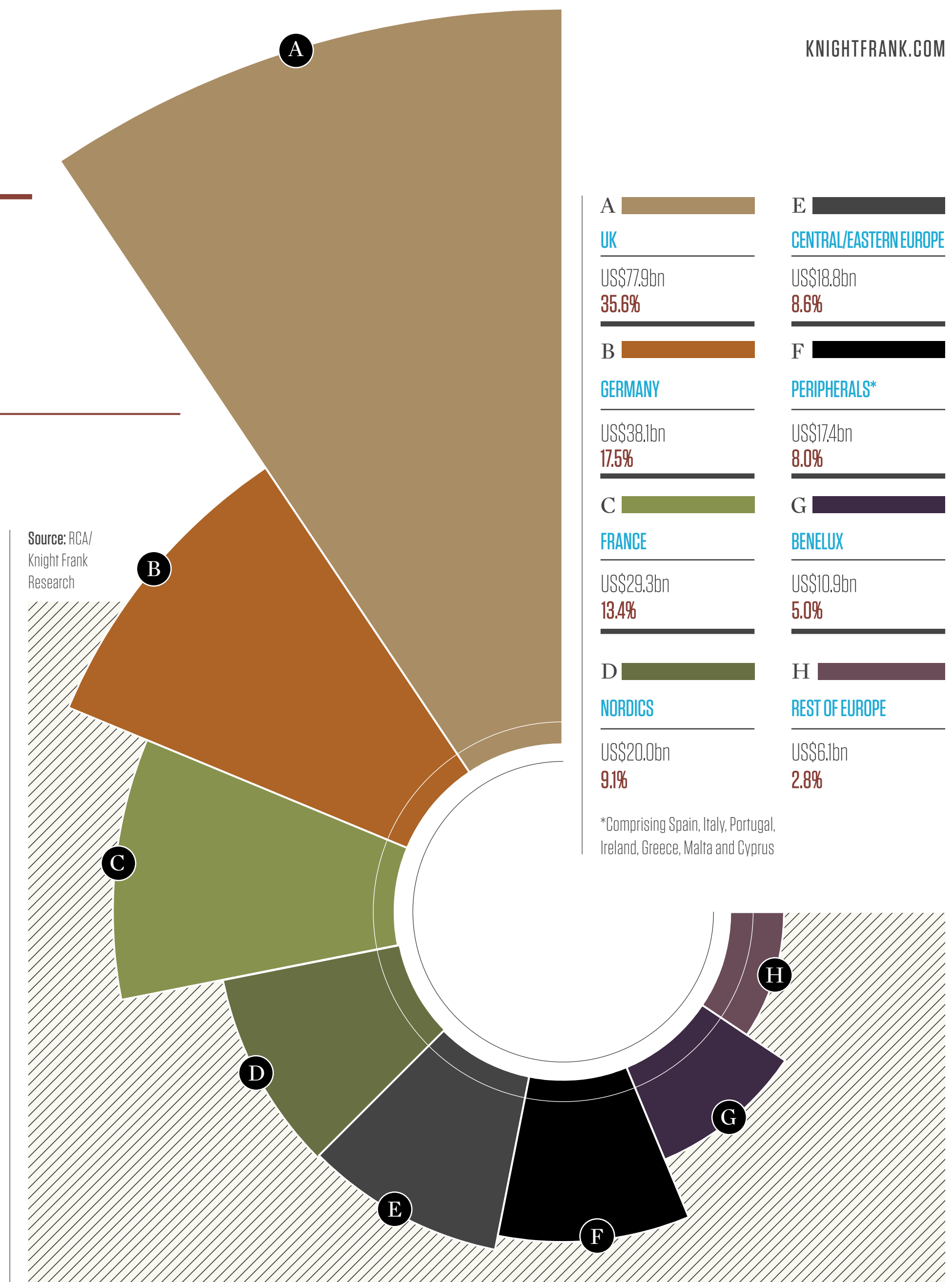
Source: Knight Frank Research



DESTINATION OF EUROPEAN INVESTMENT

YEAR TO Q2 2014

Source: RCA/ Knight Frank Research



Take-up is accelerating, with 2014 producing solid data for Paris and London, while a number of key German cities have also been strong. Low levels of development since the global financial crisis have helped to keep vacancy rates on a steady downward trend in most core markets. Steadily improving business confidence, combined with limited availability, should lead to stronger take-up and the return of rental growth in 2015.

Development is picking up on the back of stronger economic growth and the improving availability of finance. However, there are some issues of potential over-supply, notably in parts of Central and Eastern Europe such as Warsaw and Prague, which has led to a softening of rents, while the Ukraine crisis has compounded the weakness of an already slowing Moscow market. On the whole though, the increase in development will provide a boost to economic growth and much needed regeneration in many areas.

In fact, regeneration will be a key source of opportunities for occupiers, developers and investors, with Europe now seeing an increasing number of redevelopment projects such as former public housing blocks, disused barracks (e.g. Prague 8 Karlín near Florenc in the Czech Republic) and railways sites (e.g. the Manchester Exchange railway station site in Salford, UK) being kick started again. Opportunities will continue to emerge from distressed sales and the disposal of publicly-owned assets, as governments pursue their debt reduction strategies.

So, what do we see for Europe going forward? Europe's longer term future is undoubtedly bright. The 'Old Continent' remains a beacon of culture, democracy and the rule of law and continues to be a magnet for skilled people seeking to better themselves and companies looking to access wealthy markets.

The next 6-12 months will be tough and we may see the odd crisis. But the important thing is that growth has re-emerged across most of Europe, including parts of the periphery, while business and consumer confidence is undoubtedly improving.

Occupier activity will steadily increase as the economic recovery takes hold more widely, with growth

9.3m
sq ft take-up in Central London in 2009

13.4m
sq ft take-up in Central London in 2013

Source: RCA

in technology and infrastructure among the main drivers. The European logistics sector in particular will benefit from the steady growth in online retail across the Continent, while the property investment 'universe' will continue to expand, with alternative sectors such as hotels, healthcare and student housing becoming increasingly part of the mainstream.

And, finally, while the short term economic forecasts are relatively muted, these are likely to be revised up in the coming months, as sentiment begins to change for the better. No one said it would be quick or easy, but Europe is finally turning the corner and we can be more optimistic about the future than we have been for some time.

THE IMPORTANCE OF INFRASTRUCTURE

Infrastructure is critically important because it underpins our entire social and economic fabric.

Around the world, governments are investing billions in infrastructure, whether it is utilities, transport, telecommunications or buildings.

Modern infrastructure, economic growth and the creation of real estate opportunities all go hand in hand. Two of Europe's leading cities - London and Paris - are seeing significant investment in infrastructure. Both cities will see major new rail networks in the next few years, namely Crossrail in London and the Paris Grand Express.

> “THE ENHANCED TRANSPORT NETWORK IS THEREFORE LIKELY TO LEAD TO A SIGNIFICANT INCREASE IN DEMAND FOR PROPERTY AROUND THE MAJOR TRANSPORT HUBS”

A key aim for both projects is to enhance the movement of an increasing number of passengers around their respective cities, thus future proofing their growth as key Global Cities. In the process, they are acting as catalysts for new development and the creation of new commercial hubs.

In London, Crossrail has been described as a "game-changer". Forecasts suggest that Bond Street, Tottenham Court Road and Farringdon stations could handle 165 million additional passengers a year above current levels. An extra 1.5 million people will be able to reach Central London within 45 minutes. At Liverpool Street, Crossrail will provide the transport capacity to support the rise of the new Tech City IT hub.

The enhanced transport network is therefore likely to lead to a significant increase in demand for property around the major transport hubs. A significant amount of new development will be needed across a number of sectors – including retail, offices, hotels and residential, with locations like Canary Wharf, Whitechapel, and Paddington likely to benefit. Rail lines will extend from London into surrounding counties, reaching Shenfield in Essex and Reading in Berkshire.

In Paris, the Grand Paris Project was first announced in 2007, in order to provide improved government in Paris and better integrate the city core and its surrounding locations.

The Grand Paris Express will comprise new metro lines joining up the outer suburbs, instead of running through central Paris. A series of local economic development plans are also being implemented to create commercial hubs close to new stations. These include the Paris Saclay project which will create a major hub of innovation, effectively France's Silicon Valley.

While the first trains are expected to run in 2017/18, the experience of Crossrail was that property values started to benefit from the moment building commenced. Capital values for all types of commercial properties within 1km of a Grand Paris station could receive a boost of up to 15%. Locations expected to see significant benefit from improved transport connections include Batignolles/Saint-Ouen, Villejuif/Arcueil, Saint-Denis Pleyel, Noisy-Champs and Saclay/ Vélizy/Massy.

Paris, La Défense business district – a stop on the Grand Paris Express

INFRASTRUCTURE PROJECT DETAILS

	PARIS GRAND EXPRESS	LONDON CROSSRAIL
SCHEDULED COMPLETION DATE	Partial completion in 2017/18, with final completion by 2030	2018
NUMBER OF NEW LINES	4	1 (plus spur to Heathrow and a second branch line to Abbey Wood)
NUMBER OF STATIONS	72 (57 new)	37 (incl. nine new stations)
COST	US$41.9bn	US$25.2bn
PROPERTY DEVELOPMENT	A whole range of real estate opportunities, from residential to commercial, with 1,600 m sq ft of development and construction planned in locations connected by the Grand Paris Express	More than 3.0 m sq ft of office, retail and residential space is planned for above the central London stations

Source: Crossrail and Grand Paris web sites

Source: Crossrail

1.5 MILLION

estimated number of extra people who will be able to reach Central London within

45 mins

Source: Arup

166 MILLION

Additional passengers delivered with Crossrail in London, Bond Street, Tottenham Court Road and Farringdon stations

Q+A

PARIS LEADING THE WAY

INTERVIEW:
Jean-Louis Missika

RESPONSIBLE FOR URBAN PLANNING AND ARCHITECTURAL ISSUES IN THE OFFICE OF THE MAYOR OF PARIS

Jean-Louis Missika examines what makes Paris so attractive and how the city will evolve over the next few years.

Q What makes Paris attractive (to people and businesses) as a global city?

A Paris' dynamic economy and ambition for innovation nurture entrepreneurial excellence and audacity, as well as attracting talent and investors. Already ranked first in the world for innovation and intellectual capital, Paris is now ready to move from the experimental stage to a higher plane, implementing urban innovation, sustainable energy solutions and digital applications throughout the city. New, state-of-the-art hubs which merge business incubators, co-working areas and multifunctional workspaces will continue to be created, and the city's innovative ecosystem will become more international. Between now and 2020, one billion euros will be invested to support Paris in its ambition of becoming a smart city and an international standard-bearer for innovative territorial development, participatory democracy, sustainable development, the digital economy and the transition to new energy sources.

Q What can politicians do to enhance this?

A Current reports show that Paris is home to a remarkably vibrant economy. The capital owes these positive results to the proactive policy in force since 2001, its rich business network, and the influx of foreign investment, which has doubled in 10 years. These efforts must be maintained and reinforced, especially in the field of open and participatory innovation. The City of Paris promotes connections between small and large businesses, between entrepreneurs and investors. These efforts to encourage links between the different players in the Parisian economy are vital to the politics of the years to come, as they allow people to join forces to enrich the economy together.
As well as reinforcing and consolidating our most dynamic sectors, such as tourism and digital technology, we shall promote new activities that generate high added value and job opportunities. We shall continue to improve the appeal and quality of reception at decision-making centres such as the headquarters of international groups and major economic players. We must also preserve Paris' status as a strong financial base by supporting its banking sector and ensuring fast, secure transactions.
Lastly, Paris boasts unique assets in terms of facilities for families, healthcare, parks, culture, services and living environment. It remains committed to preserving and improving its heritage and cultural richness to offset the inevitable constraints of urban development, such as pollution and traffic congestion.

Q What are the emerging locations in the city?

A Ten percent of the city's area has been enhanced by development projects since 2001. Various new neighbourhoods are currently on the rise: Paris Rive Gauche and Clichy Batignolles, for example. The 'Paris Nord Est' area will be the largest site of upcoming developments, followed by Bercy-Charenton and the Boulogne/Foch area. All of these neighbourhoods will be at the forefront of urban innovation and ecology.
At the same time, we plan to construct the 'Arc of Innovation', building the Paris of the future by using the territory close to the ring road to install multi-faceted projects combining housing, work spaces and facilities, offices, business incubators, co-working areas, research institutes, and businesses of varying sizes. This 'Arc of Innovation' will be developed in partnership with the neighbouring communities and, as part of the project, the extension of tramline T3 (also known as the Maréchaux tramline) will be completed.

Q What are the growth industries?

A The industries for which Paris is famous – luxury goods, fashion and tourism – continue to thrive, with steady growth and highly positive financial reports. However, growth is not limited to the traditional sectors: solid progress is being made by the high-tech industries of biotechnology, sustainable development, digital technology, and the smart city, all of which are supported by specific projects led by Paris City Council.

Q How do you see the future of Paris?

A Anne Hidalgo's election as Mayor marks Paris' entry into a new era, in which the city's place in the circle of attractive, competitive global cities will be cemented thanks to an active economy and technological innovation. Paris has an audacious future ahead of it: conserving the aspects that define it – its distinctive architecture, high urban density, cultural intensity, rich historical heritage, and public services – whilst increasing its international competitiveness and its position in emerging markets. This urban dynamic is the driving force behind enriching projects for the Parisian ecosystem, such as the world's largest incubator (1000 Start-ups), which is to be installed in the Halle Freyssinet. The Arc of Innovation will fortify this dynamic, driven not only by economic growth but also by sustainability and responsibility and, in doing so, will add to numerous inspiring projects launched under Bertrand Delanoë's mandate, of which Velib, Autolib, the tram system and the development of the riverbanks are just a few of the finest examples.

Q How important is infrastructure to a city and how will the Grand Paris project impact on the city?

A Paris is Europe's most accessible city. The interconnections between its various infrastructures create an exceptionally rich transport network, with six major railway stations, five RER lines, 16 metro lines, one tramline, 74 bus lines and connections to six motorways. In addition, the Ile-de-France region is equipped with top-class infrastructure: it is the second largest air transport hub in Europe, offers access to the TGV high-speed railway network and boasts extensive transport solutions, including 210 km of metro lines, 1,400 km of RER and railway lines, 3,000 km of bus lanes and 2,100 km of major roads and motorways. With 70 ports spread out along 500 km of navigable waterways, the region is also Europe's second largest river transport hub, a status which looks to be reinforced by the Axe Seine development project.

> *As well as reinforcing our most dynamic sectors, such as tourism and digital technology, we shall promote new activities that generate high added value*
>
> JEAN-LOUIS MISSIKA

Paris' two airports serve almost 90 million passengers each year. This accessibility is strategically valuable, and we are developing it further by way of the extension of tramline T3 and the Grand Paris Express metro project which is under way.
The Grand Paris project will allow the city to upscale and to renew its links with neighbouring towns. Grand Paris will build upon proactive policy-making to focus on more accessible housing, smoother journeys and efficient social policies, whilst promoting economic growth and the transition to alternative energy sources.

THE ROLE OF ENERGY IN EUROPE

DAMON VANCE
HEAD OF OIL ANALYSIS
AT GLENCORE

Energy is crucially important to all industrialised countries because it lies at the heart of all commercial and social activity. In Europe, its importance has been highlighted in recent years due to sharp price increases, not to mention an often tense relationship with Russia, which supplies over half the EU's imports of fossil fuels and over a third of its oil. In fact, the EU is the largest energy importer in the world.

However, European fossil fuel demand is in the midst of a downward spiral despite a fledgling economic recovery. EU oil demand peaked back in 2005 at 15.1 million barrels per day (mmbd), has fallen to 12.8 mmbd in 2013, and is forecast to be 2% lower by the end of this decade. The 16% drop in just eight years stands in stark contrast to the 13% rise in oil demand for the remainder of the world over the same period of time.

Whilst oil has seen the steepest drop in the fossil fuel category, natural gas, coal, and nuclear demand have also shown relatively big declines. Renewables including wind, solar, and biomass make up the smallest absolute proportion of energy demand but have been increasing at 15-20% per annum over the last eight years and are up by 225% overall since 2005.

In many ways, Europe has become far less dependent on energy with the declining structural demand detailed above, increasing efficiency, dieselisation of the automotive fleet, and slowing population growth rates.

In housing terms, increasing urbanisation, the focus on environmentally conscious building standards (LEED), the breakthrough of 'smart'technology (Nest Thermometers), LED light bulbs, highly efficient new appliances and much cheaper solar panels – all have the ability to significantly lower home energy use.

However, there are a few potential issues in European energy markets that could threaten the stability of the region. Firstly, largely as a consequence the drop in demand and the unsophisticated/high input and labour costs of European refiners, approximately two million barrels per day of net refining capacity has permanently closed since 2008.

Secondly, Europe depends on Russia to a large degree for natural gas imports and to a far lesser degree for diesel imports. Given the upheaval seen recently with events in Ukraine, the reliability and price of that natural gas source is being called into serious question. Third, the largest source of 'domestic' European crude supply is the North Sea (mostly UK and Norway), for which production has halved over the past 10 years.

If you take those three elements together, Europe produces less crude oil, has fewer refineries to turn that oil into transportation products such as diesel and gasoline, and has a less reliable source of natural gas imports to heat homes and businesses.

On the bright side, fracking technology – which has been a game changer in the US – offers similar potential in Europe. However, progress to-date has been slow, due mainly to environmental concerns and difficulties in gaining drilling permissions.

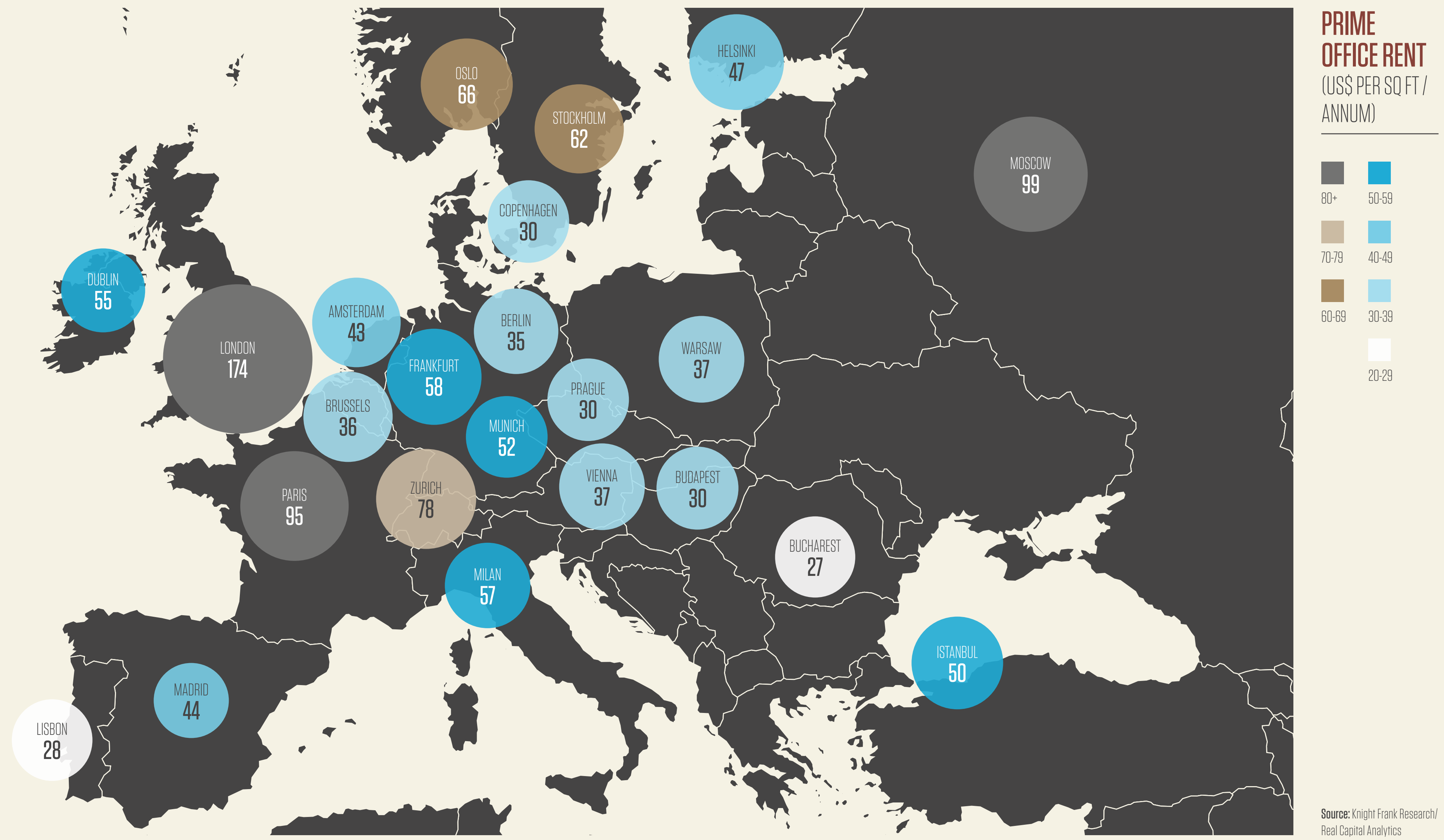
So, with a shale revolution unlikely in the short term, how will Europe balance the need for reducing carbon emissions with greater energy independence? Greater pan-European cooperation will be encouraged by the recent crisis in Ukraine, which has pushed the European energy debate up the agenda. For now though, the sensible way forward would seem to be an appropriate mix of sustainable fossil fuels, safe nuclear, renewables and – of course – greater efficiency.

With buildings still accounting for around a third of the EU's greenhouse gas emissions, it is here that real estate can play its part. While much progress on building efficiency has been made in recent years, both residential and commercial property still have a huge role to play in shaping Europe's energy security.

> *European fossil fuel demand is in the midst of a downward spiral despite a fledgling economic recovery*
>
> DAMON VANCE

MAPPING THE EUROPEAN COMMERCIAL PROPERTY MARKET

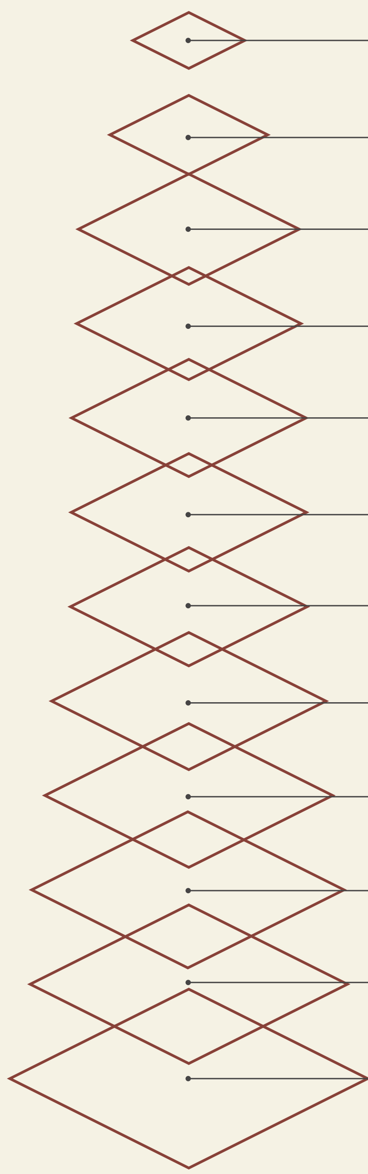
Commercial property values vary widely across Europe, with the largest and most established markets of London and Paris being the most expensive in terms of rents.



Source: Knight Frank Research/ Real Capital Analytics

HOW MUCH PRIME OFFICE SPACE DOES US$100M BUY?

(SQ FT)



City	SQ FT
London	21,593
Paris	42,072
Frankfurt	81,307
Munich	83,839
Dublin	91,514
Milan	92,032
Moscow	93,191
Madrid	124,674
Amsterdam	136,888
Warsaw	160,990
Brussels	166,073
Prague	210,697

Source: Knight Frank Research

KEY MARKET DRIVERS

AEROSPACE
TECHNOLOGY
FINANCIAL
TOURISM
HEALTHCARE
ENERGY
AUTO MANUFACTURING

AMSTERDAM

Amsterdam is popular tourist destination, and a leading financial and professional centre. Schipol Airport is a core asset to the economy. The office market has evolved beyond the city centre, with the rise of the Zuidas district.

BRUSSELS

This is a capital city twice over, being the capital for Belgium and The European Union. Inevitably government is a large part of the economy. The office market has lately seen rents stabilise..

DUBLIN

Home to a large number of multinationals, notably in the technology sector, including IT, Pharma and Digital Media. Commercial property has seen a significant rebound in the last 18 months.

MUNICH

One of Germany's wealthiest and fastest growing cities, which ranks consistently highly in terms of business, innovation and quality of life. Recent property market trends have been very upbeat.

LONDON

London has swung from being strongly financial and business services led, to a more diverified city today with fast growing technology and creative industries. The new Crossrail project has created real estate investment opportunities.

MADRID

Madrid is a diverse and vibrant city which is the economic, financial and cultural heart of Spain. After several very tough years, commercial property markets are now firmly in recovery mode.

MILAN

The commercial capital of Italy and home to a wide range of national and international companies. Milan is seeing significant urban renewal and, appropriately, is hosting Expo 2015.

MOSCOW

Commercial property markets in the Russian capital have developed very rapidly over the last decade. The new skyscrapers of the Moscow-City business district are symbolic of the city's commercial growth.

PARIS

Paris is a major global economic centre, which is home to the worldwide headquarters of more Fortune Global 500 companies than any other city in Europe. Office market activity slowed in 2013, but has shown signs of recovery in 2014..

PRAGUE

Recent years have seen a dramatic shift from an industrial-based economy to a strong bias towards services. Prague is home to a wide variety of companies and numerous projects are underway which will enhance the city's transport network, public spaces and real estate infrastructure.

FRANKFURT

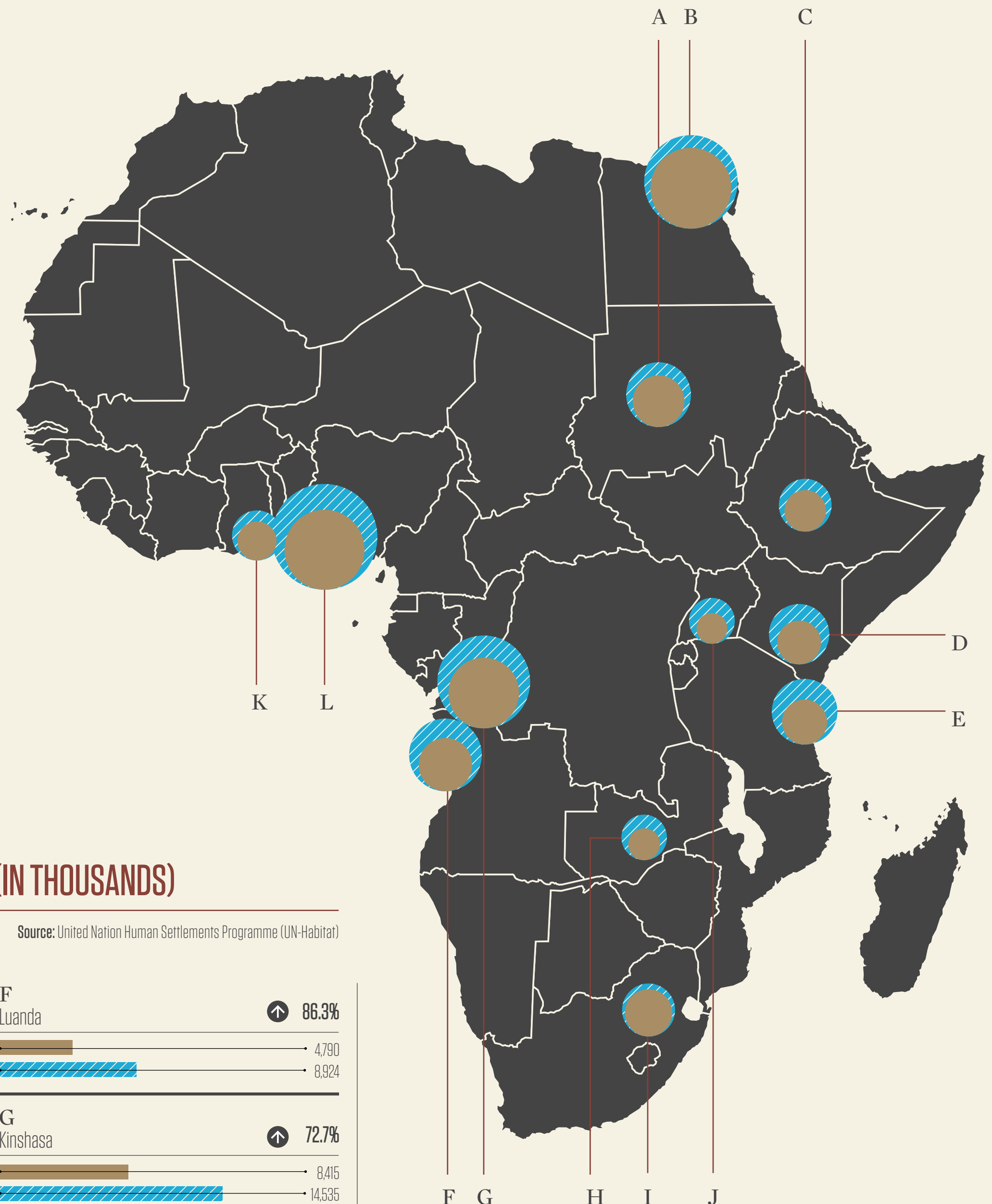
Frankfurt has a large exposure to finance and business services, although it is a major transport hub, and known for its trade shows. The office market has struggled with high a vacancy rate, but rents are again rising.

WARSAW

The economy largely escaped the global financial crisis, as did the property market. Significant investment in infrastructure in recent years, including a second metroline which should complete in 2014.

PROJECTED AFRICAN POPULATION GROWTH AND MIDDLE EAST KEY DRIVERS

Cities in Africa will be among the fastest growing in the world.



POPULATION GROWTH 2010-2025 (IN THOUSANDS)

2010 · 2025

Source: United Nation Human Settlements Programme (UN-Habitat)

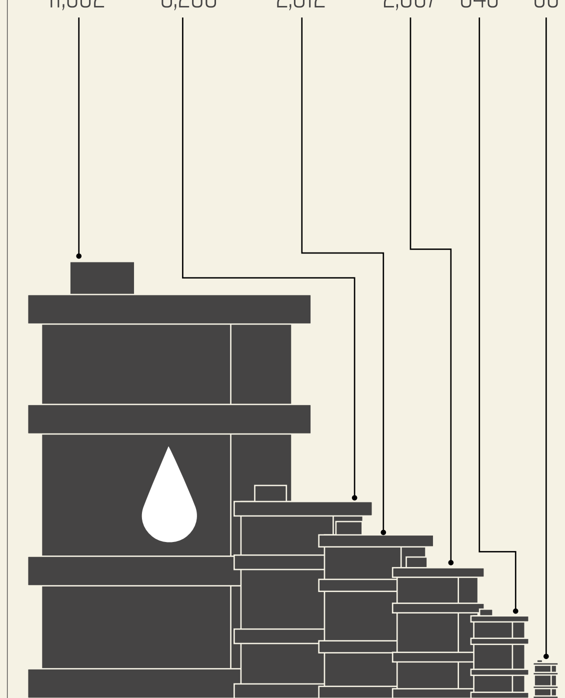
			2010	2025
A	Khartoum	57%	4,516	7,090
B	Cairo	33.6%	11,031	14,740
C	Addis Ababa	61.2%	2,919	4,705
D	Nairobi	89.8%	3,237	6,143
E	Dar es Salaam	113.1%	3,415	7,276
F	Luanda	86.3%	4,790	8,924
G	Kinshasa	72.7%	8,415	14,535
H	Lusaka	103.4%	1,719	3,496
I	Johannesburg	25.8%	3,763	4,732
J	Kampala	122.1%	1,594	3,540
K	Accra	64.3%	2,573	4,228
L	Lagos	74.8%	10,788	18,857

Middle East property markets are benefiting from an improving global economy.

THE MIDDLE EAST IN FIGURES

OIL PRODUCTION

(THOUSAND BARRELS PER DAY)



Global Rank		
02	Saudi Arabia	11,592
06	UAE	3,230
11	Kuwait	2,812
15	Qatar	2,067
23	Oman	945
63	Bahrain	55

A — **23%** of Saudi Arabia's oil is for local consumption

B — **$25bn** of projects under construction in Qatar

C — **50%** rise in new construction schemes in Kuwait in 2014

D — **70%** of UAE's GDP is now non-oil

E — **1st** Dubai International now the world's busiest airport

F — **2.1m** tourists visited Oman in 2013

Source: Knight Frank/International Monetary Fund/Population Research Bureau/ US Energy Information Administration/World Bank

THE AMERICAS- DIVERSIFYING MARKETS

A new era of abundant energy and perpetual technological change is creating opportunities for commercial property investors.

AUTHORS — ROBERT BACH
Director of Research - Americas, Newmark Grubb Knight Frank

— JONATHAN MAZUR
Tri-State Managing Director of Research, Newmark Grubb Knight Frank

IN THIS CHAPTER

- **Early investors in Class A properties are flipping them for handsome profits in global gateway cities.**
- **Central city neighborhoods are attracting educated millennials and the companies that want to hire them.**
- Some analysts and authors have disparaged American suburbs, but these are bouncing back with the housing market, creating opportunities for investors.
- **Risks to investors at this stage of the cycle include tighter monetary policy, rising construction and the side-effects of fiscal austerity – most visible in Washington, D.C.**

For the Americas section of this report, Newmark Grubb Knight Frank was asked to profile five cities — not an easy choice given the many cities across the western hemisphere that offer interesting opportunities. New York, the largest urban area in the U.S., was an obvious choice, as was the nation's capital, Washington, D.C. We bypassed Los Angeles and Chicago, to focus instead on San Francisco and Houston, because technology and energy are driving the U.S. economy. Our fifth choice was Mexico City, the largest urban agglomeration in the Americas.

Several of the catalysts profiled elsewhere in this report are driving property demand across the Americas. Most notably, the unprecedented policies of the Federal Reserve to keep interest rates low and spur businesses to hire have pushed investors into riskier, higher-yielding assets, including commercial real estate. The grab for trophy properties in the leading American cities began shortly after the recession ended. Investors have begun to flip those properties and recycle their capital, often in secondary markets offering a higher initial yield.

Leasing markets have returned more slowly, but nevertheless continue to improve. CBDs and nearby residential neighborhoods have flourished, while the recovery in the suburbs has trailed.

As the Federal Reserve continues to wind down quantitative easing, the debate among economists has shifted to when the Fed should begin raising interest rates.

The Fed's decision will reverberate throughout the investment world, including commercial real estate, and beyond U.S. borders. Financial market reaction last year when the Fed first hinted it would start to wind down QE, dubbed the 'taper tantrum', saw money exit Latin America and other emerging markets. Mexico, however, was buffered by its close economic ties with the recovering U.S., while the formation of Mexican REITs (FIBRAs) attracted capital to the country's property markets.

Our view is that the economy will be strong enough to withstand a gradual rise in interest rates beginning in the first half of 2015, but not without some volatility in the capital markets. Expect property leasing market fundamentals to continue improving gradually over the next two years, helping to buffer the impact of higher interest rates on asset prices. Class A prices in gateway cities will prove more resilient to rising interest rates than prices for Class B and C assets in secondary markets.

NEW YORK

New York City (NYC) is the premier gateway market for international investment in the United States. With a population of 8.4 million (19.9 million in the larger catchment area), it is the largest city in the country. NYC's economy proved to be surprisingly resilient during the financial crisis and recession despite its role as the global financial capital, thanks in part to its increasingly diversified business mix.

Manhattan is the epicenter of this market with over 447 million square feet of office space. FIRE (finance, insurance, real estate) remains an anchor, but increasingly TAMI (technology, advertising, media, information) has become a bigger slice of the employment picture. Moving forward, the healthcare and education sectors will play a growing role as well.

FIRE companies historically have been focused on Midtown Manhattan. While TAMI companies are looking beyond Midtown to Midtown South, Downtown and Brooklyn (across the East River). Initially, lower rents were the draw, but rents are, in some instances, approaching Midtown levels.

Property sales prices are nearing 2007 peak levels. With interest rates low in the short term and institutions flush with capital, domestic and international buyers are chasing opportunities. Several landlords who purchased buildings between 2008 and 2010, when the market was depressed, have flipped their assets for substantial profits.

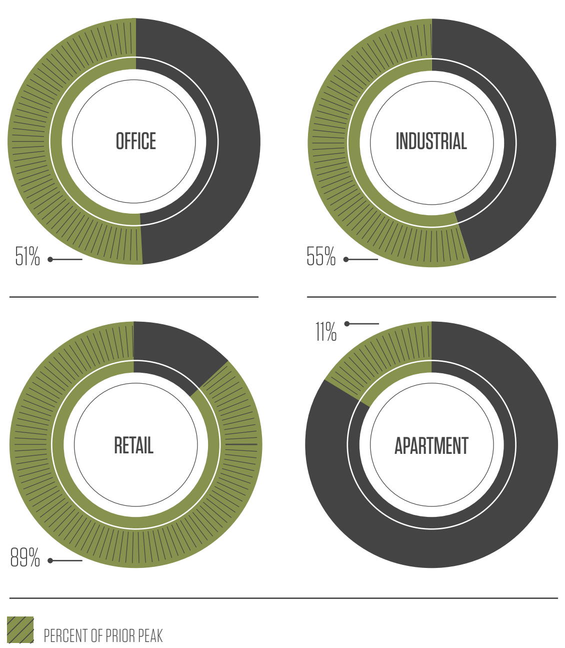
New developments are underway, including the World Trade Center redevelopment Downtown and the ground-up Hudson Yards development in Midtown South. Even Midtown is likely to see new office buildings rise by the end of the decade.

Risks: a financial services industry coping with tighter regulations; another tech bubble; a higher vacancy rate in the near future due to new construction and revised workplace strategies; and a high cost of living and doing business.

Advantages: a safe and liquid global market; a diversified economy; 24/7 environment.

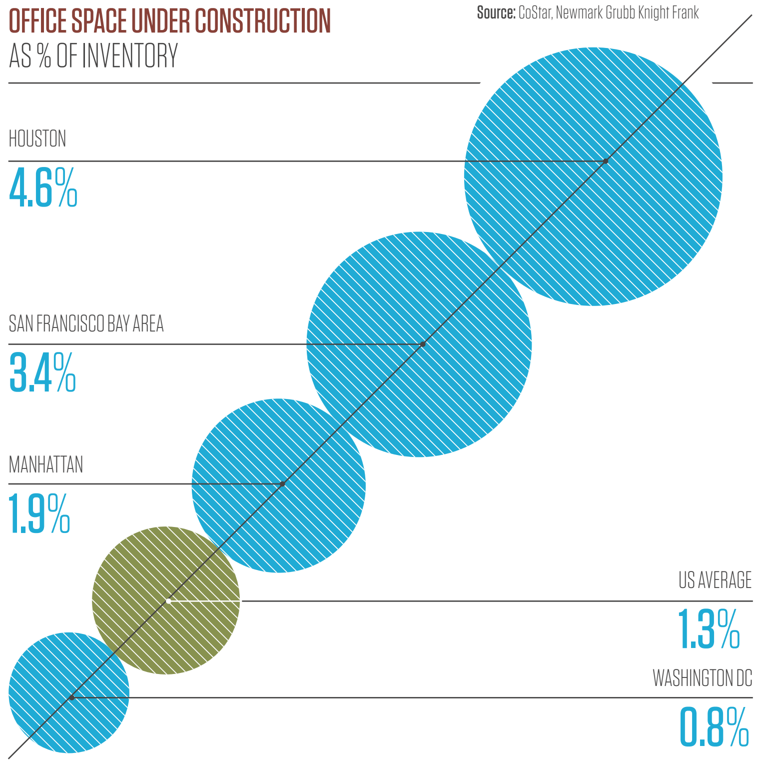
US SPACE UNDER CONSTRUCTION
PERCENT OF PRIOR PEAK

Source: CoStar, U.S. Census Bureau, Newmark Grubb Knight Frank



OFFICE SPACE UNDER CONSTRUCTION
AS % OF INVENTORY

Source: CoStar, Newmark Grubb Knight Frank



'Burbs Bounce Back

"Reports of my death have been greatly exaggerated," said Mark Twain, and the same is true of the suburbs, where office vacancy rates, though higher than in CBD markets, have been falling faster lately. Suburbs suffered inordinately from the housing bust and the related plunge in construction jobs. However, the rebound is pumping new life into suburbs, particularly communities that offer walkable, mixed-use districts to complement traditional single-family neighbourhoods. Many of these districts qualify as suburban downtowns and feature good transit linkages to their region's primary downtown and other destinations.

Not all suburbs fit this profile, however. In some communities lacking these advantages, home prices have stagnated, crime has increased, and school districts have struggled to maintain standards in the face of declining tax revenues. In some ways, American suburbs are becoming more like cities with diverse demographic profiles, a mix of land uses, and varying housing types.

The 'burbs are bouncing back in the capital markets, too. The recovery in asset pricing began later in the suburbs, but prices are trending higher as investors transition into markets that are earlier in the recovery cycle. Nationally, CBD office properties set a new pricing peak in September, 2013, according to the Moody's/RCA Commercial Property Price Index. Suburban office prices have retraced only about one-third of their recessionary decline.

WASHINGTON, D.C.

As the nation's capital, Washington, D.C. weathered the recession better than nearly every other metropolitan economy. But job growth since then has been disappointing due to the shrinkage of government employment and related sectors, a trend that could persist for several years. This has affected the leasing market in the form of weak absorption, minimal rent growth and rising vacancy rates.

Government contractors dominate the office tenant base in Northern Virginia; law firms and the federal government occupy almost half of downtown D.C.; and the life sciences and financial firms are the largest industry sectors in suburban Maryland.

Despite soft leasing market conditions, the property sales market is performing well thanks to Washington's position near the top of the list of cities targeted by global capital. There is significant demand for product near transportation centers, which makes downtown D.C. currently more valuable than the suburbs. Downtown prices have risen steadily since 2009 and are 20% higher than one year ago. Cap rates have stayed within a tight range, between 5.4% - 6.0% over the past two years.

Metrorail is opening the new Silver Line in the summer of 2014, extending service to Tysons Corner, Virginia. A second phase, to be completed in 2018, will connect Dulles International Airport and Loudoun County. This will create new opportunities for property investors.

Risks: The federal government and law firms are scaling back their real estate footprints. Active tenants in both industries are looking to downsize by 30%. Only trophy properties are likely to be unscathed.

Advantages: These downsizings create opportunities for other tenants, resulting in a 'musical chairs' effect. Due to move-outs mandated by BRAC (the Base Realignment and Closure Commission), large blocks of space along Metrorail lines are available for the first time in years. Despite the leasing market respite, the investment market offers substantial long-term opportunities.

SAN FRANCISCO BAY

Thanks to the technology industry, the Bay Area economy has been outperforming most other markets in the U.S. The boom is centered on the City of San Francisco itself as well as the Silicon Valley (South Bay). The East Bay economy, while more diversified, has been slower to recover.

San Francisco proper has seen a big increase in tech firms opening or expanding. Companies have moved into older buildings in the mid-Market and South of Market districts. There has been some re-zoning near San Francisco Bay and below Market Street where new office and residential projects are being developed. This includes the newly renamed Salesforce.com Tower, a 1.4 million-square-foot office building under construction where the software firm pre-leased 700,000 square feet. Other tech-centric tenants signing major deals in the city recently include Twitter, Dropbox, LinkedIn and Uber.

In the South Bay, space is being absorbed quickly by a range of technology companies including Ericsson, Facebook, Google and Apple. Many of these companies are building or leasing suburban campuses that mimic high-density urban environments.

The East Bay houses the manufacturing and distribution centers for major tech companies, including Amazon, which took 575,000 square feet of warehouse space recently. Some firms priced out of San Francisco and Silicon Valley are moving their offices to the East Bay.

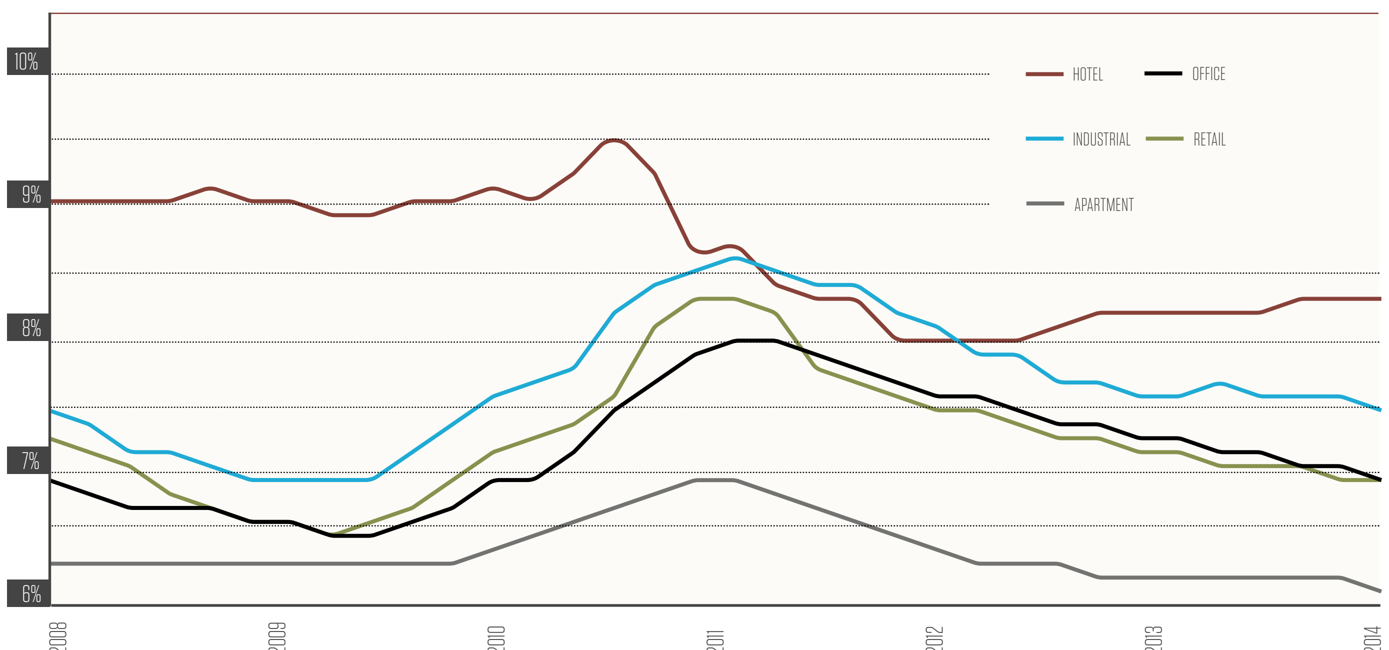
Property investors view the Bay Area as one of the safest and most consistent office markets in the U.S., matched only by Manhattan. Everything from creative loft properties to new office buildings are garnering exceptional sale prices thanks to strong market fundamentals.

Risks: Dependency on a single sector – tech; steep costs for both commercial and residential property that could price occupiers out of the market.

Advantages: Strong global demand for tech products; highly educated workforce; healthy wage growth; highest density of venture capital firms in the world.

U.S. CAPITALIZATION RATES BY PROPERTY TYPE

Source: Real Capital Analytics, Newmark Grubb Knight Frank



HOUSTON

The story of Houston is the story of energy production with all its ups and downs. Following an oil bust in the mid-1980s, Houston's real estate market cratered. A generation of institutional property investors red-lined the market, repelled by the massive overbuilding that led up to the bust, imprudent lending and the city's lack of traditional zoning standards.

But Houston has reinvented itself over the past quarter century, propelled by a more diversified economy that includes world-class healthcare services, a growing seaport on the Gulf of Mexico, and a chemical industry that is benefiting from cheaper natural gas extracted from nearby shale formations. The city is expanding its light rail network, and planners have made strides in redeveloping downtown. Population and employment growth in recent years has been at or near the top of all U.S. metro areas, and Houston's commercial property market has responded accordingly with strong rent growth despite an active construction pipeline and low barriers to entry.

Investors are recognizing Houston as a primary or gateway city. The volume of office building sales has grown exponentially in recent years. While typical per-square-foot averages are in the US$200-US$300 range, pricing has approached US$450-US$500 on new construction of prime product. Cap rates have trended considerably lower and now average approximately 6.0-6.5%.

Risks: High equilibrium vacancy rates; developers and lenders will initiate a new construction cycle earlier in Houston, aided by the city's longstanding pro-growth policies.

Advantages: The energy industry is embarking on an era of more plentiful and stable supplies enabled by new technologies. This, along with Houston's growing reliance on the healthcare industry, should temper the boom-and-bust risk that bedeviled the local economy in the past. Texas's low-tax, pro-growth policies and strong population in-migration will provide a growing supply of new jobs and the workers to fill them.

An Energetic Economy

The shale oil and gas boom created by hydraulic fracturing or 'fracking,' combined with more efficient energy use, has brightened economic prospects in the U.S. Consider the following points from the *2014 Annual Energy Outlook* from the U.S. Energy Information Administration:

- Domestic production of crude oil is projected to increase sharply to a near-record in 2016, after which it will level off and then slowly decline after 2020.
- Natural gas production, currently at the highest level ever in the U.S., will continue to grow, increasing by 56% between 2012 and 2040.
- Energy use by light-duty vehicles will decline by 24% from 2012 to 2040, reflecting slow growth in vehicle miles traveled and improvements in vehicle efficiency.
- Natural gas and renewable energy will increase in the energy mix through 2040 while coal and nuclear will decrease.
- Net imports of energy, which accounted for 30% of domestic consumption in 2005 and 2006, fell to 16% in 2012 and are expected to account for less than 4% by 2030.
- Energy-related carbon dioxide emissions will remain below their 2005 level through 2040.

The energy revolution in the U.S. is expected to add 0.5% to 1% of extra real GDP per year for the next five years along with several hundred thousand jobs annually. Demand for commercial real estate will be strong in areas near the shale plays including Texas, Oklahoma, Pittsburgh and North Dakota. The benefits will extend to all energy users, including commercial property landlords and retailers whose customers will have more disposable income to spend.

MEXICO CITY

Mexico has the world's 14th largest economy in terms of GDP. The country is closely aligned with the North American economy and, along with Brazil, is a leader in the economic development of Latin America. Following a currency crisis dubbed the "Tequila Effect" during the 1990s, Mexico has enjoyed 20 years of economic stability, featuring single-digit inflation, relatively low interest rates and, over the last five years, a booming real estate investment market.

With 20 million inhabitants, Mexico City is the world's fifth most populous urban area according to the United Nations. A partial result of its sheer size and proximity to the U.S., Mexico City is attracting large amounts of foreign direct investment, including investment in real estate.

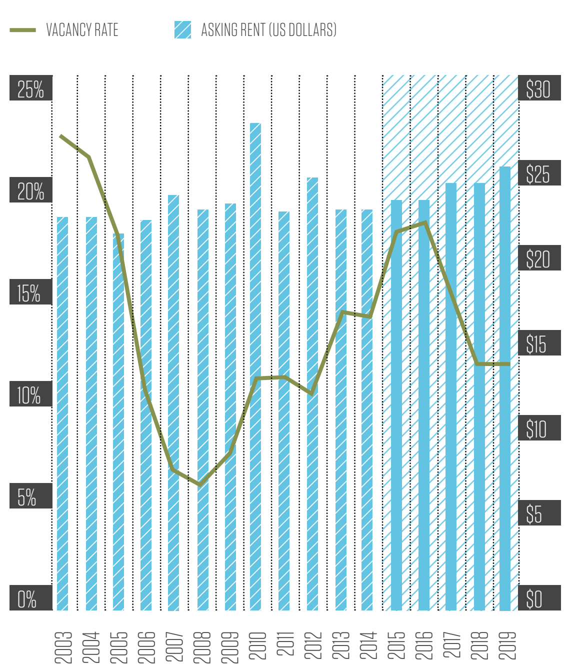
In the last 20 years, developers have added 45 million square feet of new office space in Mexico City, and an additional 15 million square feet will be ready by 2017. The city's industrial sector has become a major logistics and distribution hub with an inventory of over 60 million square feet of modern space. The commercial sector includes more than 1,000 modern shopping centers (mostly power centers) with more than 45 million square feet of space currently in operation.

Avenue in Mexico City

MEXICO CITY

GRADE A RENT VS VACANCY RATE

Source: Newmark Grubb Mexico City



With the recent emergence of REITs (FIBRAs) in Mexico, there has been a significant injection of capital, resulting in cap rate compression and an increase in development of office buildings, logistics centers and shopping centers.

Risks: The wave of capital could give rise to temporary oversupply. Many economic sectors are waiting for Congress to pass the secondary legislation needed to fully implement recent energy and tax reforms.

Advantages: Mexico City's commercial property markets are currently in equilibrium. Mexico is benefiting from the booming auto manufacturing sector, the re-shoring of some manufacturing operations from China, and the accelerating recovery in the U.S. – Mexico's largest trading partner.

LATIN AMERICA

South America experienced a mild recession in 2009 followed by a strong comeback in 2010 that was driven by commodity exports to China and a growing middle class. The region caught the attention of global property investors during this period, boosting sales. But exports receded as China entered a period of slower growth, and the spike in U.S. long-term interest rates in 2013 weakened currencies and pulled capital out of emerging markets, impacting prospects for growth.

Property sales volumes, which rose on South America's strong economic recovery in 2010, slipped in tandem with the economic outlook.

In Brazil, a wave of new construction in both São Paulo and Rio de Janeiro has tipped the market in favor of tenants. Class A property market conditions in Buenos Aires are largely stable despite Argentina's rising inflation and bond default. Office construction in Santiago, Chile totals almost 6.9 million square foot, approximately 20% of its inventory. Development of modern industrial space is on the rise in Lima, Peru. Property markets are slowly rebounding in Bogotá, Columbia despite a rocky 2013.

In Mexico, REITs have become active, boosting both property sales and new development projects, especially in Mexico City (please see related article).

CANADA

As a G7 economy, with a strong energy sector, and leading financial and business services centers, Canada deserves the attention of global real estate investors.

The Canadian economy is expected to progressively strengthen in the next two years. According to the Conference Board of Canada, growth will be led by the mineral-rich Western and Maritime provinces. While fiscal issues are expected to weigh upon Quebec and Ontario in the near term, both should pick up speed in 2015.

Turning to real estate, Toronto, is expanding at a rapid rate, with new building projects set to add five million square feet of top-tier downtown office space to the market. However, there have been some corporate downsizings, which have increased the availability of sublease space.

Montreal is seeing new construction in its downtown core, while several older neighborhoods are undergoing rejuvenation adding new vibrancy to the city.

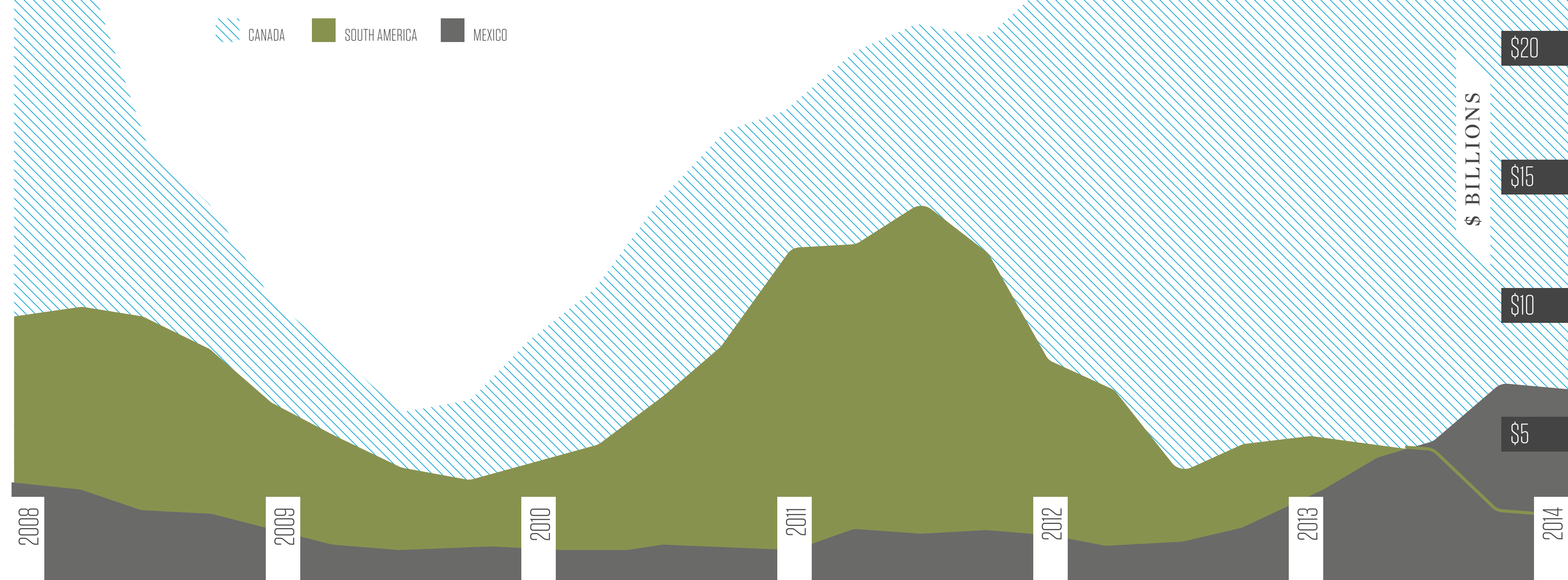
Energy-rich Calgary is benefiting from the shale boom. Although vacancy rates have risen, office construction continues, and a variety of new energy projects and pipelines are expected to boost demand.

Vancouver has attracted business interest from a number of sectors. Vacancy rates in the office market have risen, with new construction bringing much needed new space to the downtown core, and the residential and retail markets continue to perform well.

COMMERCIAL PROPERTY SALES CANADA, MEXICO, SOUTH AMERICA

TRAILING FOUR-QUARTER AVERAGE

Source: Real Capital Analytics / Newmark Grubb Knight Frank

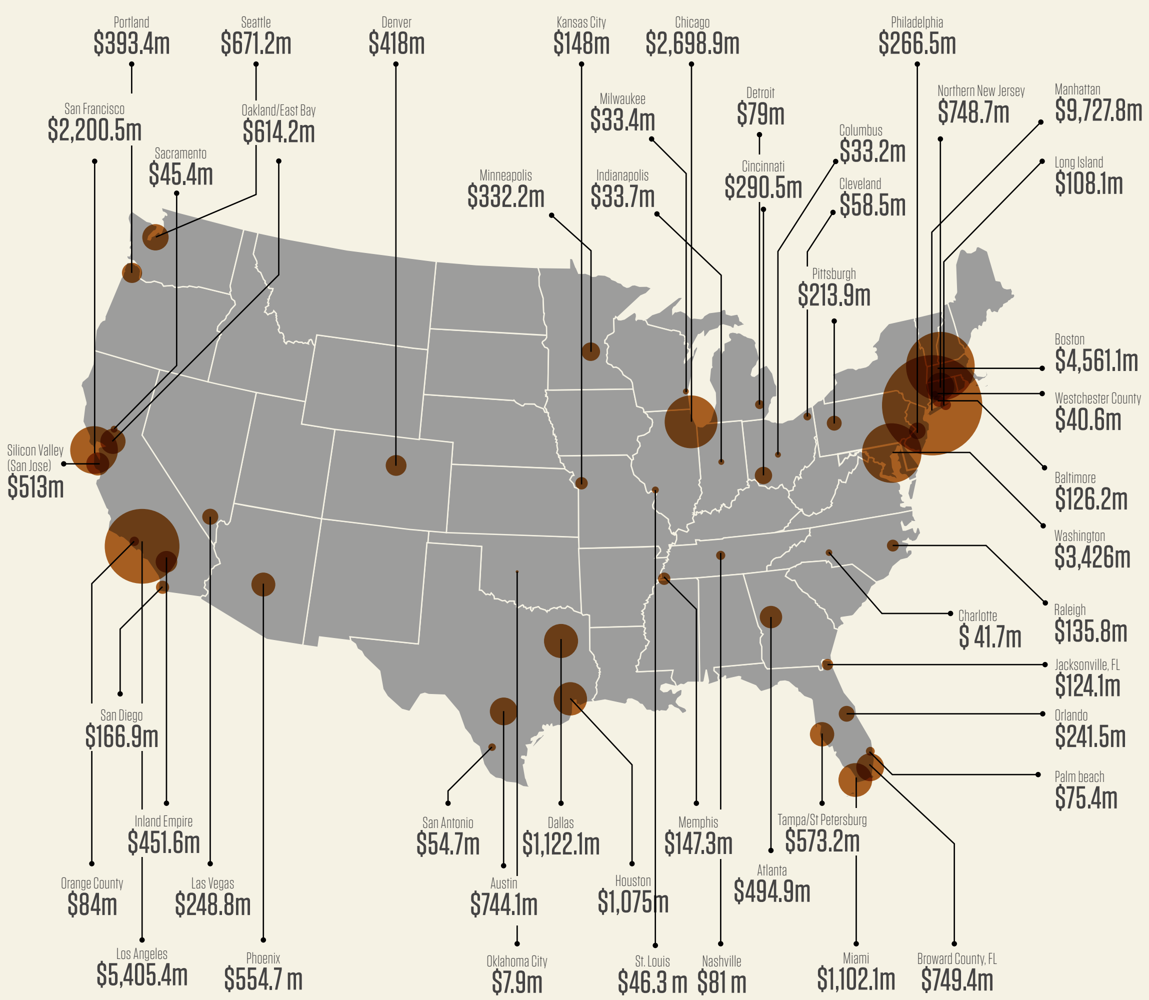


NORTH AMERICAN MARKET OUTLOOK

Global investors are getting comfortable with smaller markets beyond the major gateway cities.

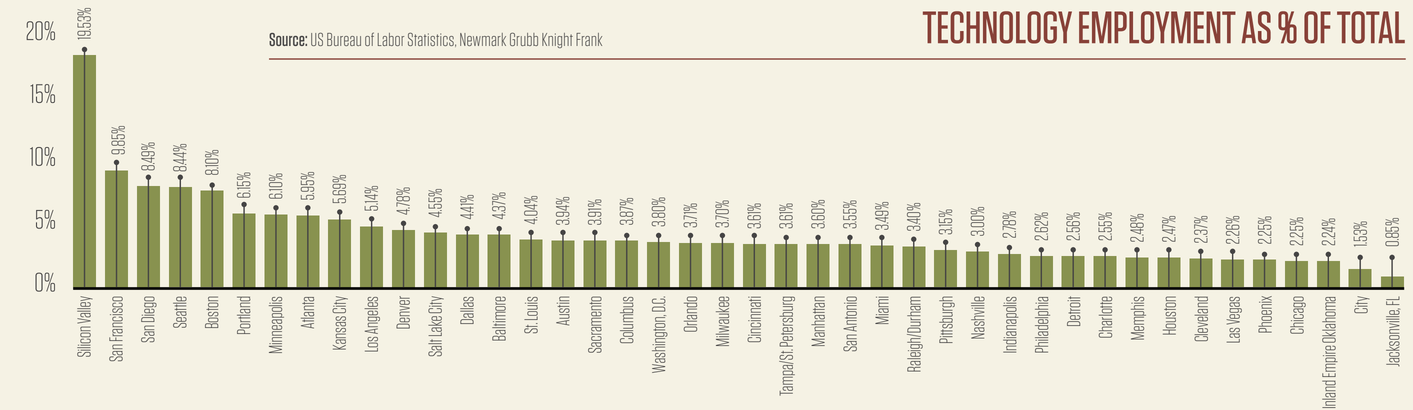
$ VOLUME OF CROSS-BORDER INVESTMENT - 2014 THROUGH JULY (MILLIONS)

Source: Real Capital Analytics, Newmark Grubb Knight Frank



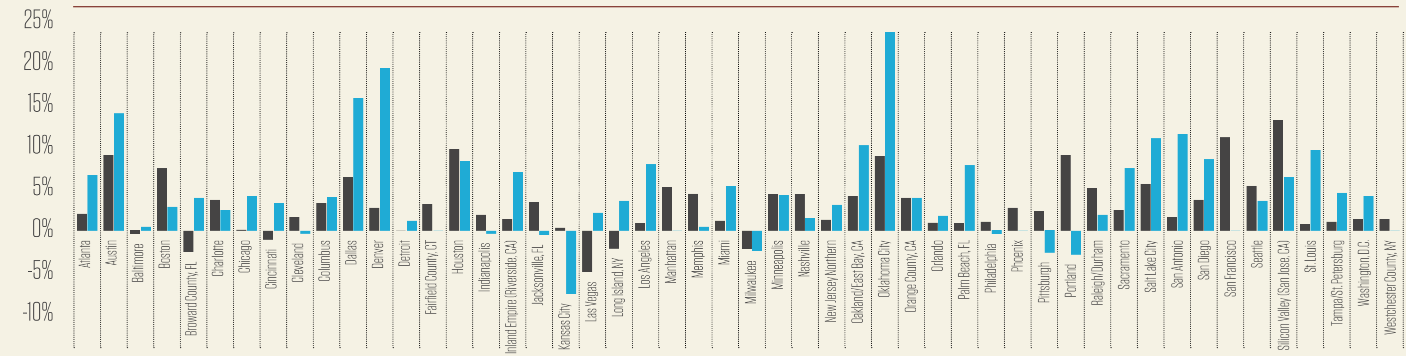
TECHNOLOGY EMPLOYMENT AS % OF TOTAL

Source: US Bureau of Labor Statistics, Newmark Grubb Knight Frank



ONE YEAR RENT CHANGE AS %

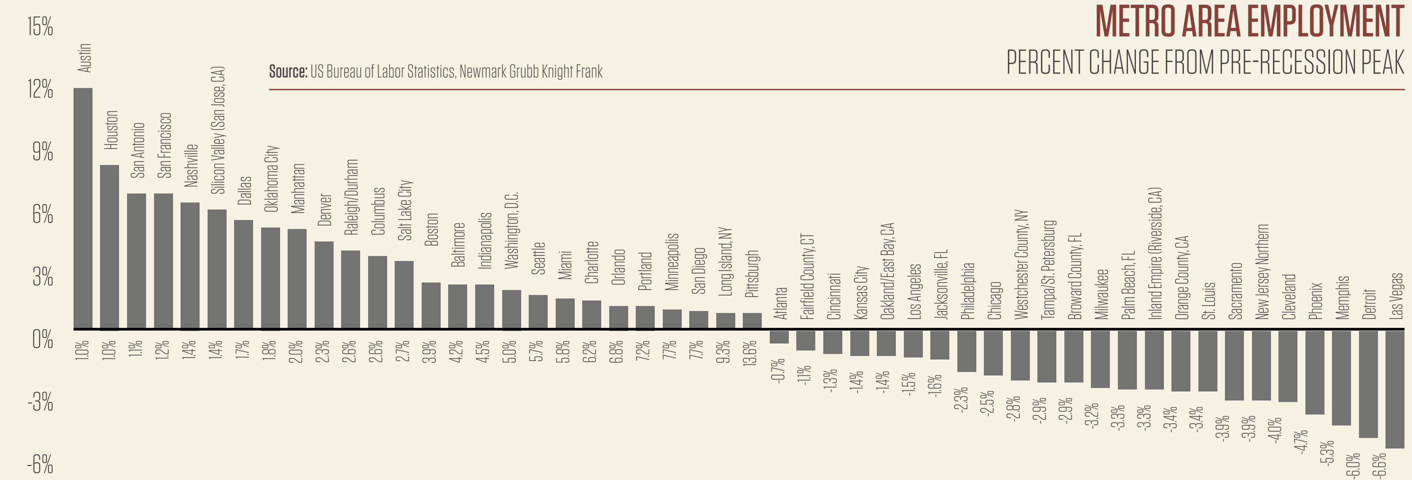
Source: Costar, Newmark Grubb Knight Frank



METRO AREA EMPLOYMENT

PERCENT CHANGE FROM PRE-RECESSION PEAK

Source: US Bureau of Labor Statistics, Newmark Grubb Knight Frank



KEY MARKET DRIVERS

AEROSPACE
TECHNOLOGY
FINANCIAL
TOURISM
HEALTHCARE
ENERGY
AUTO MANUFACTURING
SCIENCE
MANUFACTURING

CALIFORNIA

A sprawling and diverse region, Los Angeles gets its glamour from the entertainment industry in West Los Angeles and adjacent San Fernando Valley, which are also favored destinations for property investors. The massive port complex, largest in North America, supports a thriving logistics industry. Orange County and San Diego continue to expand with a mix of tech and biotech. San Francisco is ground zero for the U.S. tech industry (see article).

PACIFIC NORTHWEST

Airplanes and technology drive Seattle. Boeing will expand to build another jetliner while a robust tech industry led by Amazon and Microsoft gobbles up space. Portland offers lower costs than other coastal markets; its vaunted urban growth boundary supports property values.

INLAND WEST

Denver is booming thanks to energy and, interestingly, marijuana, which is now legally sold and taxed. Phoenix, a low-cost alternative to coastal markets, is rebounding from the housing bust. Salt Lake City is expanding rapidly. A mecca for tourists and conventions, Las Vegas has a small but growing tech sector.

CHICAGO

Chicago is the economic, financial and cultural hub of the region and a magnet for millennials with freshly minted university diplomas from across the Midwest. Downtown Chicago is, arguably, the nation's most dense and vibrant business district outside of New York, but property pricing has never risen to the same levels. Suburban markets have recovered more slowly.

EASTERN GREAT LAKES

Detroit is challenged by large swaths of crumbling buildings and empty land, but the booming auto industry and a surprising downtown renaissance are its strengths. Cleveland's downtown has benefitted from conversion of historic Class C office buildings to apartments, a trend notable in other markets.

EMERGING MIDWEST MARKETS

Minneapolis-St. Paul boasts one of the healthiest economies in the region thanks to an educated workforce and a stable of corporate headquarters. Other emerging secondary markets include Columbus and Indianapolis in the old manufacturing belt and several smaller markets in the resource-rich western part of the region including Kansas City, Omaha and Des Moines.

TEXAS

The largest of seven states without an income tax, Texas caught the attention of investors as it powered through the recession with minimal damage. Houston is the nation's energy capital (see article), growing apace with Dallas-Fort Worth, its more diversified rival to the north. Austin is booming with a potent mix of technology, energy, higher education and culture (the city's motto is "Keep it Weird").

SOUTH EAST

Atlanta is the region's powerhouse with its diverse economy; it was slow to emerge from recession but is firing on all cylinders now. Nashville, Charlotte and Raleigh-Durham are regional growth magnets looking to follow in Atlanta's footsteps but without the side effects of rapid growth. Tourism remains the economic driver in Florida, especially in Orlando and Miami, with the latter also filling the role of a U.S. business hub for Latin America.

MID-ATLANTIC

Washington D.C. is working to diversify its economy beyond government and its private contractors (see article). The Baltimore-Washington corridor is a focus for science/biotech.

NEW ENGLAND

Boston has had great success as a leader in technology, biotech, health care and higher education; but Boston, like NYC, is seeing cutbacks in financial services. Hartford is a hub for the insurance industry while Providence benefits from its location along the Northeast Corridor transport route.

PENNSYLVANIA

Philadelphia offers one of the lowest costs of living in the region plus good transportation infrastructure. Pittsburgh weathered the recession well thanks to concentrations in energy and education. Central and Eastern Pennsylvania has become a vibrant logistics market.

GREATER NEW YORK CITY

The New York City economy is expanding thanks to TAMI while it remains the financial center of the U.S. (see article). New Jersey has the most aggressive business incentives in the region plus a growing port and 20 million square feet of prime office inventory along the Hudson Waterfront. The suburban office markets of Long Island (healthcare), Westchester County (biotech and professional services), and Fairfield County (finance and media) have yet to see much spillover from NYC.

OPPORTUNITIES IN THE ASIAN CENTURY

Asia's real estate markets face significant changes over the next five years, on top of the transformation already seen. Economic growth, greater cross-border activity, and changing consumer patterns are set to transform the property landscape.

AUTHOR — NICHOLAS HOLT
Head of Research, Asia Pacific

IN THIS CHAPTER

- **Asian economies are more interconnected than ever, with growing cross-border trading and investment. This is reflected in greater demand for real estate.**
- **The maturing of Asia, moving beyond manufacturing and into funding overseas investment, is accelerating the new trends and creating new sources of occupier demand.**
- **More Chinese institutions are looking to acquire the buildings they occupy abroad, increasing their exposure to other real estate markets.**
- **Further economic growth requires upgrading the region's infrastructure, which is underway and will be matched by a new wave of property development.**

It is not only the pull of China that is dragging the global centre of economic gravity eastward. A re-energised India, an increasingly integrated Southeast Asia and a Japanese economy that has been jolted back to life, all provide opportunities for corporate occupiers and real estate investors in Asia.

To put it lightly, Asia has scale. The region accounts for over 60% of the world's population, 30% of its land mass and approximately 40% of the world's GDP. But beyond these headline figures: an industrial base which supplies large parts of the world, an emerging consumer class and urbanisation on a scale never seen before in human history – all provide a compelling narrative to the region going forward.

INTEGRATION AND EXPANSION

So what can we expect to see in Asia over the next five years? We can highlight two trends we expect to see more of, firstly, the increasing inter-connectivity of Asia – led by China, and secondly, a more outward looking approach of Asian corporates and investors.

On the first, as a large part of Asia transforms itself from a cheap production base to a trading block, intra-Asian trade is on an upward trajectory. China, most notably, is now the dominant trading partner of most Asian countries, including being the leading export market for Hong Kong, South Korea, Thailand and Taiwan. In Southeast Asia, the move towards the ASEAN Economic Community, including the full removal of barriers to trade, will increase connectivity and interdependence over the coming months and years.

Further integration is not restricted to the trade of goods and services; we are also witnessing an increase of cross-border capital flows, again, led by China. The announcement in April of the Hong Kong-Shanghai stock connection – allowing equity trades between the two Chinese financial hubs – is a precursor to further loosening of capital controls, which will extend the country's economic influence. Indeed, over the next five years, we expect the increasing internationalisation of the renminbi, which will soon be traded and cleared in London, to extend China's economic reach even further.

On the second, Asian corporate occupiers are expected to be increasingly active in global cities around the world, led by banks, financial services and energy sectors. We are already seeing this trend in cities across Asia. Similarly, for diversification, growth opportunities and wealth preservation, Asia is now an important exporter of capital for real estate and we are seeing more investors and developers look outside their home markets for opportunities.

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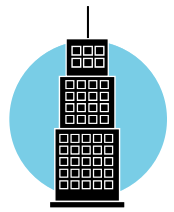
ECONOMIC GROWTH DRIVES ACTIVITY

Office occupier markets, which have been fairly subdued over the last few years given the sluggish global economic recovery, saw a relatively strong end to 2013. Net absorption of office space picked up in the second half of the year, reversing a downward trend stretching back to the second half of 2011.

In our core Global Cities, technology and IT sectors have been the key drivers of the take-up of office space. Financial services and banking, the sectors that led the pre-Global Financial Crisis (GFC) boom, continue to be more cost conscious, and while there is still demand from these sectors, there has been less 'front' or 'prime' office demand. Over the coming years however, we expect financial services and banking occupiers to come back to drive sizeable segments of demand.

Other sectors prominent in the Asian office markets include international law firms and the oil and gas sector. The former has benefited from the liberalisation of the legal sectors in South Korea, Singapore, Malaysia and China, with a number of key transactions over the past two to three years. In the latter, oil and gas companies continue to be important prime office occupants in Jakarta, Kuala Lumpur and Vietnam. The future exploitation of Cambodia's oil and gas reserves, could also lead to increased activity from this sector in the nascent Phnom Penh office market.



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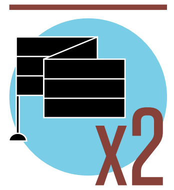
Fortune 500 companies have Asian HQs



x2

Two Germanys – the equivalent of Asia's GDP growth in the last five years

Phnom Penh, Cambodia

JAPAN AND INDIA LOOK FORWARD

In the region's second and third largest economies, Japan and India, recent events have raised expectations for improved economic performance. In Japan, Prime Minister Abe's economic stimulus programme along with the prospect of hosting the 2020 Olympics has strengthened corporate demand in Tokyo. Grade-A, earthquake tolerant office space in central Tokyo is seeing its vacancy rate fall, with the prospects of rental growth over the coming years. In India, the election of Narenda Modi has set expectations that a successful reformist agenda will free up a flagging economy, boosting occupier markets.

THE BIGGEST DOWNSIDE RISK?

Throughout the 20th century, we saw both the Japanese economic miracle (1950-1990) and the Korean Miracle on the Han River (1961-1996) come to an end. It is not if, but how the inevitable slowdown of the Chinese economic boom (1983-?) is managed, that will have a significant impact on the regional (and world) economy. Given the increased interconnectivity of the Chinese economy, a sharper than expected slowdown, could undoubtedly impact growth trajectories and subsequently occupier markets. All eyes will therefore be on the Chinese government, and how they manage the rebalancing of the country's economy over the coming years.

THE OWNER-OCCUPIED EXPANSION OF CHINA'S FINANCIAL INSTITUTIONS

In China, it is not an unusual sight to see large corporates own and occupy their office premises. Tier-1 cities on the country's mainland are notably home to the headquarters of a large number of Chinese corporates with strong balance sheets. They have been developing and purchasing office developments either for owner occupation or in some cases for long-term investment.

Of course, China is not the only country with such office market characteristics. However, the interesting trend we have been witnessing is the flurry of real estate investment activity by mainland financial institutions in Hong Kong. One of the major deals in 2012 was China Construction Bank (CCB)'s purchase of a Grade-A office tower in East Kowloon for US$313m. This is added to their previous investment in CCB Tower in Central. Other notable deals include the Agricultural Bank of China's purchase of a prime Central district office tower for US$629m, along with numerous strata deals (ownership of a floor/s of an office building) by Chinese institutions.

Chinese financial institutions' aggressive expansion is driven by a number of factors: "These acquisitions help brand building while allowing the institutions to manage their future occupation costs," says Paul Hart, Executive Director, Knight Frank Greater China. "They already have extensive domestic real estate exposure and offshore investment allows them to diverse their risks. The Chinese investment landscape has also become very competitive and a desire to expand in overseas markets for better returns is also a driver," he adds. "Hong Kong, the biggest international financial market close to home, with its mature legal system and financial regulatory supervision, is ideal for this."

111 Broad Street

Hong Kong is not the only market to have seen an uptick in this activity. The recent purchase by China Construction Bank of 111 Old Broad Street, a central London office building for circa US$187m, signals the latest move by one of China's big four in purchasing owner-occupied office space in the UK's capital. The bank, recently selected to become the first Chinese bank to provide renminbi clearing services in the UK, joins the Bank of China (BOC), who purchased One Lothbury, and the Industrial and Commercial Bank of China (ICBC) who have also bought office space in the city.

Chinese financial institutions' expansion into offshore markets is expected to continue, with the relaxation of regulations and the freeing up of the currency providing huge opportunities overseas. Following Hong Kong and London, other financial centres of the world are likely to be targeted as centres for expansion.

STRATA TITLE: A THING OF THE PAST?

Coming back to Hong Kong, aside from en-bloc ownership, one of the key routes to owner occupation by many institutions and investors has been through strata title. However, times are changing. "Policy makers in Hong Kong are increasingly aware of the difficulties of an office market with too much fractional ownership and have started to react with the last two government land sales in Kowloon East precluding strata in the lease," says Hart. "Strata ownership is a double-edged sword, as it creates lots of opportunities for smaller investors but can preclude a building from being occupied by multinational corporations."

Strata title is a form of ownership devised for multi-level buildings with horizontal subdivisions and shared areas.

En-bloc translates from French as "the whole thing" typically refers to the purchase of a whole building.

CHINA'S BIG FOUR BANKS' RECENT OVERSEAS ACQUISITIONS

Source: Knight Frank Research

BUYER	MARKET	DATE	PROPERTY NAME	SQ FT	PRICE IN US$ M
Agricultural Bank Of China	Hong Kong	Q2-12	50 Connaught Road Central	175,000	628.9
Bank of China Limited	London	Q4-09	One Lothbury	117,000	141.9
China Construction Bank	London	Q2-14	111 Old Broad St	123,000	187.2
China Construction Bank	Hong Kong	Q2-13	18 Kowloon (now CCB Centre)	349,000	312.9
Industrial and Commercial Bank of China	Madrid	Q4-12	Medio Ambiente	79,000	27.7
Industrial and Commercial Bank of China	London	Q3-10	81 King William St	40,000	25.9

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MATURING INVESTMENT MARKETS AND NEW SOURCES OF CAPITAL

The Asian growth story sees two distinct investment markets and an increasing number of participants.

The narrative around real estate investment in Asia can be summed up relatively simply: a lot of capital chasing limited stock. While this has led to an increase in capital values across the board, it has also led to increasing outflows of capital towards other regions of the world. Over the next few years, we expect to see a slow maturing of investment markets and a continued emergence of a new wave of institutional capital targeting property, which could have a lasting impact on real estate markets in the region and beyond.

DIFFERENT INVESTMENT MARKETS

When looking at property markets in Asia, there are really two different sides to its investment markets. In terms of investment-grade product, the most significant liquidity is in the core markets of Japan, South Korea, Singapore and Hong Kong. Japan continues to be the most active market, with domestic groups competing aggressively for prime real estate, aided by the low cost of debt. In much of developing Asia, there is a distinct lack of transactions for income producing assets, as either owner-occupiers or developers hold-on tightly to product.

Overall, in the market for income producing or completed assets, Asia saw increased activity in 2013, with volumes across the region rebounding to hit 2007 levels (see graph on right).

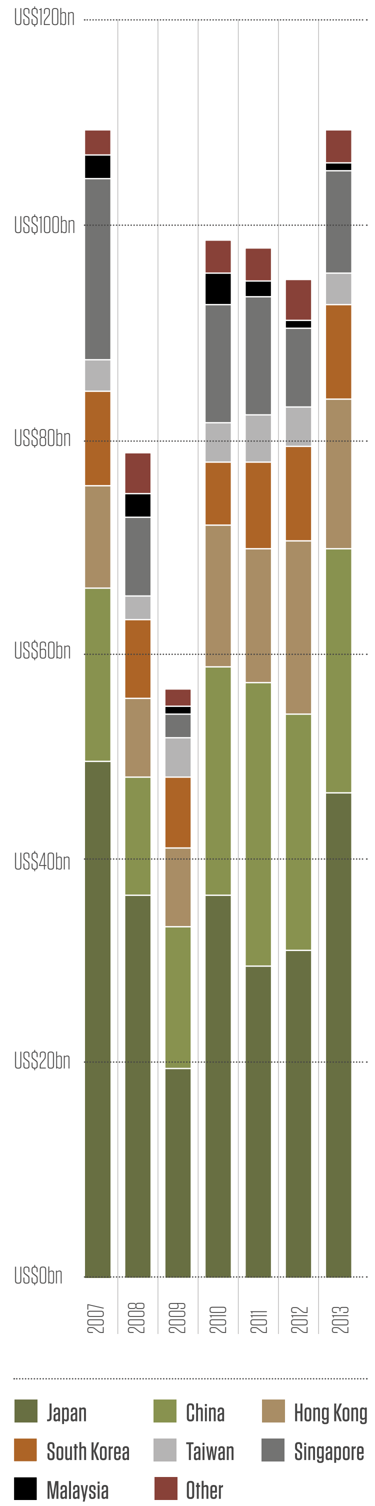
The second market is the development market, which, due to the limited availability of investment-grade stock, has seen an increasing number of participants. To gain or increase exposure to Asian property markets, many investors are now taking on development risk – looking at the full spectrum of opportunities, from core development opportunities, to en-bloc redevelopments, to new townships. In contrast to the more mature regions of North America and Europe, the development market contributes the highest transaction volumes in the region, with the Chinese development land market the largest sector by far (see Knight Frank's Prime Development Land Index on pages 75-76).

OLD AND NEW SOURCES

In terms of sources of capital, REITs remain important players, especially in Japan and Singapore. Otherwise, listed and un-listed funds have also been active – with

INVESTMENT VOLUMES IN ASIA (US$)

(EXCLUDING LAND SALES)



Source: Real Capital Analytics, Knight Frank Research

private equity groups from the US such as Blackstone and Carlyle actively buying in the region. In general, foreign (non-Asian) groups, who were more active pre-GFC, have started to come back to the market as demonstrated by M&G's recent acquisition of two assets in Japan. In China however, state-owned enterprises remain the key buyers of both development land and income producing assets, with access still proving difficult for foreign groups.

Private wealth continues to be an extremely important source of capital in the real estate markets. Asian HNWIs have traditionally viewed property as a core investment, heavily weighting their portfolios towards bricks-and-mortar. Following the numerous rounds of cooling measures we have seen in the residential markets, an increasing number of private investors have been looking at commercial real estate. The growth in private wealth in Asia is likely to continue unabated, with Knight Frank's Wealth Report forecasting a 43% growth in UHNWIs between 2013 and 2023 – a growth in absolute numbers of 17,474 – higher than any other region in the world. The increasing number of family offices in Asia reflects this growth. These top-tier HNWI investors typically take a longer-term view to investing, with succession planning a core objective. Property either at home or overseas will continue to be high on their agenda.

INSURANCE AND PENSION FUNDS

Over the next five years and beyond, Asian insurance companies and pension funds are set to play an increasingly important role in the real estate landscape. Looking at volumes

ASIAN PENSION FUNDS BY GLOBAL RANK

1
JAPAN
GOVERNMENT PENSION INVESTMENT
US$1,292bn

4
KOREA
NATIONAL PENSION SERVICE
US$368bn

7
JAPAN
LOCAL GOVERNMENT EMPLOYEES
US$201bn

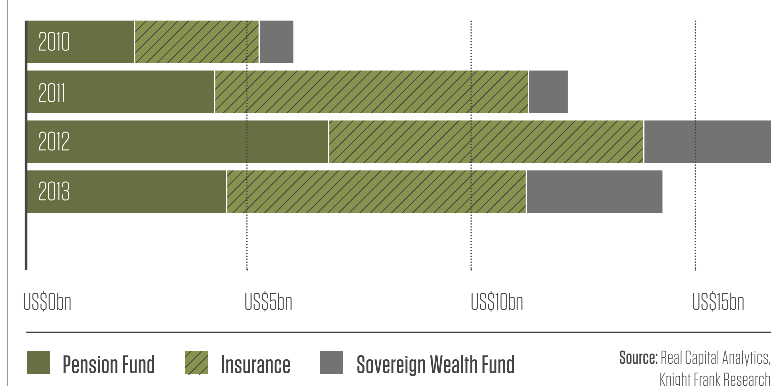
8
SINGAPORE
CENTRAL PROVIDENT FUND
US$188bn

10
CHINA
NATIONAL SOCIAL SECURITY
US$177bn

12
MALAYSIA
EMPLOYEES PROVIDENT FUND
US$176bn

Source: APREA, Knight Frank Research

KEY INSTITUTIONAL BUYERS IN ASIA



Source: Real Capital Analytics, Knight Frank Research

invested within Asia-Pacific by these institutions (and sovereign wealth funds), we can see that they have been increasingly active over the last two years. This does not account for the growing amount invested outside the region: where core, well located prime assets in gateway cities continue to attract their attention.

> "TARGET ALLOCATIONS ARE SIGNIFICANTLY HIGHER AND SOME OF THE BARRIERS TO INVESTING IN REAL ESTATE ARE COMING DOWN"

The huge potential for real estate investment from these groups is apparent when we look at the existing vs. target allocations for real estate. Existing allocations typically range from 0 to 5%, with regulatory barriers, a lack of knowledge of the sector and a historic reliance on equities and fixed income investments holding this back. Target allocations are significantly higher and some of the barriers to investing in real estate are coming down. Changing regulations and improved knowledge of the sector are allowing these investors more access to alternative investment classes. It is likely that we will see these groups increase allocations towards levels seen in the west of nearer to 10%.

Examples can be found in Taiwan and China, where recent regulatory changes are leading to increasing outbound activity. Most notably, the China Insurance Regulatory Commission's (CIRC) announcement allowing Chinese insurers to go offshore has led to the notable purchases of Lloyd's Building in London by Ping An Insurance Group for US$416m (see interview page 74) and Canary Wharf Tower by China Life for US$1.35bn (in partnership with Qatar Holdings). Expect Chinese insurers who are now allowed to invest up to 30% of their assets in real estate to become more important purchasers in global cities over the coming years.

With ageing populations in many parts of Asia, pension funds in the region, which hold over US$30trn in assets, are increasingly looking at alternative investments such as

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real estate as a way of matching future liabilities. Funds across the region are looking at increasing allocations and diversifying into offshore property markets. National Pension Service (NPS) of Korea and Employees Provident Fund (EPF) of Malaysia are very much leading the way. The former recently acquired assets in Europe, Australia, China and Japan while the latter has been active in the UK over the last year.

Depending on the prevailing regulations, these insurance and pension funds will continue to target core, income producing assets in gateway cities. These are long-term investors and will be more and more visible in our global cities around the world.

THE FUTURE?

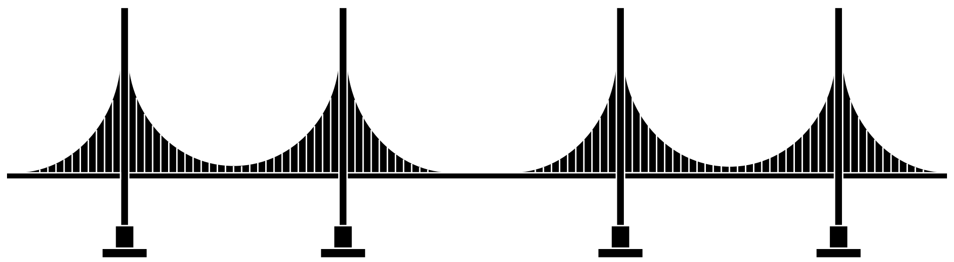
The growth in the aforementioned Asian institutions and their increasing exposure to real estate is likely to be one of the key headlines in the real estate investment landscape over the next few years. We are also likely to see new institutions emerge from other developing Asian economies, as they shift gear away from simply building wealth towards building welfare states. Expect more institutional capital in the form of insurance, pension and sovereign wealth coming from China, Indonesia, India and Thailand.

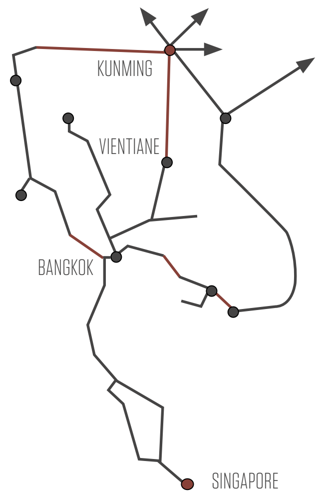
Otherwise, as markets continue to mature, we will slowly see increasing liquidity in developing Asia, improving levels of transparency and higher levels of securitisation. Some changes will happen slowly; others, such as the impact of Chinese insurers, will happen quickly. Continue to watch this space.

MEGA-INFRASTRUCTURE PROJECTS IN ASIA

SUNDA STRAIGHT BRIDGE – INDONESIA

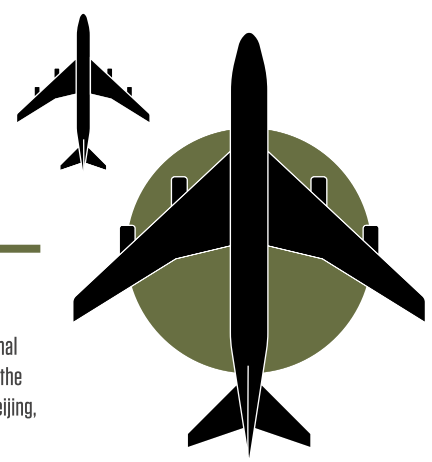
The long mooted bridge linking the resource-rich Indonesian island of Sumatra, with its densely populated neighbor Java still has some way to come to fruition. At a potential cost of over US$25 billion, the 30km bridge would be one of the longest bridges in the world.





KUNMING – SINGAPORE RAILWAY

China's access to Southeast Asia will be made easier once the proposed railway connecting the capital of China's south-western province, Yunnan and Singapore is completed. The Central Route which is proposed to pass through Laos, Cambodia, Thailand, Malaysia and Singapore aims to bring travel times down to less than 12 hours.

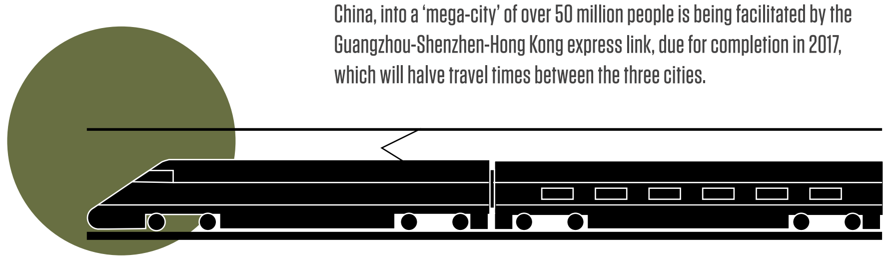


BEIJING AIRPORT

The Beijing Capital Second International Airport will be the new international airport in China's capital. Planned for completion in 2018, it will be among the biggest and busiest airports in the world. Situated 37km to the south of Beijing, a high-speed rail link is planned to connect the airport to the city.

MEGACITY INFRASTRUCTURE – GUANGZHOU, SHENZHEN, HONG KONG

The closer integration of Hong Kong and the Pearl River Delta in the south of China, into a 'mega-city' of over 50 million people is being facilitated by the Guangzhou-Shenzhen-Hong Kong express link, due for completion in 2017, which will halve travel times between the three cities.



CHINESE INSURERS LOOK OFFSHORE

Q+A *Nicholas Holt talks to Johnny Zhang, Senior Executive Director of Ping An Trust's Real Estate Investment Department.*

The Lloyd's Building

INTERVIEW - JOHNNY ZHANG

Ping An Insurance

Q How does Ping An Insurance view property as an investment class?

A Stock market performance has not been very good, especially in the Chinese domestic A-Share markets – and yields are low. So over the past two years, as a group, we have been trying to decrease our portfolio in capital markets – in A-Share markets. The strategy is to try and increase our investment into alternative investments – real estate, private equity and infrastructure (in order to) increase the yield on the whole portfolio for our life insurance.

Q Currently, what percentage of your portfolio is allocated to real estate? Do you think this is likely to increase over the coming years?

A When compared to the China Insurance Regulation Committee (CIRC) regulations, which permit up to 30% of total investment in real estate, we have a low percentage of our total portfolio allocated to property – so there is still a lot of potential.

How far we increase our allocation will partly depend on the government's attitude and whether we find suitable opportunities that meet our investment criteria. The most recent regulations encouraged insurance companies to diversify their portfolios – not just in capital markets, but also into alternative investments. Over the longer term – over 10-15 years – we could probably reach that (30%) percentage.

Q What is your view of the Chinese commercial property market at the moment?

A The office markets in Beijing and Shanghai are still ok, because global and local companies are still trying to expand into the future. For the retail markets, we are very cautious – due to the expansion of e-commerce.

From an investment point of view – the Grade-A office markets in Shanghai and Beijing are quite expensive – yields are roughly 3-4% so it is difficult to find a good project in China. Comparing the yields onshore and offshore – it makes more sense to put money in the offshore markets where the yields are higher.

Q And last year you invested offshore, buying the Lloyd's Building. Could you tell me a little about what attracted you to this asset and the London market?

A We look for yield and controlled risk in a safe market. That is why we prefer a single tenant on long term income lease – quite like a bond. You can get stable income for 15-20 years. That is why when the Lloyd's building came to us – the yield is higher than in Shanghai – we did the deal.

Q Are you looking at any other markets?

A It really depends on the fundamentals of the economy. The US, UK and Germany are our priorities. Australia could be – but only if there is a very good opportunity.

Q What are the key challenges Ping An face in investing in property markets around the world?

A Legal and tax issues. Each country is totally different – you have to spend a lot of time to make sure you fully understand the legal and tax structures. Offshore buyers have to compete with many global investors, so sometimes if you see a good project you have to decide very quickly or you could lose the deal. We are a new player in the market – but are learning step by step.

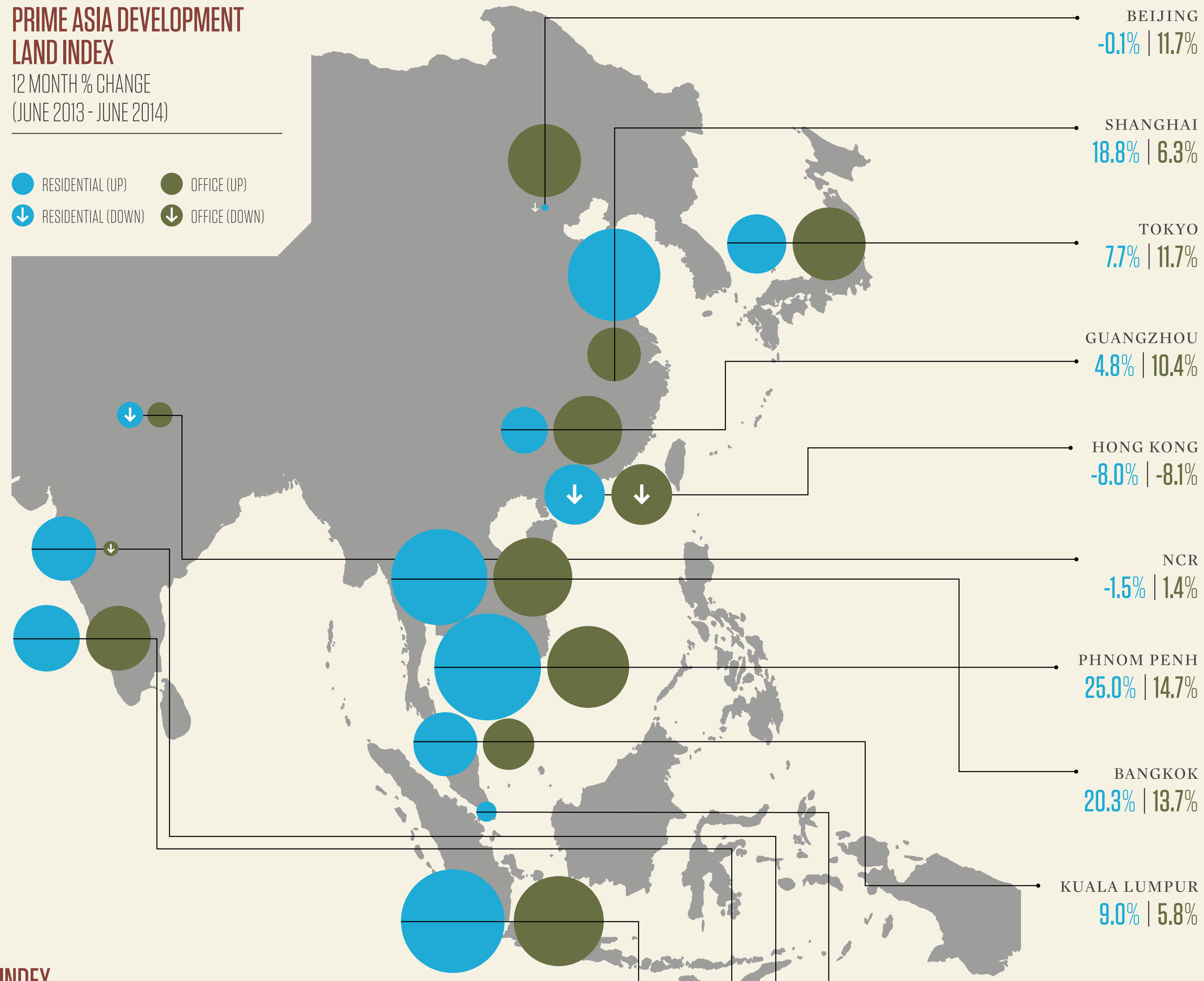
ASIAN LAND DEVELOPMENT

Development sites make up by far the largest proportion of investment volumes across Asia and we are witnessing investors and developers of all stripes increasingly look at land development opportunities in their home markets and abroad.

Knight Frank's Prime Asia Development Land Index derives the price of prime residential (apartment or condominium) and commercial (office) development land in 13 major cities across Asia. It is the first index of its kind to track development land prices across the region.

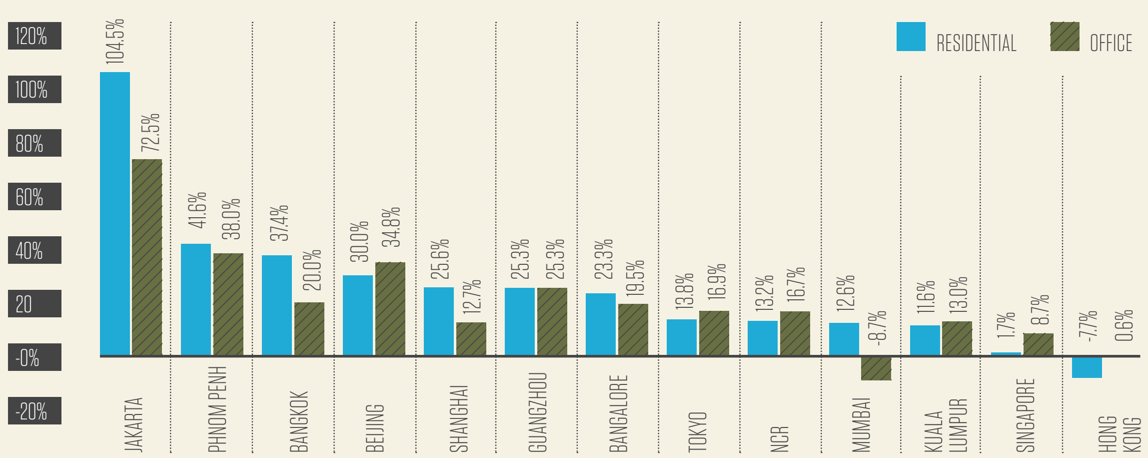
PRIME ASIA DEVELOPMENT LAND INDEX

12 MONTH % CHANGE (JUNE 2013 - JUNE 2014)



PRIME ASIA DEVELOPMENT LAND INDEX

24 MONTH % CHANGE (JUNE 2012-JUNE 2014)

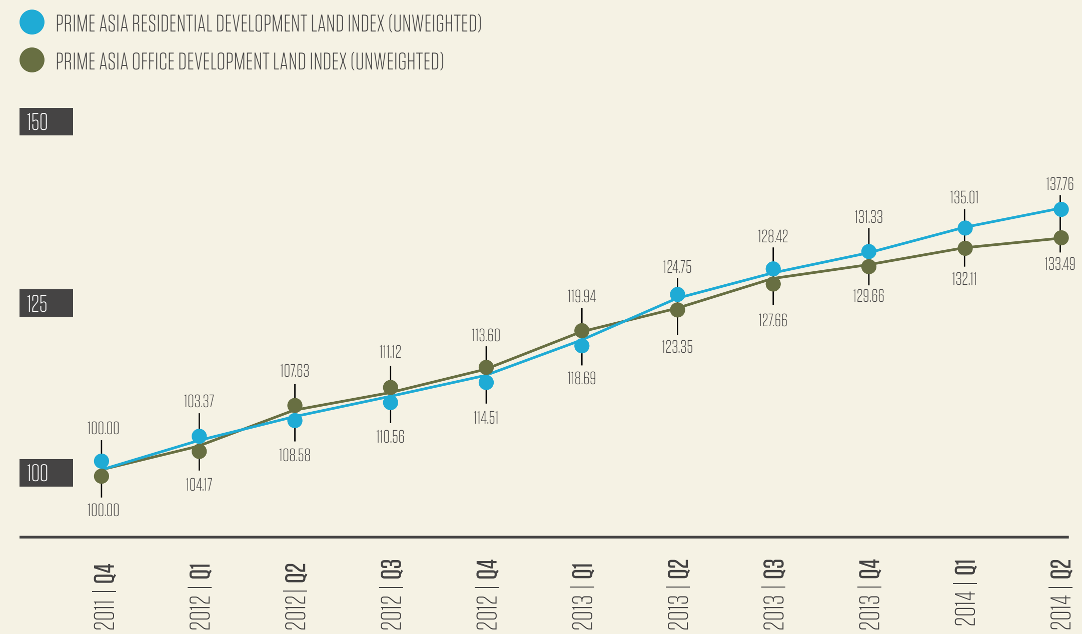


Source: Knight Frank Research

PRIME ASIAN DEVELOPMENT LAND INDICES

(UNWEIGHTED)

Source: Knight Frank Research



DEVELOPMENT LAND PRICE RANKING*

Source: Knight Frank Research

HIGHEST LAND PRICE

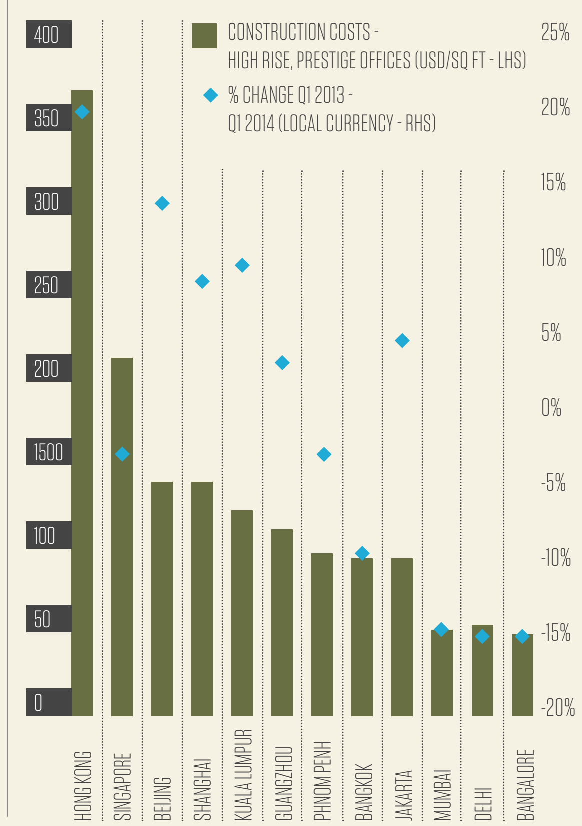
- HONG KONG
- SINGAPORE
- TOKYO
- SHANGHAI
- GUANGZHOU
- BEIJING
- MUMBAI
- NCR
- BANGKOK
- JAKARTA
- KUALA LUMPUR
- PHNOM PENH
- BENGALURU

LOWEST LAND PRICE

*Based on the average value of the prime residential and commercial (office) sites tracked

CONSTRUCTION COSTS FOR HIGH RISE, PRIME OFFICES

Source: Langdon and Seah, Knight Frank Research



AUSTRALIAN OUTLOOK

The Australian property market has remained strong through tough economic conditions, and continues to punch above its weight.

AUTHORS — JENNELLE WILSON
Director - Research, QLD Research, Knight Frank Australia

— MATT WHITBY
National Director, Head of Research & Consulting, Knight Frank Australia

IN THIS CHAPTER

- **Australian office space is dominated by the Sydney market which accounts for 39% of all metropolitan office space within recognised office precincts.**
- **New construction will cause the office stock of major CBDs to grow by 7.4% and non-CBD locations by 7.3% over the next five years.**
- **Tenant demand is in early upswing in Sydney and Melbourne, while Brisbane and Perth are a little further behind in the cycle.**
- **Offshore purchasers accounted for 45% of all office transactions (US$9.3m) in 2013/14 as Australia was a hotly contested location for investment**

The six Australian cities with significant office markets are Sydney, Melbourne, Brisbane, Canberra, Perth and Adelaide and within recognised office precincts contain in the order of 315m sq ft of office space. The dominant city is Sydney with some 123m sq ft, accounting for 39% of the metropolitan office space within the major cities. This is significantly higher than Melbourne with 89m sq ft as, despite having relatively similarly sized CBDs, the suburban office space is far greater in Sydney – led by satellite locations such as Parramatta and North Ryde.

Over the past five years, despite the generally tougher economic conditions, construction has been strong with major office precincts in Sydney, Melbourne, Brisbane, Canberra and Perth adding over 10% to their stock base. The standouts were Canberra (which includes Civic & non-Civic) at 18.9%, Perth CBD at 17.7% and the Brisbane Fringe at 16.2%.

Australian office markets have been attracting increasing levels of international investment over the past 18 months. The stable legislative environment, transparent market structure and having demonstrated a degree of counter cyclical robustness to the rest of the global markets following the GFC have all attracted international investment. Steady supply additions, with substantial long-term tenant commitments, have ensured that sufficient stock of modern office assets are available to core investors, along with opportunities for investors to move up the risk curve with secondary or value-add assets.

CONSTRUCTION STRONG

Larger tenants have shown a clear preference to relocate to new accommodation with recent examples including Woodside (544,000 sq ft), PwC (285,000 sq ft Sydney, 188,000 sq ft Melbourne), KPMG (291,000 sq ft Melbourne) and Leighton (319,000 sq ft North Sydney). Relocating into new accommodation, whether in the CBD or non-CBD market, provides occupiers with strong Green Star and efficiency credentials (Energy & Water), larger floor plates and buildings designed to take a higher density of occupation (circa 110-160 sq ft per person); all elements which support the more open and flexible workspaces that are now the norm.

Feasibility for construction of new space has been supported by steady declines in prime yields (particularly for fund through developments with strong pre-commitments) over the past two years. This increase in end value, along with generally competitive construction costs, has allowed this new space to compete strongly for tenants, with rentals often comparative to existing buildings. This trend requires owners of existing assets to compete to retain major tenants against the competition of new space, and this can also draw tenants from different sub markets (i.e. CBD to non-CBD locations).

CONTINUED

The steady pre-commitment of larger tenants to new accommodation has ensured that the next five years will continue to see relatively strong construction levels and within the major markets analysed by Knight Frank, CBD space is projected to grow by 7.4% and non-CBD by 7.3%.

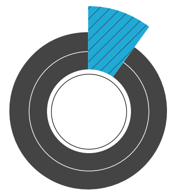
However despite strong investment take-out demand supporting feasibility, office developments are now coming under pressure due to the exceptional uptick in residential demand. The clamour to obtain residential development projects is now converting the vast majority of the available development sites from commercial to residential, where planning permission allows, across both CBDs and inner ring suburbs.

RECYCLING OF STOCK

In addition, due to the relatively softer leasing market conditions for existing secondary accommodation there is a growing trend to purchase older commercial buildings for conversion to residential accommodation. Despite the relatively condensed nature of most Australian CBDs, with physical constraints (Rivers/Harbours) defining their boundaries, this wave of demolition and recycling of significant properties is unheralded.

This recycling of older stock, along with continued steady new supply is expected to see the average age of CBD stock stabilise over the next three years with the weighted average increasing by only six months over the next three years to 28.8 years, with Perth actually reducing its average age base.

The provision of major development sites and the expansion of the CBDs has in many instances been supported by government action. The largest current project is Barangaroo in Sydney which involves the regeneration of 22ha of disused wharves, extending the CBD to the west. The three commercial towers of Barangaroo South, 'International Towers Sydney', will contain 2.9 m sq ft with pre-commitments from Westpac (646,000sq ft), KPMG (409,000sq ft), Lend Lease (189,000sq ft) and PwC (285,000sq ft). Similar projects include City Link, Perth (a 13.5ha site) and the long running Docklands in Melbourne which now houses 8.2m sq ft of office space with the potential for a further 3.8m sq ft.



10%
Major Australian CBDs stock growth over the last 5 years

Total stock within recognised major metropolitan markets

315 MILLION SQ FT

> "THIS WAVE OF DEMOLITION AND RECYCLING OF SIGNIFICANT PROPERTIES IS UNHERALDED"

In other markets, such as North Sydney, there is unrestrained competitive tension between commercial and residential uses. In North Sydney this is expected to manifest as a concentration of office accommodation to the core of the precinct, with residential development establishing on the edges. Other markets, such as St Kilda Road in Melbourne and Chatswood in Sydney, are already losing the battle to residential and/or medical uses with the office stock in the precincts gradually shrinking.

EARLY UPSWING

Occupier demand for office space has steadied across the Australian markets with vacancies stabilising across most markets and the amount of sub-lease space declining. Melbourne and Sydney in particular are in the initial stages of an upturn in demand. However, weighed by their exposure to the resources sector the Brisbane and Perth markets have yet to see any major improvement in office demand. The Sydney market has the greatest exposure to the financial services sector and thus was the city which fared the worst immediately post the GFC, followed by Melbourne which also has exposure to financial markets and major corporates.

In contrast the Brisbane and Perth markets were supported by strong expansion in the resources sector which cushioned these markets from a direct GFC impact. However from late 2012 the fortunes have reversed with Sydney and Melbourne benefiting from slowly recovering financial/corporate demand while weakness in the resources sector has slowed demand in Perth. Brisbane was impacted by both the resources sector weakness and also major contraction of space occupied by the State Government in early 2013.

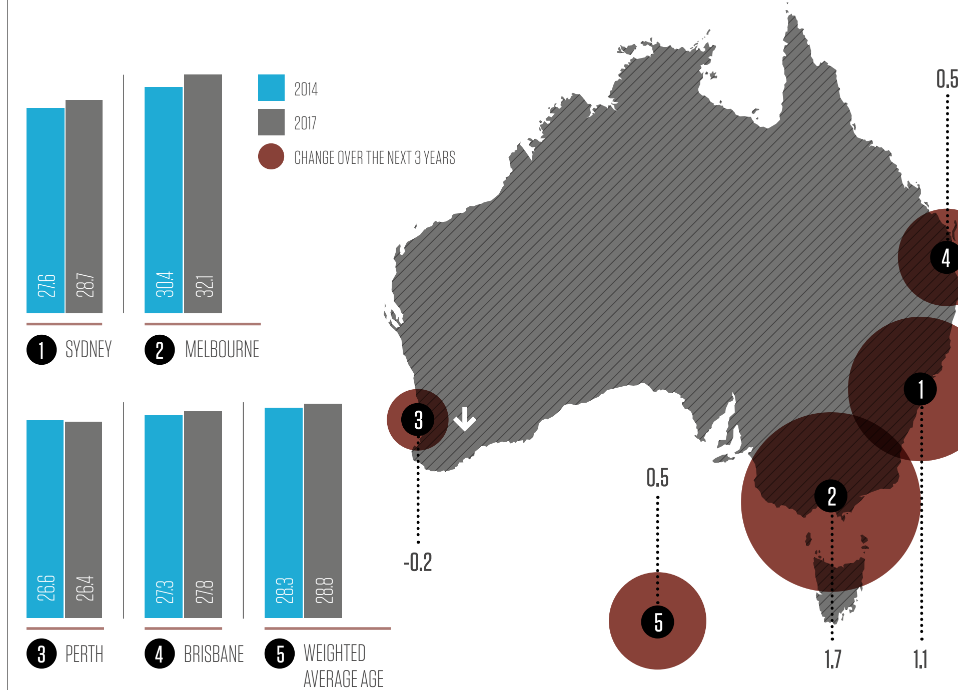
The rental levels across the Australian office markets are quite diverse, even amongst the CBD markets, and the current average prime net face rentals range from US$42 per sq ft in the Melbourne CBD through to US$71 per sq ft in the Sydney CBD. Melbourne's rents have traditionally been lower than its main competitors, despite frequently having lower vacancy, largely due to the relatively unlimited amounts of development land surrounding the CBD. However medium term rental growth projections for Melbourne are amongst the strongest of the CBD markets.

Prime effective rental growth has been modest across all major markets as tenants retain the upper hand in most negotiations. Incentives are now an entrenched part of the market with prime incentives lower in the Perth and Canberra markets (18-21%) but higher in Sydney, Melbourne and Brisbane (28 – 33%). Across all markets however, given the expected improvements to occupier demand from late 2014 and into 2015, incentives are at or very close to their expected peak for this cycle. Stronger business conditions are forecast, which will support recovery in the tenant markets through 2015, reducing leasing risk for many investors.

TURNING BACK TIME – AVERAGE AGE OF STOCK

WEIGHTED AVERAGE AGE INCREASES BY 6MTHS IN THE NEXT 3YRS

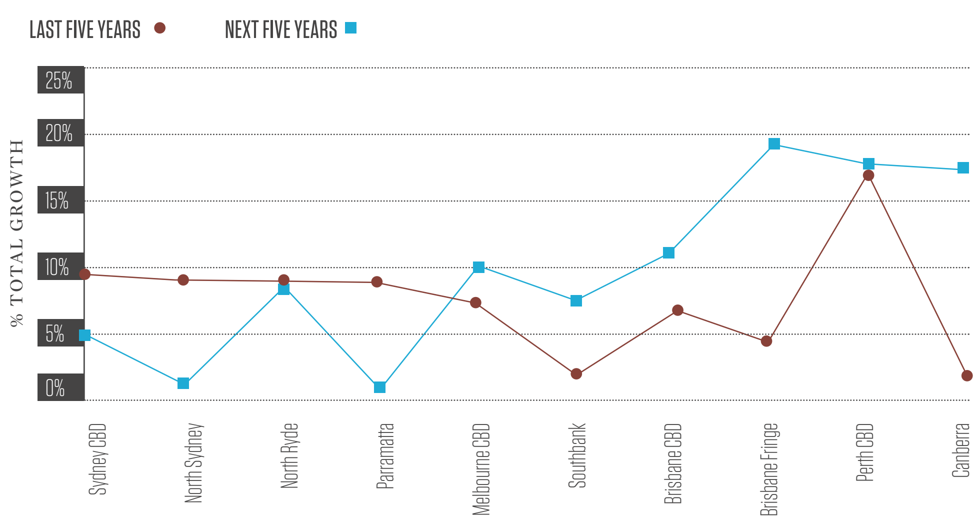
Source: Cityscope/Knight Frank

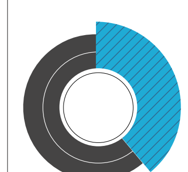


GROWTH IN OFFICE STOCK

HISTORIC AND PROJECTED

Source: PCA/Knight Frank





39%
of stock within major metropolitan markets is within Sydney

A WORKING DAY IN SYDNEY

JANE JOSE
URBANIST AND WRITER

CHIEF EXECUTIVE, SYDNEY COMMUNITY FOUNDATION

Think Sydney, think Harbour. Office life in Sydney's business district is shaped by the sense that the magnificent landscape and harbour is never far away. If there is not a harbour glimpse or a sweeping panorama from city centre offices, it is only a short walk to the water's edge.

The office day in Sydney for many starts with a ferry ride, a bike ride or a walk. It is a city where office life can keep you fit. Thousands arrive by bus and train but the system is not the London underground or Paris metro with many well located stations so there's usually a walk involved.

I've worked in Sydney since the mid-1990s and in the 21st century office life has become more relaxed. Sydney was an early adopter of sustainability in office tower design with the leading developers and their architects jumping on board the sustainability challenge of designing work places flooded with natural daylight, able to recycle water and generate power. The design of more casual open workplaces with long shared tables, stairs between floors, natural materials and colour-splashed interiors and cafés on tap has made workplace culture friendly. Australian developer Lend Lease led the change. Their Hickson Road Offices, known as 30 the Bond, a new building connected to an old woolstore and built against a sand stone cut down by the wharves set a benchmark for environmental sustainablility. The top new office towers in Sydney have harbour views, rooftop decks, staircases connecting floors, all making the new office tower work efficiently yet feel like smaller buildings with a human scale. The best recycle water, generate more power than they need and offer stylish, comfortable gathering places for teamwork that have the informality of working round the kitchen table.

If the sun is shining and it often does, city workers head out at lunch time to run in the botanic gardens; kick balls on the Domain; find a quiet spot in Hyde Park for a sandwich or go west to the foodie strip of indoor-outdoor eateries along the Darling Harbour and Hickson Road wharves, that line the western edge of the city.

So what's my favorite reason for loving office life in Sydney? Walking along the harbour's edge to my office in the Rocks. Then there's the rooftop café at the MCA for lunch, great shopping, good coffee everywhere and surprise views in business meetings that lighten your heart – even when it's a hard day's work.

Jane has written and informed urban policy for cities across Australia. She brings experience in urban planning, working with government and corporate leaders to her work at the Sydney Community Foundation. Sydney Community Foundation directs philanthropic wealth to people in need, grassroots organisations, and creates change.

Jane Jose's book Places Women Make will be published by Australian publisher Wakefield Press in 2015. It tells stories cities and how women have contributed to making great places in Australian cities.

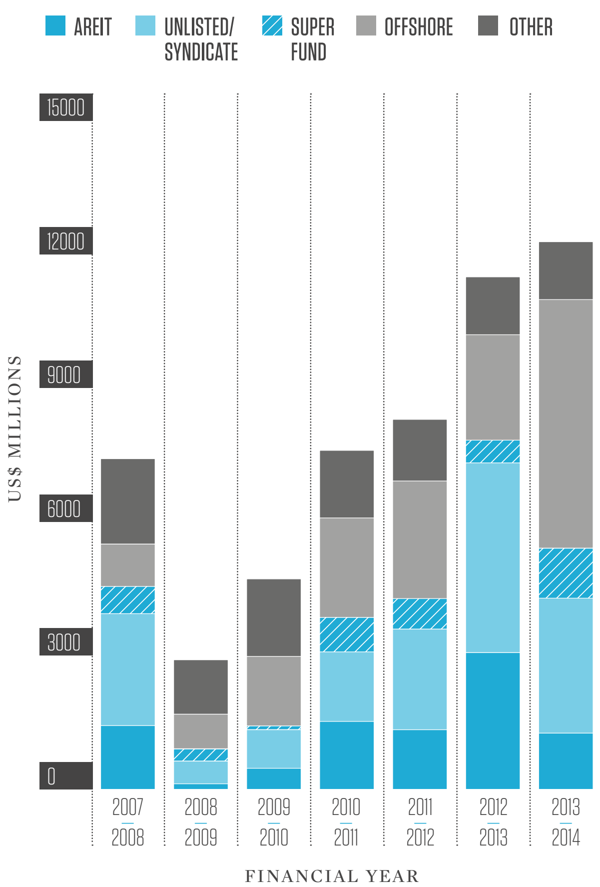
AUSTRALIAN PROPERTY ATTRACTS INTERNATIONAL CAPITAL

Australian property is in favour with international buyers competing with improved market conditions.

FINANCIAL YEAR TRANSACTION VOLUMES BY PURCHASER TYPE

(OVER US$9.3M)

Source: Knight Frank Research



The Australian office investment market has experienced favourable conditions over the past 18 months with demand from both domestic and offshore investors steadily increasing. The total transaction level (office assets US$9.3m+) was US$12bn for the 2013/14 financial year. This increasing activity comes as the market has shown steadily broadening demand for properties beyond core assets and also a deepening pool of buyers, particularly from offshore locations.

The improving investment market conditions, and associated tightening yields, have been driven by concurrent upswings in demand from AREITs (Australian Real Estate Investment Trusts), offshore funds (both listed and wholesale) and domestic wholesale and super funds. During 2013 and into 2014 the investment market has transformed from one where only core assets were likely to attract investors, to a situation where a number of competitive bids can be expected across the whole gamut of asset types – from core to secondary/value-add. Major investment interest has also built outside of the CBD locations with offshore purchasers in many cases more tolerant of a non-CBD location than domestic funds.

FRACTIONISATION OF OWNERSHIP

Increasing fractionisation of ownership is a feature of the current market, as the strongly contested core assets are relatively scarce and part ownership has been one of the first entry points for major offshore investors. This has sometimes led some foreign buyers to partner with domestic funds to buy an asset.

Examples include Charter Hall and PSP (Canada) who have jointly purchased the Gasometer 2 development in Brisbane's Fringe (end value US$164m) and along with another frequent joint venture partner, Telstra Super, have taken equal shares in 300 Murray Street, Perth CBD for a total of US$431m. Mirvac and TIAA-CREF (USA) have also formed an association, with the TIAA General Fund taking a 50% interest in 699 Bourke Street (fully committed to AGL for 10 years) on a fund through basis for a maximum of US$69m. TIAA also purchased 20 Hunter Street in the Sydney CBD for US$90m in late 2013. These two assets were purchased for core market yields of 6.5% and 6.9% respectively, indicative of the strong demand for core investments and the ability of offshore funds to pay these tight yields.

> "YIELDS HAVE SHOWN A STEADY FIRMING TREND OVER THE PAST TWO YEARS, HOWEVER THEY REMAIN WELL ABOVE THE YIELDS IN PLACE ACROSS COMPETING ASIAN AND INTERNATIONAL MARKETS"

Local institutions also manage their mandates by co-investing a listed entity with a wholesale fund such as DEXUS Property Group and DEXUS Wholesale Property Fund who have co-purchased assets (i.e. 12 Creek Street, 480 Queen Street Brisbane; 39 Martin Place Sydney and KS1-3, Perth) on a 50/50 joint basis for a combined US$1.3bn during 2012 and 2013.

Where capital recycling is required and given the higher capital values on offer, entities have sold partial interests in assets to capitalise on these higher values while maintaining exposure to that asset. As an example Stockland (SGP) sold a 50% interest in 133 Castlereagh St, Sydney CBD to Investa Office Fund (IOF) for US$183m in early 2014. Stockland retains the other 50% interest but will recycle the capital from the sale into other areas of the business.

YIELDS TIGHTENING

In response to increasing investment demand, yields have shown a steady firming trend over the past two years, however they remain well above the yields in place across competing Asian and international markets. These relatively higher levels of return, despite a degree of lingering weakness in the leasing market, has been a major driver and attracted offshore funds to Australia. To an extent these higher returns have also assisted to keep a greater level of domestic capital within Australia, despite some diversification purchasing in other markets. Median core prime market yields have tightened by 50-70 basis points across the cycle to date, with downward pressure continuing. The lowest average Australian yields are within the two markets with the greatest exposure to international capital with Sydney (6.32%) and Melbourne (6.38%) both established, recognised destinations for international investments. Brisbane (average prime yield of 7.00%) and Perth (7.60%) have recently seen the proportion of offshore investment increase with buyers from North America (Pembroke Real Estate, Blackstone Group, PSP), Europe (Union Investment Real Estate, Credit Suisse) and Asia (Far East Organisation, MGPA, Keppel REIT Asia) all increasing their exposure in these cities.

Despite this tightening, the current yield spread to indexed 10 year bonds indicates the risk premium for Australian property remains above the 15-year average for prime CBD assets, which supports the potential for further yield tightening within a stable interest rate and exchange rate landscape. It can be argued that Melbourne, which has a higher risk premium average (435 basis points) compared to Sydney (388 basis points), is now in the midst of a re-rating as the city is now a destination considered along with the Sydney market for major global investment. Despite the recent reduction in the spread between 10 year bonds and prime yields, and the potential for further falls, the cost of capital in Australia (with the 10yr nominal bond yield 3.47%) does place a floor under prime yields.

Offshore investors accounted for

45%

of office transactions during 2013/14

Offshore entities invested US$5.4bn in the Australian office market during 2013/14, more than double the previous high of US$2.3bn in 2011/12.

The insatiable demand for core assets across the globe has brought the spotlight to Australia, however there has also been strong offshore purchasing of value-add, non-CBD and development assets arising from this increased focus. The future for the Australian office market is expected to entail further competition between local and offshore funds with greater joint venture opportunities and further fractionisation of assets.

Large scale industrial assets draw offshore investment

The Australian industrial market is beginning to show many parallels to the office market, with increased investor interest from both local and offshore groups, although the penetration into the market by offshore capital as yet is much lower than for the office market.

One major barrier to widespread investment by offshore entities has been the quantum of investment, with the industrial market traditionally providing limited assets of a scale (US$70m+) that would be considered attractive to an offshore purchaser, however this is changing. Portfolio purchasing has been one model to attract offshore funds (i.e. GIC Logos) along with development pipeline joint ventures (GIC/Australand). Excluding geographically diverse portfolio sales, recent sales of note have included Sydney Corporate Park, Alexandria for US$320m and 85 William Angliss Drive, Laverton North (Melbourne) for US$87m.

In line with the office market, larger tenants are expressing a clear preference to relocate into newly built accommodation rather than remain in, or relocate to, existing facilities. In part this is also due to the lower yield environment allowing for these developments to be offered at highly competitive rental levels.

Another, less welcomed, element being imported from the office market is the rise of incentives and this is being experienced to the greatest extent in pre-leases with incentives of up to 15% reported.

Most tenants committing to new accommodation are retailers or 3PL providers and this is the most active industrial sub-market by far. The size of the facilities being committed to are also growing as large scale distribution centres are providing the economies of scale being sought by users to control their costs. Commitments of 40,000 – 50,000m²+ are no longer rare across the East Coast and provide the quantum of asset that will appeal to offshore investors.

Unlike the office market, most of the major industrial developers are also end investors with entities like Goodman and DEXUS developing largely to provide a pipeline of new assets under management. However falling prime yields in the industrial market (7.00% - 7.50% for premium product) are now shaking loose some of these assets with partial or full sell downs of developed stock, or potentially development pipelines. This is expected to increase under the weight of money and be a method for offshore entities to obtain core industrial investments.

AUSTRALIAN CITY DEVELOPMENT

Australia's real estate market in numbers.

LARGEST BUILDINGS UNDER CONSTRUCTION & POPULATION GROWTH

AREA (NLA SQ FT)

SYDNEY CBD

T1, Barangaroo
1.1m sq ft

T2, Barangaroo
950,000 sq ft

T3, Barangaroo
840,000 sq ft

BRISBANE CBD

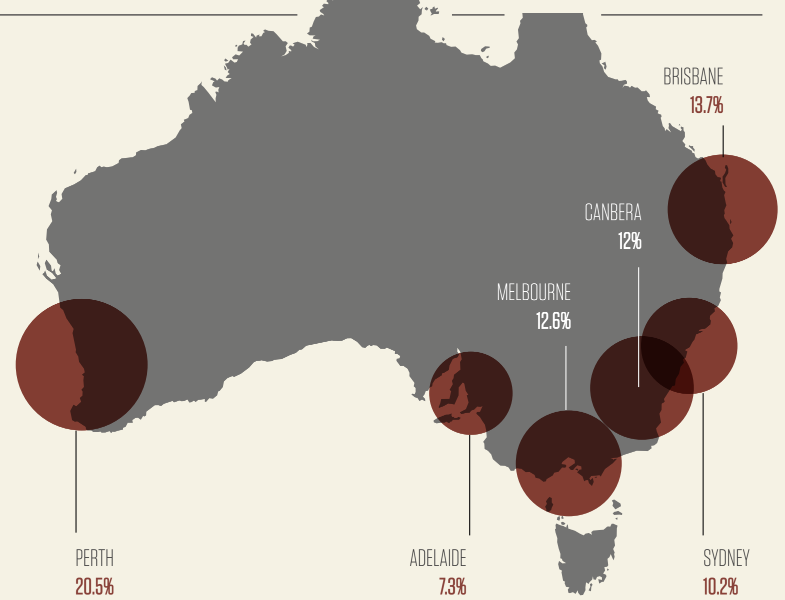
1 William St
805,000 sq ft

180 Ann St
620,000 sq ft

MELBOURNE CBD

2 Collins Square
590,000 sq ft

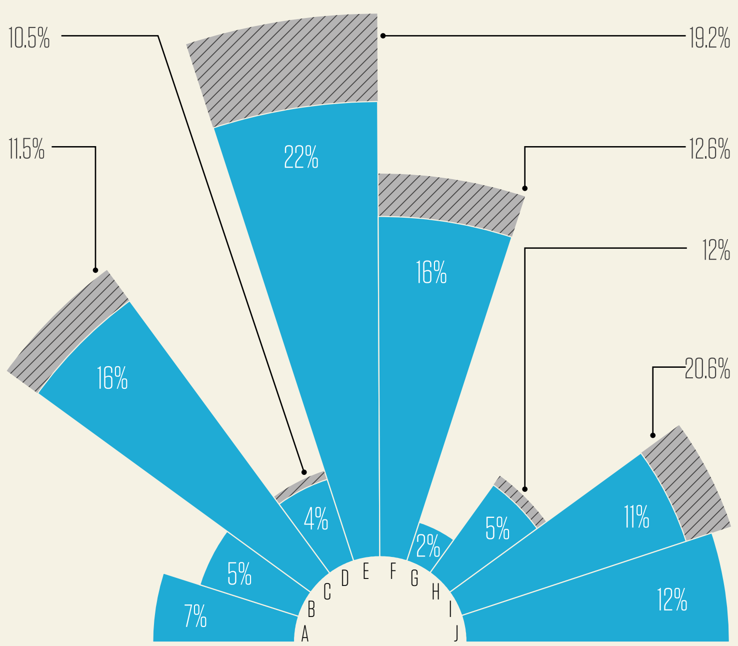
567 Collins St
590,000 sq ft



Source: Australian Bureau of Statistics (ABS) Greater Metropolitan Areas - Medium Series

AUSTRALIAN CBDs

WHITE COLLAR EMPLOYMENT

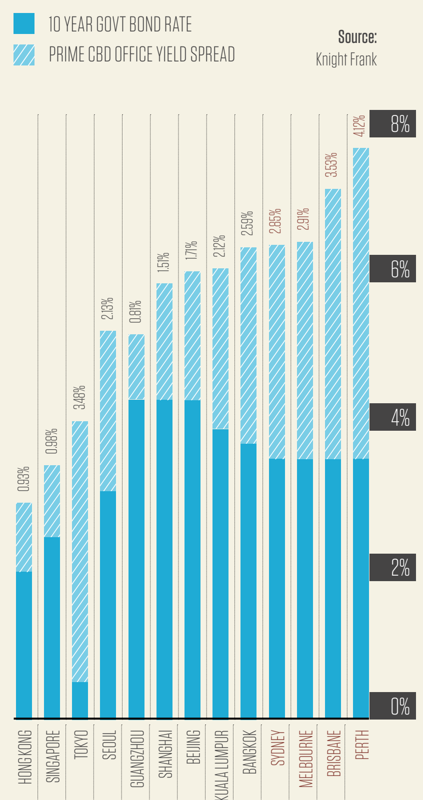


A Wholesale + Retail Trade
B Information Media & Telecoms
C Finance & Insurance Services
D Agriculture, Mining + Utilities
E Professional, Scientific and Technical Services
F Public Administration
G Manufacturing, Construction, Transport & warehousing
H Accommodation & Food Services
I Education, Healthcare & social Assistance
J Other

Source: Deloitte Access Economics

AUSTRALIAN PRIME YIELDS

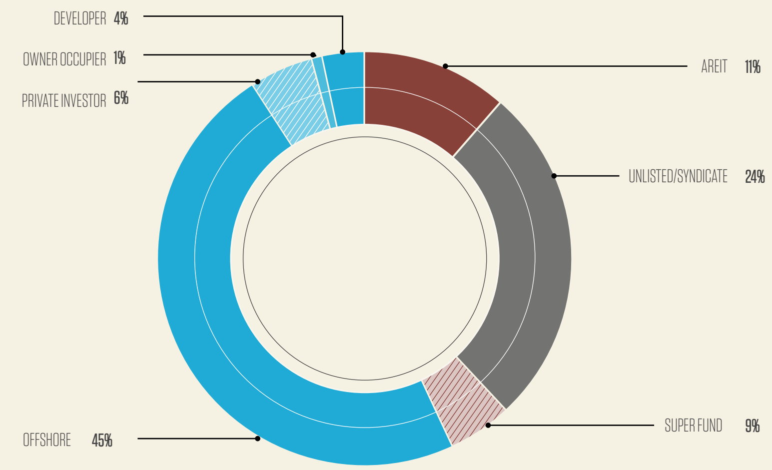
COMPARED WITH REGIONAL NEIGHBOURS, PRIME MARKET YIELD (LOCAL MARKET DEFINITION)



PURCHASER PROFILE

AUSTRALIA MAJOR OFFICE TRANSACTIONS 2013/14

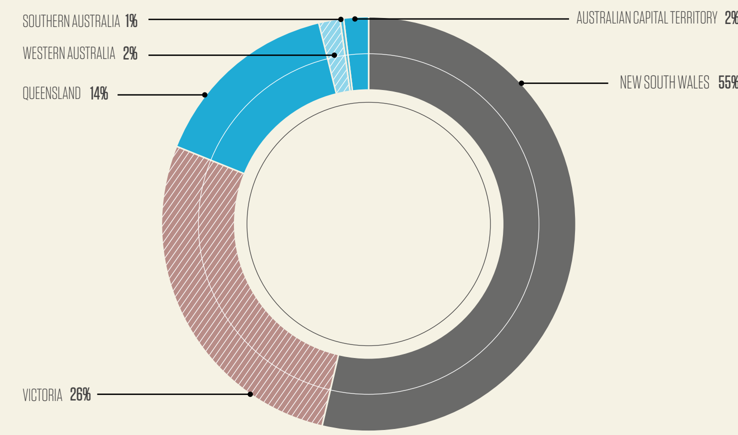
Source: Knight Frank Research



LOCATION OF SALES

AUSTRALIA MAJOR OFFICE TRANSACTIONS 2013/14

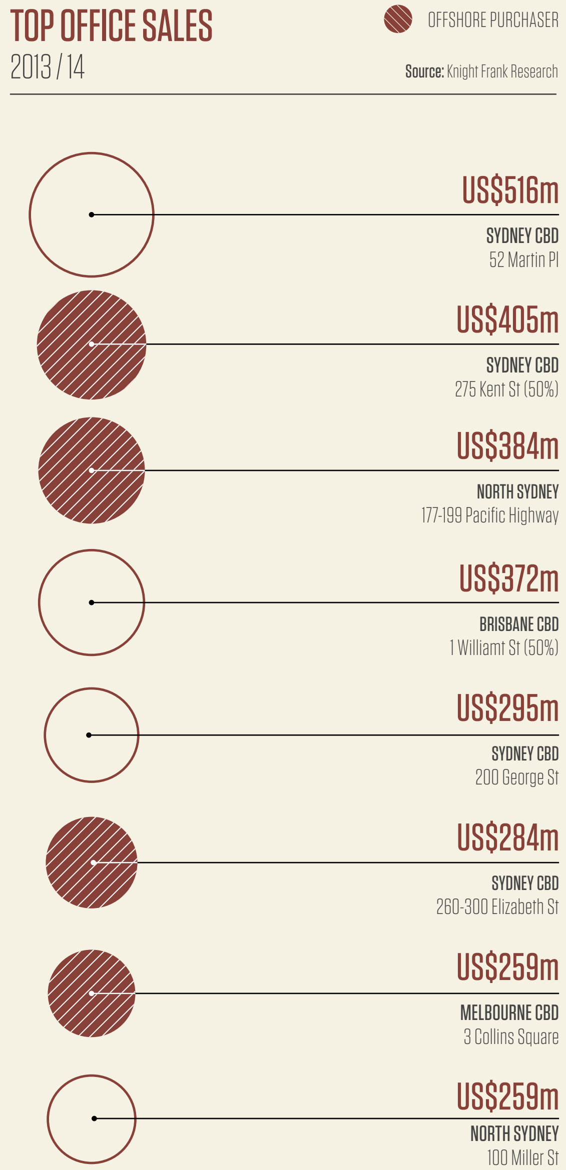
Source: Knight Frank Research



TOP OFFICE SALES

2013 / 14

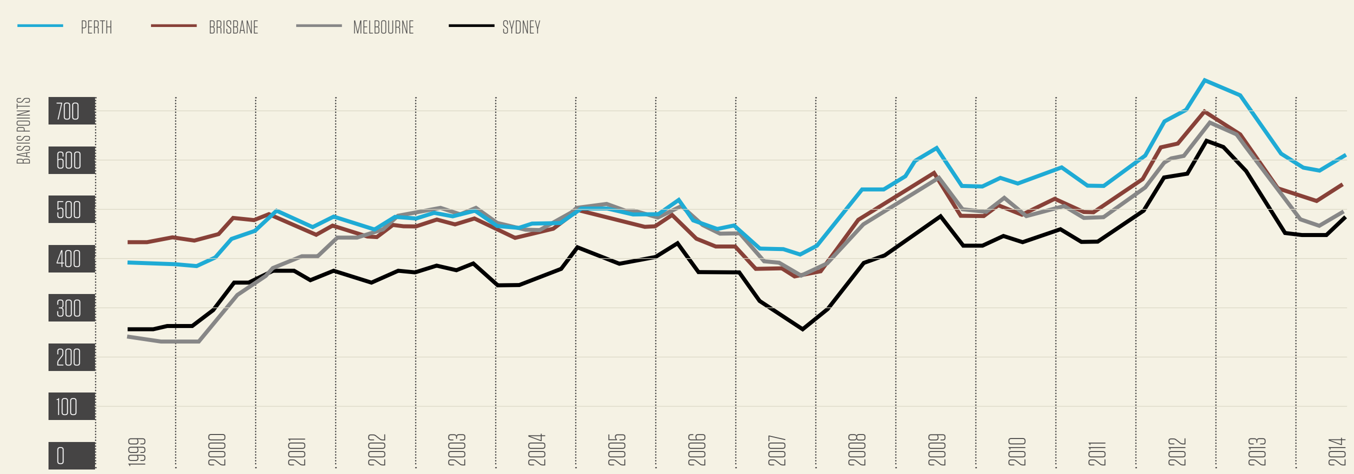
Source: Knight Frank Research



MAJOR CBD MARKETS

PRIME YIELD SPREADS TO INDEXED BONDS

Source: RBA/Knight Frank

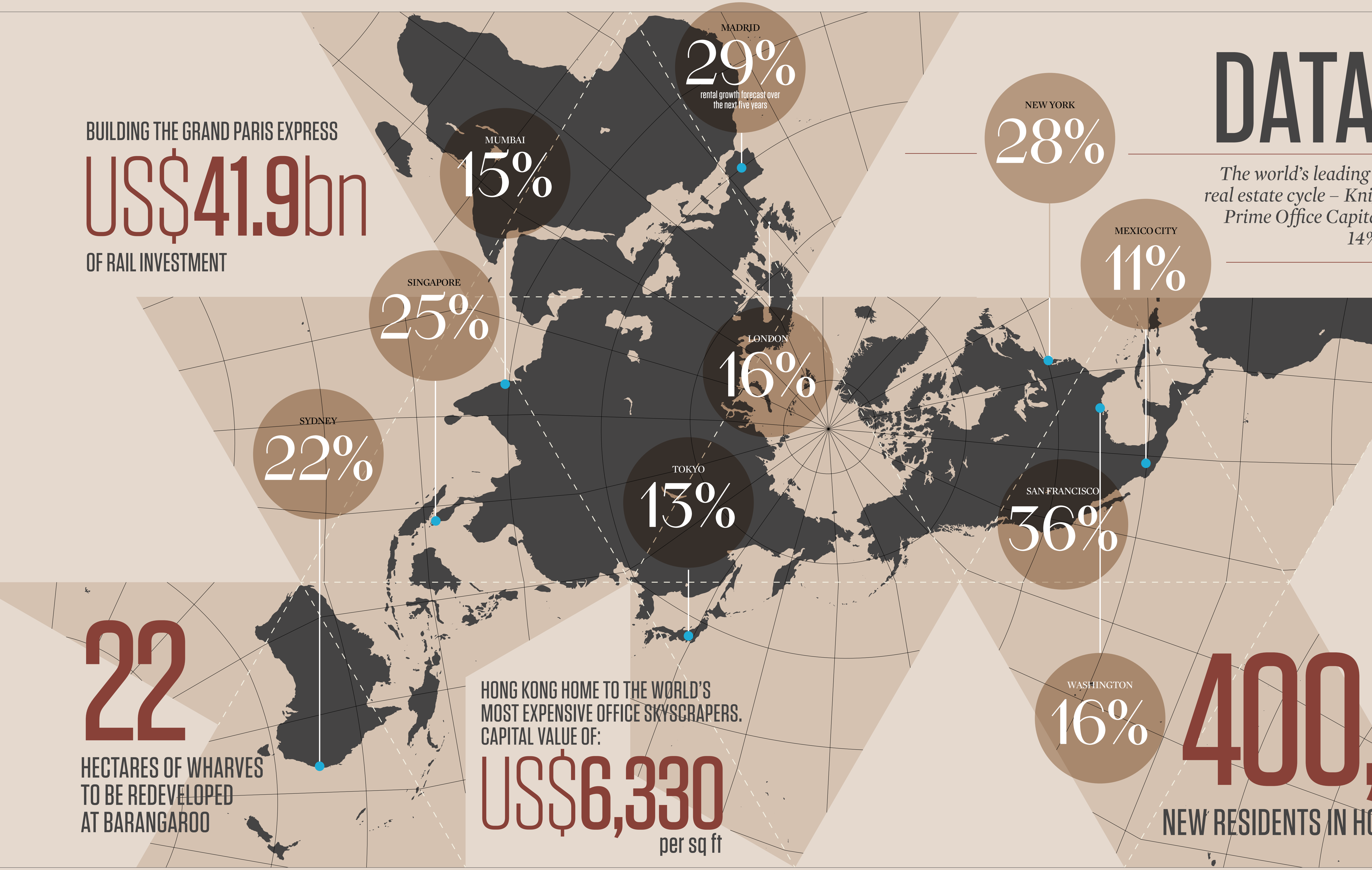


DATABANK

The world's leading cities have entered a new real estate cycle – Knight Frank's Global Cities Prime Office Capital Value Index to grow by 14% over the next five years.

rental growth forecast over the next five years

Source: Knight Frank Research / Newmark Grubb Knight Frank



BUILDING THE GRAND PARIS EXPRESS

US$41.9bn

OF RAIL INVESTMENT

22

HECTARES OF WHARVES TO BE REDEVELOPED AT BARANGAROO

HONG KONG HOME TO THE WORLD'S MOST EXPENSIVE OFFICE SKYSCRAPERS. CAPITAL VALUE OF:

US$6,330 per sq ft

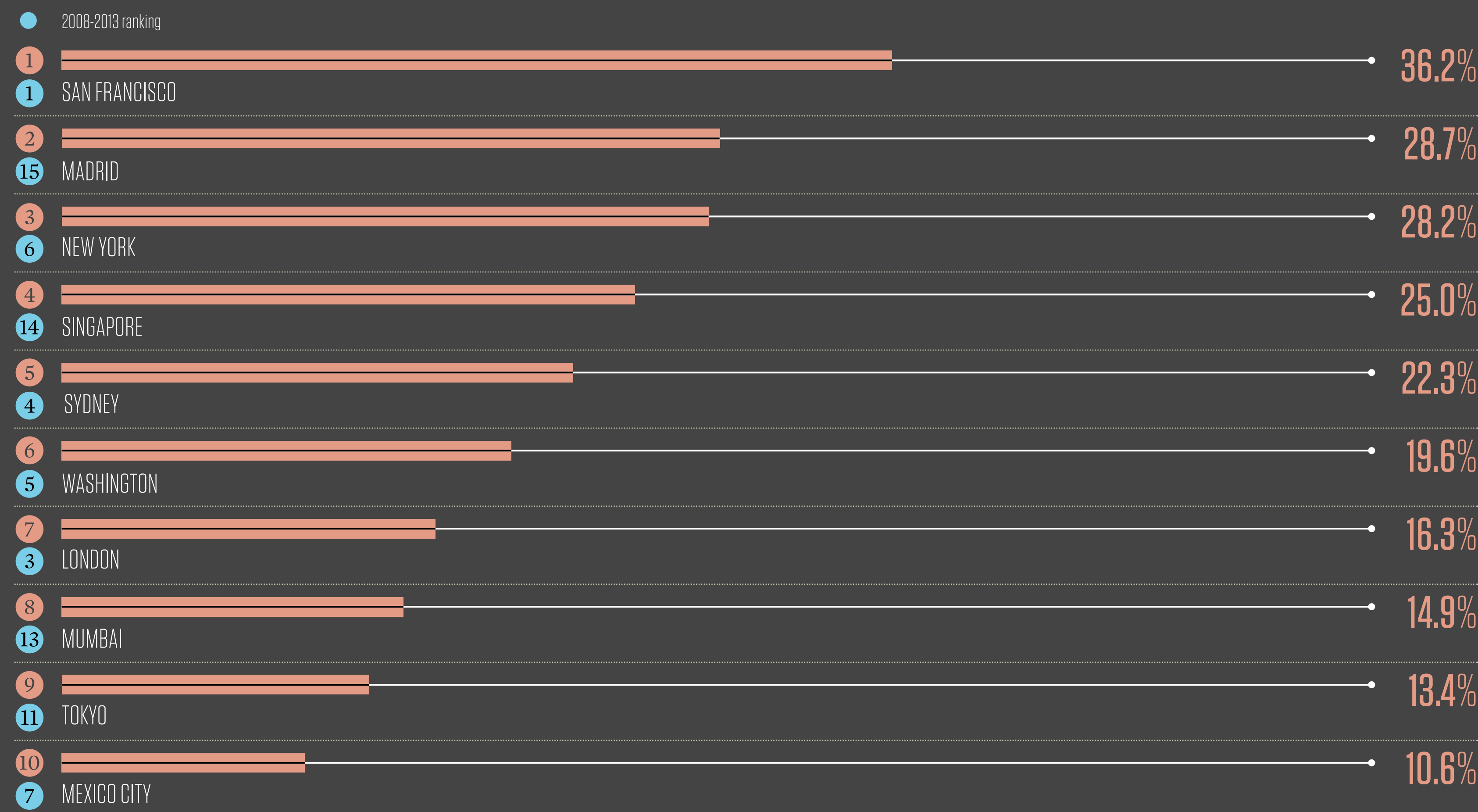
400,000

NEW RESIDENTS IN HOUSTON SINCE 2010

DATABANK

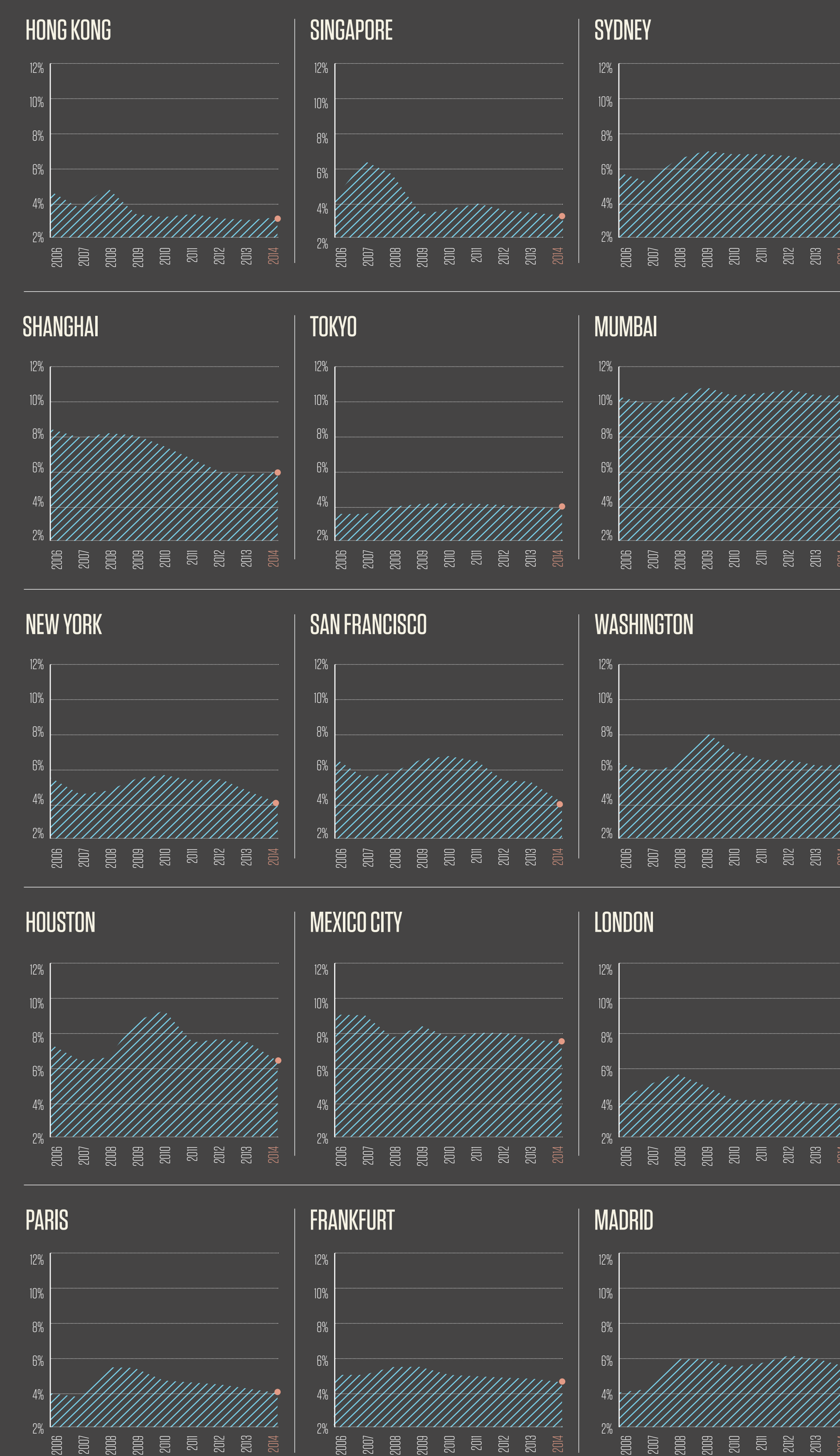
RENTAL GROWTH RANKING (% GROWTH 2014-2019) BASED ON LOCAL CURRENCIES

Source: Knight Frank Research, Newmark Grubb Knight Frank



OFFICE PRIME YIELDS (%)

Source: Knight Frank Research, Newmark Grubb Knight Frank



OFFICE VACANCY RATE (% OF TOTAL BUILT STOCK)

Source: Knight Frank Research, Newmark Grubb Knight Frank

NOTE: ALL FIGURES ARE YEAR END.

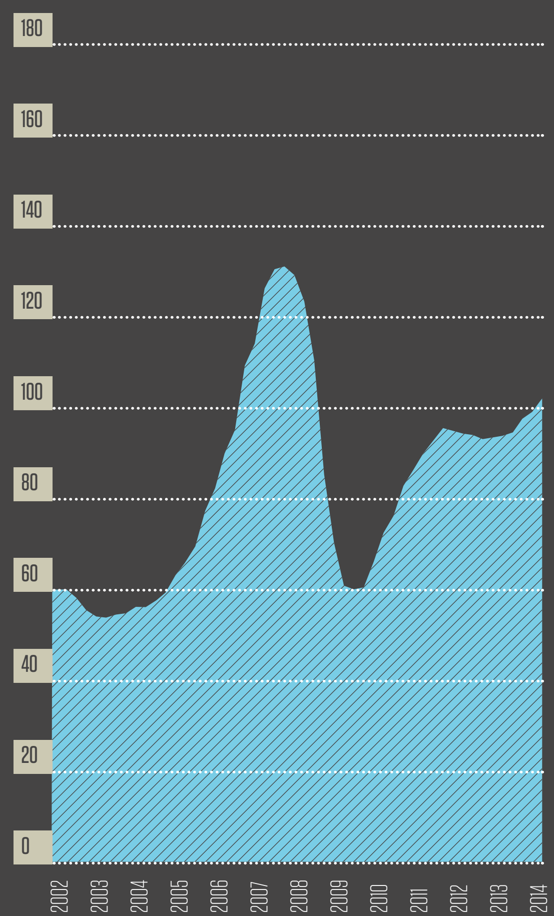
	HONG KONG	SINGAPORE	SYDNEY	SHANGHAI	TOKYO	MUMBAI	NEW YORK	SAN FRANCISCO
2006	7.7%	10.3%	7.9%	8.2%	2.7%	4.9%	5.9%	9.3%
2007	8.9%	7.3%	3.7%	5.5%	2.0%	2.9%	5.0%	8.1%
2008	8.4%	8.8%	5.4%	13.5%	3.6%	4.3%	6.7%	11.6%
2009	10.3%	12.1%	8.2%	16.7%	7.2%	12.2%	8.3%	14.8%
2010	8.0%	12.1%	8.3%	12.0%	8.0%	14.0%	8.6%	14.3%
2011	6.5%	11.3%	9.7%	6.6%	7.8%	19.3%	7.8%	9.3%
2012	6.0%	9.4%	7.2%	5.1%	8.4%	23.2%	7.9%	7.4%
2013	4.9%	9.9%	9.0%	4.3%	6.8%	23.0%	8.9%	6.0%
2014	5.2%	10.3%	8.8%	5.9%	5.8%	23.0%	8.4%	5.9%
2015	5.3%	9.8%	10.1%	6.4%	5.0%	18.7%	8.0%	5.8%
2016	5.0%	9.3%	12.3%	5.9%	4.2%	16.1%	7.8%	5.7%
2017	4.8%	8.8%	11.9%	5.6%	4.0%	15.1%	7.7%	5.5%
2018	4.6%	8.4%	11.5%	5.4%	4.0%	14.1%	7.5%	5.5%
2019	4.5%	7.7%	11.1%	5.1%	3.9%	13.5%	7.4%	5.7%

	WASHINGTON	HOUSTON	MEXICO CITY	LONDON	PARIS	FRANKFURT	MADRID
2006	10.5%	15.0%	11.1%	6.5%	4.9%	16.7%	11.2%
2007	10.0%	11.9%	6.8%	6.2%	4.3%	14.2%	7.0%
2008	11.9%	14.1%	6.1%	8.2%	4.9%	13.7%	8.7%
2009	14.1%	16.5%	7.7%	10.2%	7.3%	14.3%	10.3%
2010	13.7%	16.3%	11.3%	8.1%	7.0%	14.4%	10.5%
2011	14.3%	16.1%	11.4%	7.3%	6.9%	13.5%	11.0%
2012	14.6%	14.4%	10.4%	7.2%	7.0%	12.1%	11.3%
2013	15.4%	14.2%	14.6%	7.0%	8.1%	11.4%	11.4%
2014	15.8%	14.0%	14.3%	6.1%	8.1%	11.4%	11.3%
2015	15.7%	13.9%	18.5%	5.4%	7.0%	10.8%	10.9%
2016	15.4%	14.2%	19.0%	5.3%	6.1%	11.3%	10.6%
2017	15.1%	14.4%	15.0%	4.6%	6.1%	10.7%	9.7%
2018	14.9%	14.3%	12.0%	4.6%	5.9%	10.3%	8.5%
2019	14.8%	14.1%	12.0%	4.4%	5.9%	10.0%	8.4%

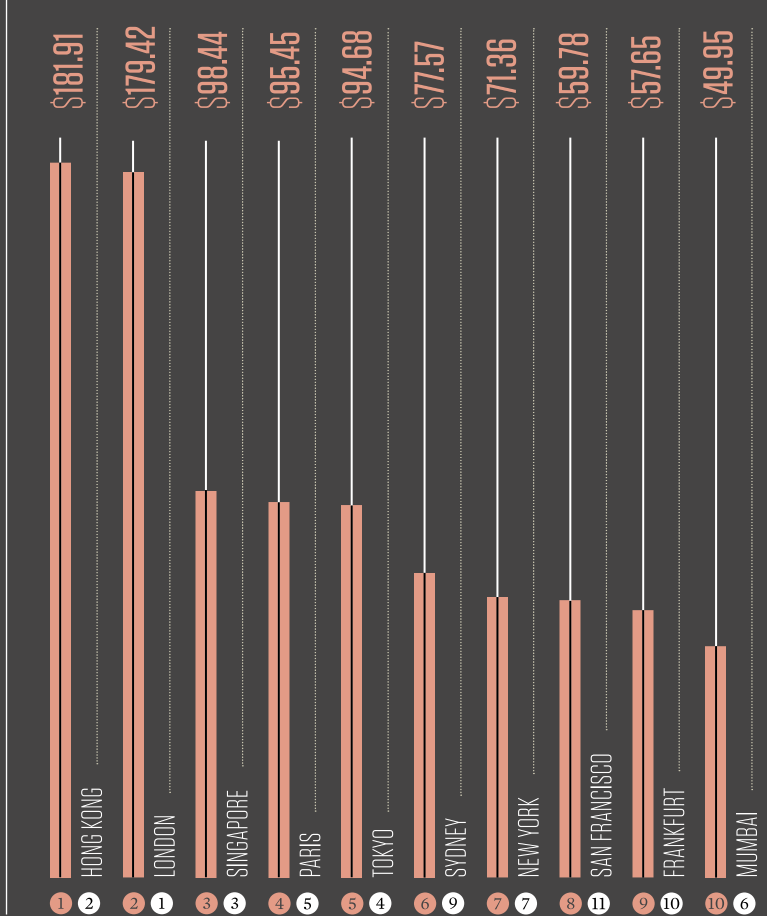
EUROPEAN PRIME OFFICE CAPITAL VALUES INDEX

Based on a weighted average of prime office capital values in 18 major markets

Source: Knight Frank Research

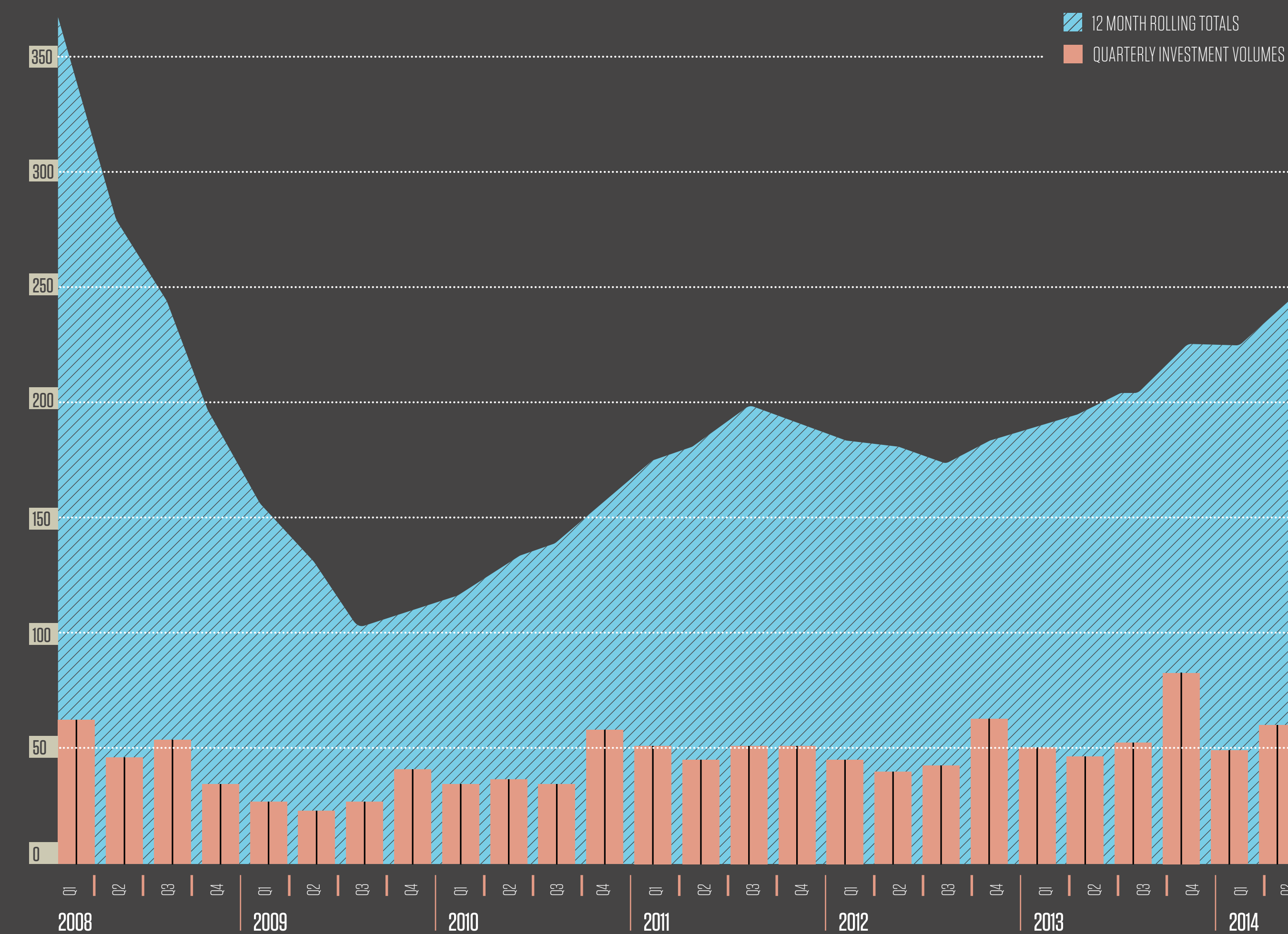


PRIME OFFICE RENT RANKING - 2014



EUROPEAN COMMERCIAL PROPERTY INVESTMENT VOLUMES (US$BN)

Source: Knight Frank/Real Capital Analytics



PRIME OFFICE RENTS INDICES (2006 = 100)

NOTE: BASED ON NOMINAL AND YEAR END RENTS IN LOCAL CURRENCIES, EXCEPT MEXICO CITY, WHICH IS IN US DOLLARS.

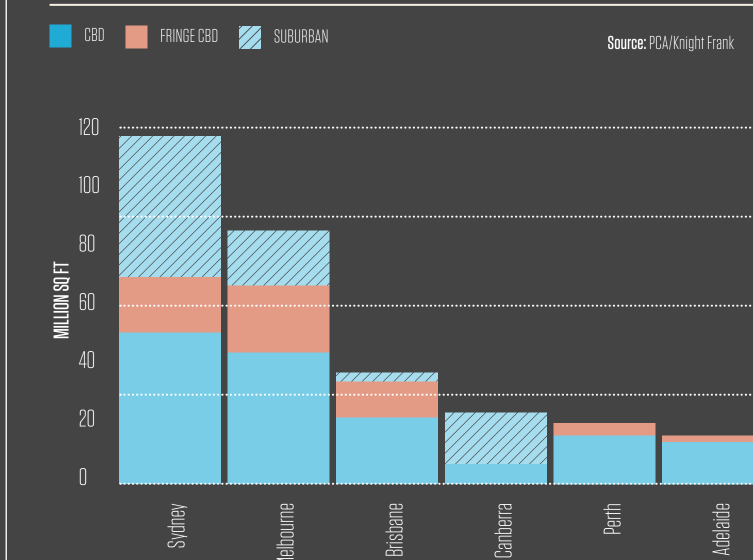
Source: Knight Frank Research, Newmark Grubb Knight Frank

	HONG KONG	SINGAPORE	SYDNEY	SHANGHAI	TOKYO	MUMBAI	NEW YORK	SAN FRANCISCO	WASHINGTON
2006	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
2007	142.2	190.5	109.3	108.1	106.8	150.0	119.4	127.2	104.7
2008	132.1	161.7	116.2	109.8	80.2	165.0	107.3	112.1	105.7
2009	99.2	82.7	112.0	91.0	55.0	96.5	85.4	94.1	106.6
2010	137.8	110.8	113.6	95.2	59.5	161.5	88.0	99.7	105.1
2011	149.7	127.3	115.6	106.6	57.4	127.5	97.9	114.4	104.1
2012	127.8	113.1	119.3	108.9	64.3	126.4	105.7	143.3	105.2
2013	128.0	114.6	121.9	109.3	74.5	122.1	107.8	153.3	109.1
2014	129.1	125.8	121.9	107.1	77.1	122.2	112.6	162.5	110.2
2015	131.3	134.7	125.6	105.0	82.2	124.9	117.7	172.4	113.3
2016	132.3	143.5	129.4	103.1	84.1	132.2	123.6	182.1	117.0
2017	134.3	145.3	135.8	106.1	85.0	133.7	129.7	194.2	121.6
2018	140.2	153.2	144.0	110.0	86.0	137.8	138.8	207.7	126.7
2019	142.0	157.2	149.1	111.8	87.5	140.4	144.4	221.2	131.8

	HOUSTON	MEXICO CITY	LONDON	PARIS	FRANKFURT	MADRID
2006	100.0	100.0	100.0	100.0	100.0	100.0
2007	110.9	106.3	122.2	113.5	108.6	110.5
2008	117.6	102.4	102.8	113.5	111.4	110.5
2009	119.5	104.1	72.2	95.9	100.0	78.9
2010	117.8	124.7	94.4	101.4	100.0	73.7
2011	120.1	102.4	102.8	112.2	102.9	71.1
2012	123.8	110.9	105.6	108.1	102.9	65.8
2013	126.9	102.8	108.3	101.4	108.6	64.5
2014	131.9	102.8	119.4	102.0	108.6	75.0
2015	137.0	105.0	126.7	103.3	109.0	78.9
2016	139.0	105.0	130.0	106.1	110.4	87.7
2017	140.9	109.4	133.3	107.9	110.5	92.1
2018	142.7	109.4	136.1	110.7	111.5	94.7
2019	144.4	113.8	138.9	112.8	111.9	96.5

AUSTRALIAN MAJOR METROPOLITAN OFFICE STOCK - RECOGNISED PRECINCTS

Source: PCA/Knight Frank

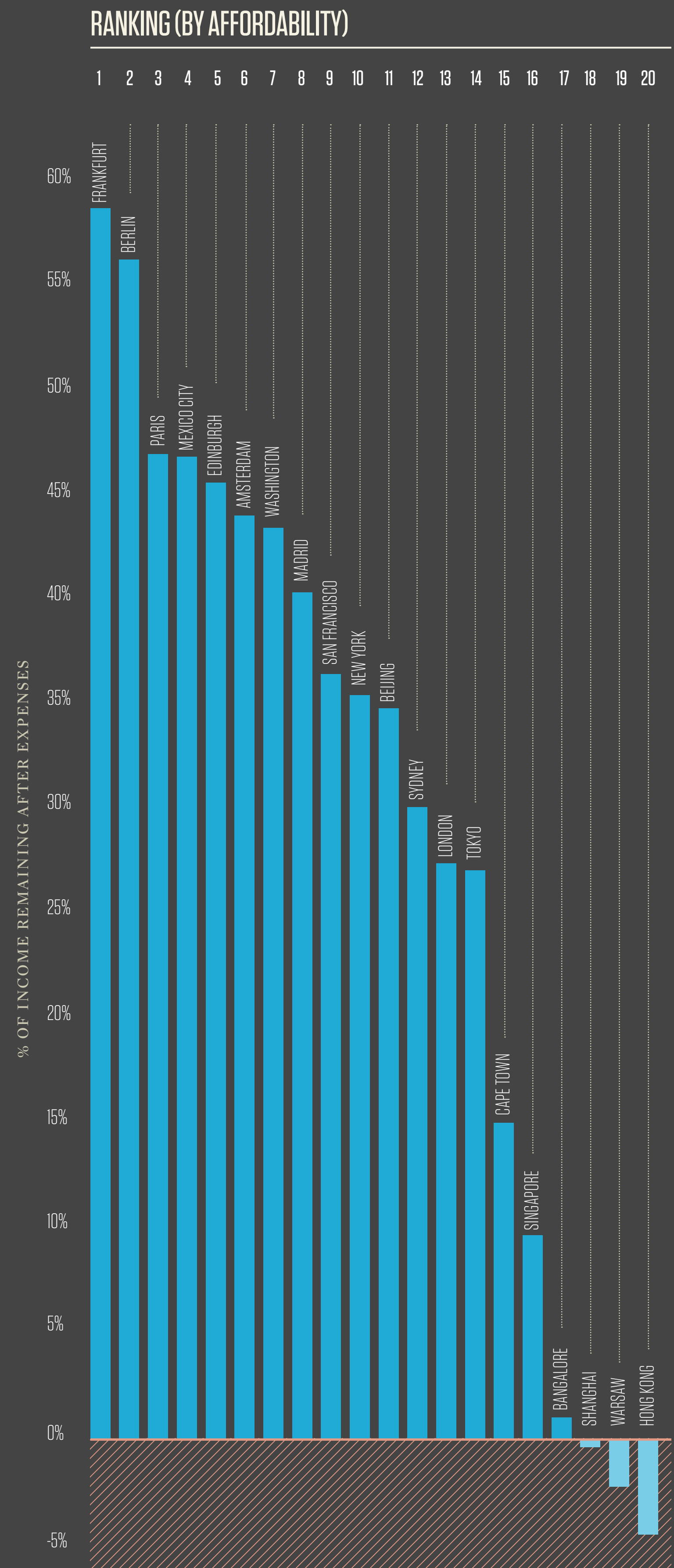


GENERATION Y COST OF LIVING INDEX

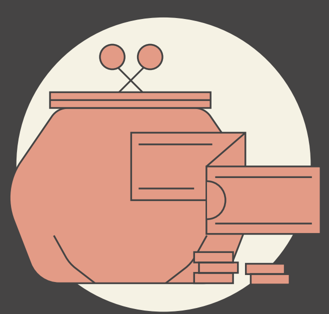
Many of the new districts emerging around the traditional CBDs have developed as vibrant and edgy places to live, and often appeal to young graduates starting out on their career. However, as the areas gain popularity, prices rise and often the young graduates struggle to remain in the area.

Knight Frank has compiled a Cost of Living Index for young graduates in the districts surrounding the CBD in the 20 global cities listed below. We have used variables including graduate starting salary, cost of rented accommodation and utility bills as well as the cost of a pint of beer, a coffee and groceries.

We have found that young graduates in Frankfurt have the most disposable income, with around 60% of their net salary left at the end of each month. However, in Hong Kong, young graduates wishing to live close to the city centre are likely to find themselves turning to their parents for support or taking on debt merely to survive.



Source: Knight Frank Research



Young graduates in Frankfurt have around

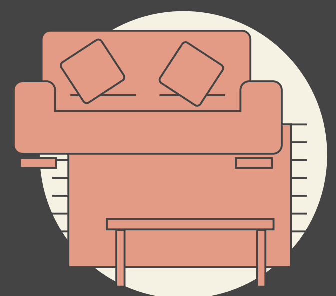
60%

of their net salary left at the end of the month

Young graduates in Hong Kong are forced to over spend and can be as much as

4.61%

in the red each month



ABOUT KNIGHT FRANK

YOUR GLOBAL PROPERTY PARTNER

The four ingredients which set Knight Frank apart are our independence, our global network, and our commercial and residential platforms.

Through our US alliance with Newmark Grubb Knight Frank we have grown to a group of over 12,500 property professionals, with more than 335 offices around the world, our global capability allows us access to wealth, properties and occupiers in 52 countries.

Just as important as reach is depth. In every country we are active in we aim to provide a range of services, predominantly covering Capital Markets, Office Agency and Tenant Representation, Valuations, and Residential. We deliver a range of professional consultancy services which are supported by our dedicated market research teams.

Knight Frank's track record of trust and integrity means we are becoming increasingly recognised as the advisor of choice in the global real estate market. Together with our independence, unmatched advice and ability to deliver seamlessly on both the commercial and residential front, we set ourselves apart in the global market place.

For many of our clients, Knight Frank is a lifelong experience, a fact exemplified by two thirds of our business being repeat clients. We focus on giving the best advice and putting long term relationships before short term wins, fully understanding client motivations, needs and behaviour.

We put smart technology to use to produce outstanding market intelligence. It means we can anticipate and respond to market trends worldwide with relative ease, providing informative research and advice to exploit properties and areas to their full potential.

The combination of our people, network, research and technology has helped us grow our enviable track record and that's why clients come back to us for their personal and professional property requirements. Strengthening partnerships, committed to uncompromising standards, our clients deserve nothing less.

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CAVEATS

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Within this report all figures quoted for 2014 (unless stated otherwise) are year-end estimates formulated in July 2014 based on available data. They constitute forecasts and our caveat below on forecasts applies.

All references to the "next five years" cover our forecast period – 2015 to 2019. References to the "last five years" apply to the 2009 to 2013 period, and data references are to historic figures.

This report was largely written in June and July 2014 based on available data and drawing from the business news and market sentiment at the time; with editing occurring during August 2014, then going to press in early September 2014.

Rent figures quoted for Houston, Mexico City, New York, San Francisco, and Washington, and any other cities in the Americas, are prime average asking rents. Rents elsewhere are quoted normal prime achieved.

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