Economic acceleration has improved prospects for occupier property markets in China, Hong Kong and Singapore. Against this background demand for investment property in Asia has stayed firm: deal volumes rose 19% YOY in H1 2017 to USD61.4bn. Hong Kong and Singapore saw robust activity across many sectors, while Shanghai was also strong. Yields have dropped further and spreads over bonds look very narrow.

However, demand shows little sign of slowing, while US dollar weakness has reduced upward pressure on interest rates and so further bolstered Asian property markets. Hence yields may fall still further over H2. Singapore appears especially attractive as an investment target. Looking ahead, we think the shift in Chinese interest from the US to Asia will persist, and spread to “Belt & Road” markets in South East Asia over the next few years.

**Executive Summary**

Globally and in Asia, economies are picking up: China, Japan, Hong Kong and Singapore should all record faster GDP growth in 2017 than last year. Improved economic conditions have boosted occupier property markets in leading Chinese cities, and in Hong Kong and Singapore. As a result prospects for rent growth, office net absorption and vacancy levels are generally more positive than we had assumed earlier this year.

Against this background demand for investment property in most Asia Pacific markets has stayed firm: excluding Australia, total transactions of completed properties rose 19% YOY in H1 2017 to USD61.4bn. Hong Kong and Singapore saw robust investment activity across most market segments - office, retail, residential and hotels - and rose to become, respectively, the first and fourth ranked APAC urban investment markets in H1. Hong Kong was stronger still including high mainland Chinese investment in undeveloped land sites. However, Shanghai was also strong, ranking in third place in H1 with far higher deal volumes than any other Chinese city.

Net yields on prime grade office property in major Asian investment centres have now fallen to between about 2.0% and 4.2%. Retail and industrial yields are higher but likewise flat or falling. Spreads over ten-year bonds are narrow or even negative. However, demand shows little sign of slowing, while US dollar weakness has reduced upward pressure on Asian interest rates and so further bolstered property markets. Hence we think yields may fall even further. Singapore stands out due to recovering occupier markets, higher yields than Hong Kong and a wider spread (1.5-1.7 percentage points) over bonds than Hong Kong or Tier I Chinese cities.

The focus of Chinese investment in foreign property seems to be shifting from the US to Asia. Despite capital controls, we expect continued Chinese interest in APAC gateway cities in the near term. Thereafter we foresee material Chinese investment in “Belt & Road” markets in South East Asia. This should be a long-run trend.

**Figure 1. Summary of prime grade office markets (leading greater China cities plus Singapore)**

<table>
<thead>
<tr>
<th>City</th>
<th>Rent growth (2016-2019 avg pa)</th>
<th>City avg vacancy (end Q2 2017)</th>
<th>City avg vacancy (end 2019E)</th>
<th>Net income yld*</th>
<th>10 year bond yld</th>
<th>Spread</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>+3.9% (+6.0%)</td>
<td>4.0% (2.1%)</td>
<td>6.2% (3.6%)</td>
<td>2.7% (2.0%)</td>
<td>1.3%</td>
<td>1.5pp (0.7pp)</td>
</tr>
<tr>
<td>Singapore</td>
<td>0.8%</td>
<td>6.9%</td>
<td>7.2%</td>
<td>3.5% -3.7%</td>
<td>2.0%</td>
<td>1.5pp - 1.7pp</td>
</tr>
<tr>
<td>Shanghai</td>
<td>-3.0%</td>
<td>12.9%</td>
<td>11.6%</td>
<td>3.6% (4.0%)</td>
<td>3.7%</td>
<td>0.1pp (0.3pp)</td>
</tr>
<tr>
<td>Beijing</td>
<td>-0.6%</td>
<td>8.6%</td>
<td>13.0%</td>
<td>4.2%</td>
<td>3.7%</td>
<td>0.5pp</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>-0.2%</td>
<td>20.2%</td>
<td>20.1%</td>
<td>3.5%</td>
<td>3.7%</td>
<td>-0.2pp</td>
</tr>
<tr>
<td>Taipei</td>
<td>0.3%</td>
<td>12.8%</td>
<td>13.8%</td>
<td>2.8%</td>
<td>3.7%</td>
<td>1.8pp</td>
</tr>
</tbody>
</table>

Notes.* Average for all Hong Kong; figures in brackets are for Hong Kong Island. † Singapore figures are for CBD. ‡ Shanghai: first yield is for CBD; yield in brackets is for DBD. Source: Colliers International Research, Bloomberg, as of 6 September 2017
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Asian economies strengthen further

Global and Asian economic growth remains firm, despite a moderation in trade activity in Asia since the middle of the year. China, Japan, Hong Kong, Singapore and – less certainly – India should all achieve stronger economic growth in 2017 than most observers predicted six to nine months ago. Concerns over increased US protectionism have eased, and most Asian currencies (especially the Japanese yen and Chinese renminbi) have stabilised or appreciated against the US dollar so far this year. This improving backdrop underpins prospects for both commercial occupier and commercial investment property markets in Asia this year.

Chinese economy is accelerating modestly

The largest and most important economy in Asia is China. Announced on 17 July, YOY real GDP growth for China in Q2 2017 was 6.9%, the same as in Q1. The high figure partly reflected surprising strength in housing sales growth and housing starts, especially in smaller cities. However, resilience in residential property was not the only factor at work. Notably, goods exports growth rose from 9.6% YOY in Q1 to 10.2% in Q2, driven by firm global demand. Moreover, growth in industrial value added rose to 7.6% YOY in June, while household consumption growth and retail sales were also robust.

Following the announcement, Oxford Economics has revised up its forecast for Chinese real GDP growth for 2017 as a whole from 6.3% to 6.8%, compared to 6.7% in 2016 (see Figure 2). Certain parts of China, notably the north-east, continue to face economic pressures. Moreover, since the announcement of the Q2 GDP there have been signs of moderation in trade activity which suggest that H2 will less strong for China than H1. Nevertheless, on a year-on-year basis, China is accelerating modestly rather than slowing down.

As shown in Colliers’ reports for Q2 2017, firm economic expansion drove stronger office net absorption and rental growth in H1 in large Chinese cities than we had expected. This was true for Shanghai, Beijing and Shenzhen, while in Chengdu robust demand for leased space meant that the city-wide vacancy rate fell by 4.1 percentage points from Q1 to Q2, even though the rate remains high at 30.5%. All these cities face heavy increases in supply of office space over the next few years. However, after the strong H1 outcome we predict robust take-up of new space and only modest pressure on office rent. Rental cash flows in excess of original projections are, of course, good news for investors in commercial property.

Hong Kong speeding up, boosting sentiment among major occupiers

Hong Kong’s economy grew by 1.0% QOQ in Q2 2017, or by 3.8% YOY, underpinned by robust domestic demand and a fairly healthy export performance. For H1 as a whole, the economy grew by 4.0% YOY, representing its fastest pace of expansion since 2011. After the strong Q2 outcome, Oxford Economics expects real GDP growth to jump from 2.0% in 2016 to 3.5% in 2017, although for 2018 it predicts a slowdown to 2.3%.

Improved business sentiment in Hong Kong has been reflected in results of Colliers’ Hong Kong Occupiers Survey (published on 5 September 2017). The survey of 174 major occupiers shows that many are becoming more optimistic about their business prospects. In fact, a majority of respondents expect their businesses either to expand (44%) or remain the same (40%) over the next three years, with only 3% expecting a contraction.

Colliers believes that the Hong Kong office market will benefit from this expansionary cycle, especially for locations popular among mainland Chinese companies, notably the core CBD district in Central and Admiralty. In view of current low vacancy rates, Colliers expects rent in the CBD and CBD fringe areas to rise further in coming years.

Figure 2: Major Asian economies: estimated real GDP growth 2016-2021

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>6.7%</td>
<td>6.8%</td>
<td>6.2%</td>
<td>5.8%</td>
<td>5.6%</td>
</tr>
<tr>
<td>Japan</td>
<td>1.0%</td>
<td>1.4%</td>
<td>1.3%</td>
<td>1.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>2.0%</td>
<td>3.5%</td>
<td>2.3%</td>
<td>2.5%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Singapore</td>
<td>2.0%</td>
<td>2.7%</td>
<td>2.9%</td>
<td>3.1%</td>
<td>3.1%</td>
</tr>
<tr>
<td>India</td>
<td>7.9%</td>
<td>6.9%</td>
<td>7.4%</td>
<td>7.1%</td>
<td>6.8%</td>
</tr>
</tbody>
</table>

Source: Oxford Economics
Singapore: economic pick-up reflected in green shoots of recovery in occupier markets

Real GDP in Singapore grew by 0.6% QIQ in Q2 2017, with annual growth accelerating to 2.9% from 2.5% in Q1. Growth was underpinned by a solid contribution from net exports, while domestic demand outside of the household sector also accelerated. Indeed, private residential investment rose for the first time in nearly two years. Against this firm background, Oxford Economics expects GDP to grow by 2.7% this year. Oxford Economics is cautious about 2018, for which it recently cut its estimate of real GDP growth from 3.4% to 2.9%. This still represents a year-over-year improvement.

While the property investment market in Singapore has been very strong for most of the past year, until recently there were few signs in occupier markets that investors’ evident optimism about Singapore was justified. However, Colliers’ Q2 2017 reports for Singapore point to green shoots of recovery in many segments of the property market. We would highlight:

- **Office** – The CBD Premium and Grade A office rents declined 0.3% over H1 2017, albeit at a slower rate than before, under the weight of the large new supply
- **Office** – However, H1 2017 saw relatively strong pre-commitments in the new developments as “flight to quality” continued
- **Industrial** – After lengthy weakness, with more broad-based growth from now on, Colliers now expects rents to bottom by end-2017, and to recover 1-3% in 2018, led by independent high-specification buildings
- **Retail** – Colliers sees higher demand in locations with consistent footfall and less existing supply, and this has been reflected in early signs of stabilising retail sales, leasing volumes and rents.
- **Retail** – However, given heavy new supply in 2017-2018, we still expect rents across all locations to continue to gyrate

US dollar weakness good news for Asia

In addition to general improvement in economic conditions, Asian property markets have been supported recently by the reduction of a major potential threat - rapid increases in interest rates. This change is closely connected to the direction of US interest rates and the weakness of the US dollar so far in 2017.

Recent economic data from the US have been mixed. Real GDP growth for Q2 2017 was recently revised up to 3.0% – the strongest level since Q1 2015 – due to robust consumer spending and business investment; and employment growth has been buoyant. On the other hand, income growth has not kept pace with consumer spending; inflation is rising at a very slow rate; and Hurricane Harvey will probably shave growth 0.2 to 0.3 percentage points from growth in Q3. In consequence, it seems probable that the US Federal Reserve will only raise interest rates very gradually (if at all) over the next several months.

If US interest rates only rise slowly, there is less chance that Asian interest rates will be forced upwards too. This fact applies particularly to Hong Kong interest rates, which are effectively tied to US rates as a result of the territory’s US dollar peg. Real, i.e. inflation-adjusted, interest rates have been negative in Hong Kong almost ever since the Global Financial Crisis of 2008-2009, and we now anticipate that they will remain negative until the end of 2018. Indirectly, however, the direction of US interest rates can influence the direction of interest rates across much of Asia.

Exchange rates are the key reason why this is so. If US interest rates are rising rapidly, they will push up the US dollar. However, contrary to the expectations of many observers at the start of this year, the US dollar has weakened so far in 2017 after several years of relative strength, falling by about 7% against the Japanese yen and by about 6% against the Chinese renminbi. This is a marked change of fortune for the renminbi, which depreciated steadily against the US dollar over the period 2014-2016.

**Figure 3: USD/JPY exchange rate (past four years)**
US dollar weakness has reduced pressure on Asian emerging markets in particular to support their currencies by keeping interest rates high. This change in circumstances has permitted unexpected interest rate reductions over the summer by the central banks of India and Indonesia. The central banks of other Asian emerging countries may possibly follow suit, or at least decide that they can maintain an expansionary monetary policy for longer than might otherwise have been possible (as, for example, in Thailand).
Capital markets in Asia very firm

Investment in completed properties in Asia reaches historic high

Against the background of economic strength, continuing low interest rates and signs of improvement in occupier markets, investment property markets in Asia remained very firm in H1 2017. As originally reported by Real Capital Analytics (RCA) on 3 August 2017, aggregate investment in income-producing properties in the Asia Pacific region in H1 2017 was USD63.9 billion, an increase of 5% YOY. The corresponding figure for Q2 was USD61.6bn, a decrease of 2% YOY.

Within the H1 total of USD63.9 billion, investment in Australia declined by 35% versus H1 2016, to USD7.6 billion. Looking at Asia only, total investment in completed properties amounted to USD61.4bn in H1 2017, up by 19% YOY. This was a record for the first half of the year.

The breakdown of aggregate H1 Asia Pacific investment in income-producing properties of USD63.9 billion between the various segments of the property market is shown in Figure 6 below. Transactions involving office properties reached USD30.3 billion in H1, or 47% of the total. However, other segments of the property market were also well-represented, with particular strength in apartments, i.e. the residential sector.

Figure 6: Investment by property category in Asia Pacific region (H1 2017, USD billion)

<table>
<thead>
<tr>
<th>Category</th>
<th>H1 2016</th>
<th>H1 2017</th>
<th>YoY chg</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office</td>
<td>32.9</td>
<td>30.3</td>
<td>-7.9%</td>
</tr>
<tr>
<td>Industrial</td>
<td>6.5</td>
<td>6.3</td>
<td>-3.1%</td>
</tr>
<tr>
<td>Retail</td>
<td>11.2</td>
<td>12.1</td>
<td>8.0%</td>
</tr>
<tr>
<td>Apartment</td>
<td>5.0</td>
<td>10.4</td>
<td>108.0%</td>
</tr>
<tr>
<td>Hotel</td>
<td>5.2</td>
<td>4.8</td>
<td>-7.7%</td>
</tr>
<tr>
<td>Aggregate income-producing properties</td>
<td>60.8</td>
<td>63.9</td>
<td>5.1%</td>
</tr>
<tr>
<td>Development sites</td>
<td>173.5</td>
<td>239.7</td>
<td>38.2%</td>
</tr>
<tr>
<td>Aggregate investment</td>
<td>234.3</td>
<td>303.6</td>
<td>29.6%</td>
</tr>
</tbody>
</table>

NB As reported in by RCA in Q2 2017 report, 3 August 2017
Source: RCA

As Figure 6 also makes clear, aggregate transactions involving development sites were roughly four times greater than aggregate transactions of income-producing properties. Sales of land development sites have long been the largest segment of the overall property market in China. However, this segment has increased in popularity elsewhere in the region too, notably in Hong Kong, where purchases of residential development sites by mainland Chinese enterprises grew sharply in H1.

China is APAC’s top country investment market in Q2, followed by Hong Kong

First half of 2017

Looking at investment markets on a country basis, Japan saw the highest level of investment in income-producing properties over H1 2017 as a whole, recording a 14% YOY increase to USD17.8 billion. As we shall see, the strong total for Japan principally reflected investment in Yokohama and other cities rather than Tokyo. China ranked second, recording an 11% increase to USD14.5 billion. In third place was Hong Kong, which recorded a 5% increase to USD8.3 billion. On this basis Hong Kong ranked ahead of the whole of Australia, which recorded a 35% decline to USD7.6 billion.

Figure 7: Asia Pacific property transaction volumes by country over H1 2017 (USD million)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Market</th>
<th>H1 2016</th>
<th>H1 2017</th>
<th>YOY chg</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Japan</td>
<td>15,632</td>
<td>17,821</td>
<td>14%</td>
</tr>
<tr>
<td>2</td>
<td>China</td>
<td>13,047</td>
<td>14,482</td>
<td>11%</td>
</tr>
<tr>
<td>3</td>
<td>Hong Kong</td>
<td>7,875</td>
<td>8,269</td>
<td>5%</td>
</tr>
<tr>
<td>4</td>
<td>Australia</td>
<td>11,654</td>
<td>7,575</td>
<td>-35%</td>
</tr>
<tr>
<td>5</td>
<td>Singapore</td>
<td>3,867</td>
<td>5,801</td>
<td>50%</td>
</tr>
<tr>
<td>6</td>
<td>South Korea</td>
<td>3,380</td>
<td>5,239</td>
<td>55%</td>
</tr>
<tr>
<td>7</td>
<td>India</td>
<td>1,181</td>
<td>1,157</td>
<td>-2%</td>
</tr>
<tr>
<td>8</td>
<td>New Zealand</td>
<td>935</td>
<td>1,019</td>
<td>9%</td>
</tr>
<tr>
<td>9</td>
<td>Taiwan</td>
<td>1,289</td>
<td>799</td>
<td>-38%</td>
</tr>
<tr>
<td>10</td>
<td>French Polynesia</td>
<td>40</td>
<td>185</td>
<td>363%</td>
</tr>
<tr>
<td></td>
<td>Other APAC</td>
<td>2,019</td>
<td>1,514</td>
<td>-25%</td>
</tr>
<tr>
<td></td>
<td>APAC total</td>
<td>60,919</td>
<td>63,861</td>
<td>5%</td>
</tr>
</tbody>
</table>

As reported in by RCA in Q2 2017 report, 3 August 2017
Source: RCA, with calculations by Colliers

To repeat the point, the USD8.3 billion of investment shown for Hong Kong in Figure 7 includes only income-producing properties. Including land development sites, aggregate investment in the Hong Kong property market would have been over USD6.0 billion higher in H1. As shown in Figure 8 below, Chinese property developers accounted for the lion’s share of investment in land sites in Hong Kong in H1 2017, with combined purchases of HKD40.2 billion or USD5.1 billion.
Second quarter of 2017

In Q2 2017, China moved ahead of Japan to become the top-ranked investment market in Asia Pacific, recording a 14% increase in transactions of income-producing properties to USD7.1 billion. Japan and Australia both registered declines in Q2. In contrast, Hong Kong recorded a 53% increase in investment to USD4.4 billion, on which basis it ranked fourth in the region. Just behind Hong Kong was Singapore, which recorded an 18% YOY increase in transactions in Q2 after a jump of 164% in Q1 in comparison to a weak Q1 2016.

Hong Kong is top urban investment centre in APAC; Singapore firm too

First half of 2017

Hong Kong’s increasing importance as an investment centre is underlined by the fact that it ranked as the top market for completed property transactions in Asia Pacific in both H1 and Q2 2017. RCA regularly updates its data as new transactions are reported or completed. Based on RCA data as of end-August, investment in income-producing assets in Hong Kong reached USD9.4 billion in H1, up by 22% YOY. On this basis Hong Kong ranked ahead of Tokyo, which fell to the no.2 position for the first time with a 28% YOY decline to USD6.6 billion. In third and fourth place were Shanghai and Singapore, which both recorded YOY growth of over 50%. However, the star performer in the region was Yokohama, which recorded an increase of over 600% to USD3.1 billion.
Second quarter of 2017
In Q2 2017, Hong Kong recorded a 97% YOY increase in completed property transactions to USD5.3 billion. On this basis Hong Kong ranked as the top investment market in Asia Pacific in Q2 as well as H1. Local investors and institutional funds were the key players in the Hong Kong market in the period.

Singapore, where the property investment market has been very strong for the past several quarters, ranked as the second most active urban investment market in Q2, recording an 18% YOY increase to USD3.6 billion. Accordingly, Singapore ranked ahead of Sydney, Seoul and Tokyo, all of which registered declines. We suspect that the 57% YOY decrease in Tokyo is connected to the renewed strength in the Japanese yen since the start of 2017; currency strength probably has a slightly lagging effect on investment decisions. Shanghai ranked sixth in Q2 with a modest 6% YOY increase in investment to USD1.9 billion, followed by Yokohama which surged nearly 700% to USD1.7 billion.

More specifically, we would highlight the investment potential of the following market segments in Hong Kong:

> **CBD fringe**

Amid the compressed yield environment, investors have been searching for high value-added or high rental growth properties. Lower grade office buildings in the fringe CBD have been targeted by institutional investors looking for opportunities for repositioning, including the incorporation of co-working space to improve the tenant profile. With a positive rental outlook, in particular on Hong Kong Island, en bloc commercial property transactions, such as office and retail buildings, are very popular.

> **Hotels**

Hotel investment has been active in Hong Kong. Since Hong Kong tourism reached its peak in 2014, investors have been purchasing hotel properties for the potential of redevelopment, converting the hotels into offices or Ginza-style mixed use properties. With tourist arrivals turning the corner in 2017, hotel investments in Hong Kong have been on the rise again.

### Investment opportunities in Hong Kong, Singapore, Shanghai

It is not only the widely accepted RCA data which point to favourable conditions in many or most of the leading Asian investment property centres apart from Tokyo. Colliers’ Capital Markets & Investment Services division and our research teams across the region also gather data and other evidence which point to general market strength. Below we provide additional observations on some of the leading markets, and comment on specific investment opportunities.

**Hong Kong**

> As noted, Hong Kong ranked as the top investment market among all APAC cities in both H1 and Q2 2017. This is all the more surprising considering that Hong Kong clearly established itself as the most expensive commercial property market in Asia in H1, with a number of record-breaking transactions and CBD rents at an all-time high.

> All segments of the market were strong. Eight en-bloc office deals were transacted in Q2. In addition, there were two major government commercial land sales (Murray Road and Kai Tak, both at record prices), plus large government sales of residential land. The retail, industrial and hospitality sectors were also strong; nine hotels have now been sold within the past seven months or so.

> Given strong economic conditions, Colliers is positive about the Hong Kong investment market over H2 2017 and 2018. The latest restrictions on overseas investment by mainland Chinese enterprises may curtail future Chinese investment in the territory, although investment in residential sites should continue. Coming into H2, we recommend investors to look out for new opportunities in decentralised retail, industrial and hotel assets.

**Figure 11: APAC property transaction volumes by urban centre over Q2 2017 (USD million)**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Market</th>
<th>Q2 2016</th>
<th>Q2 2017</th>
<th>YOYchg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Hong Kong</td>
<td>2.691</td>
<td>5.301</td>
<td>97.0%</td>
</tr>
<tr>
<td>2</td>
<td>Singapore</td>
<td>3.033</td>
<td>3.588</td>
<td>18.3%</td>
</tr>
<tr>
<td>3</td>
<td>Sydney</td>
<td>3.230</td>
<td>2.554</td>
<td>-20.9%</td>
</tr>
<tr>
<td>4</td>
<td>Seoul</td>
<td>2.862</td>
<td>2.164</td>
<td>-24.4%</td>
</tr>
<tr>
<td>5</td>
<td>Tokyo</td>
<td>4.593</td>
<td>1.968</td>
<td>-57.2%</td>
</tr>
<tr>
<td>6</td>
<td>Shanghai</td>
<td>1.816</td>
<td>1.921</td>
<td>5.8%</td>
</tr>
<tr>
<td>7</td>
<td>Yokohama</td>
<td>209</td>
<td>1,668</td>
<td>698.1%</td>
</tr>
<tr>
<td>8</td>
<td>Beijing</td>
<td>1,134</td>
<td>1,443</td>
<td>27.2%</td>
</tr>
<tr>
<td>9</td>
<td>Melbourne</td>
<td>1,536</td>
<td>1,171</td>
<td>-23.8%</td>
</tr>
<tr>
<td>10</td>
<td>Guangzhou</td>
<td>235</td>
<td>1,036</td>
<td>340.9%</td>
</tr>
<tr>
<td>-</td>
<td>Total for top ten markets</td>
<td>21,339</td>
<td>22,814</td>
<td>6.9%</td>
</tr>
</tbody>
</table>

NB Data as of end-August 2017. Based on closed deals of over USD10 million for apartment, hotel, industrial, office and retail property. Land development sites are excluded.
Source: RCA, with calculations by Colliers
> **Old industrial buildings**
Old factories and warehouse buildings have been attracting substantial interest from investors searching for value-added investment opportunities. Investors can increase the rental and capital value significantly by converting the use or redeveloping the old or vacated industrial buildings into residential and commercial properties, against the backdrop of limited residential supply and diminishing industrial activity, with the expectation that the government will resume the industrial revitalisation scheme.

> **Decentralised malls**
Decentralised malls are popular among property REITs and local individual investors. While some decentralised malls have not been well managed or owned by multiple owners, investors can upgrade the properties and increase the value by refurbishment and restructuring the tenant profiles. Reflecting steady income growth, domestic consumption has recorded healthy growth, supporting the rent of decentralised shopping centres.

> **Retail sector**
Vendors of shops have become more willing to negotiate as rents for high street shops have declined over 40% on average since the peak in 2013. While we expect rents to recover next year due to the rebound of retail sales, retail property investors are re-entering the market at the bottom to achieve a higher yield and future capital appreciation.

**Singapore**

> **Based on Colliers’ own data, demand from investors and developers pushed investment sales up 46% YOY in H1 2017, to SGD16.4 billion or USD11.9 billion. This figure is substantially higher than RCA’s figure of USD5.8 billion, but includes government sales of residential land and individual strata sales of above SGD5.0 million (USD3.7 million). Colliers noted firm Chinese interest over H1 in both the commercial and residential segments in Singapore.**

> **The commercial sector was buoyant in Q2: witness the Jurong Point retail transaction for SGD2.2bn (USD1.6bn) and the transfer of the 50% stake in One George St for SGD592mn (USD429 million).**

> **But the residential segment led the way, with investment sales up 77% QOQ to SGD5.1bn (USD3.7bn), or 50% of the total, as developers bid for large sites via Government Land Sales (GLS) and Collective Sales.**

> We expect the investment sales market to conclude 2017 in the range of SGD28-29 billion (USD20-21 billion), up 8-12% YOY.

More specifically, we would highlight the investment potential of the following market segments in Singapore:

> **Residential**
Private home prices in Singapore have declined 11.6% since the peak in 2013 and are increasingly attractive compared to those in other APAC gateway cities such as Hong Kong and Sydney where prices have risen significantly in recent years. We expect prices to climb in 2018 in line with a brighter economic outlook and we should see more activity in land and completed apartments.

> **Logistics properties and data centres**
With the proliferation of e-commerce and digitisation of the global economy, we are seeing growing demand for modern logistics facilities and data centres. Investors and end-users are matching up on build-to-suit (BTS) opportunities for data centres which are attractive alternative investments in a declining yield environment.

> **Retail**
The retail sector is going through a transition in the face of challenges from e-commerce and shifting consumer preferences. Foreign investors or operators could take this opportunity to acquire and reposition retail assets, which are still attractive in a declining yield environment.

> **Office**
Grade A office properties are very scarce and will be in great demand. There are limited new office development opportunities and the tract of land at Marina South will be time-released over 20-30 years. Hongkong Land is partnering IOI Properties for the Central Boulevard site, suggesting that it does not foresee any new opportunities in the near term.

**Shanghai**

> While slightly overshadowed by surprising strength in Hong Kong and Singapore, Shanghai nevertheless ranked as the third largest urban investment market in Asia Pacific in H1 2017, and as the largest in China by far. As shown in Figure 9 above, based on RCA data, with total transactions of completed properties of USD6.4 billion in H1, Shanghai was 2.6x larger than Beijing on USD2.5 billion and 5.2x larger than Guangzhou on USD1.2 billion.

> Shanghai’s office sector remained active through Q2, particularly for domestic investment institutions.
which accounted for seven en-bloc transactions with a combined value of around USD2.4 billion. These were all office or mixed-use assets.

> We expect the office market to remain dynamic in Q3, in the CBD, DBD and business park locations. We expect the active buyers in Q3 to include RMB funds, local asset management companies, and foreign institutions which have capital ready to deploy.

More specifically, we would highlight the investment potential of the following market segments in Shanghai:

> **Business parks**
   Since building a global science and innovation centre is an important strategic mission for Shanghai, we expect that the leasing demand for business parks from technology enterprises, particularly internet and IT companies as well as manufacturers will be sustainably robust. Therefore, the business park sector’s positive outlook should continue to attract both domestic and foreign investors’ attention and interest.

> **Logistics**
   Regarding logistics property, developers and investors are interested in this sector because of the strong leasing demand for logistics facilities mainly from third-party logistics, e-commerce and automobile, medicine and integrated circuit companies. Higher occupancy rates and rental values are the consequence of this interest.

> **Retail**
   In the retail sector, few en-bloc transactions were witnessed in H1. However, in our view high-quality retail properties in prime locations with strong occupancy and rental performance should continue to appeal to both domestic and foreign investors.
Yields fall further

Yields still declining modestly for most market segments

Prime grade office

As shown in Figure 12 below, net yields for Grade A offices in Asia have decreased steadily across most markets since the Global Financial Crisis of 2008-2009. This has reflected generally easy monetary conditions and strong demand for investment property assets within the region, notwithstanding heavy outflows of investment capital from Asia to the rest of the world.

So far in 2017, yields have dropped further across Asia, reflecting strong investment demand, stable or improving economic conditions, and lack of upward pressure on interest rates. For prime grade office property in the major developed Asian investment centres, according to Colliers Research, average net yields now range between about 2.5% (for Hong Kong and Taipei) and 4.2% (for Beijing).

Figure 12: Net income yield of prime grade office property in key Asian urban centres (2009 to 2017)

Source: Colliers

Figure 13 below shows a summary of prime grade office markets for leading greater China cities plus Singapore. Net yields vary between about 4.2% for Beijing at the high end and 2.0% for Hong Kong Island (which is well below the Hong Kong average of about 2.7%) at the low end. While net yields are lower in Hong Kong than in China, so too is the ten-year government bond yield, meaning that Hong Kong offers a significantly higher spread over bonds than the Tier 1 mainland Chinese cities. Indeed, in one case, Shenzhen, the spread over ten-year bonds is negative.

Among the cities shown in Figure 13 the most attractive in terms of valuation is Singapore. Prime grade office property here offers a net yield of 3.5-3.7%, which in turn implies a spread of 1.5-1.7 percentage points over Singapore government ten-year bonds.

Figure 13: Summary of prime grade office markets (leading greater China cities plus Singapore)

<table>
<thead>
<tr>
<th>City</th>
<th>Rental growth (2016-2019 avg pa)</th>
<th>City avg vacancy (end Q2 2017)</th>
<th>City avg vacancy (end 2019E)</th>
<th>Net income yld*</th>
<th>10 year bond yld</th>
<th>Spread</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong*</td>
<td>+3.9% (+6.0%)</td>
<td>4.0% (2.1%)</td>
<td>6.2% (3.6%)</td>
<td>2.7% (2.0%)</td>
<td>1.3%</td>
<td>1.5pp (0.7pp)</td>
</tr>
<tr>
<td>Singapore¹</td>
<td>0.8%</td>
<td>6.9%</td>
<td>8.8%</td>
<td>3.5%-3.7%</td>
<td>2.0%</td>
<td>1.5pp-1.7pp</td>
</tr>
<tr>
<td>Shanghai²</td>
<td>-3.0%</td>
<td>12.9%</td>
<td>11.6%</td>
<td>3.6% (4.0%)</td>
<td>3.7%</td>
<td>0.1pp (0.3pp)</td>
</tr>
<tr>
<td>Beijing</td>
<td>-0.6%</td>
<td>8.6%</td>
<td>13.0%</td>
<td>4.2%</td>
<td>3.7%</td>
<td>0.5pp</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>-0.2%</td>
<td>20.2%</td>
<td>20.1%</td>
<td>3.5%</td>
<td>3.7%</td>
<td>-0.2pp</td>
</tr>
<tr>
<td>Taipei</td>
<td>0.3%</td>
<td>12.8%</td>
<td>13.8%</td>
<td>2.8%</td>
<td>1.0%</td>
<td>1.8pp</td>
</tr>
</tbody>
</table>

Notes.* Average for all Hong Kong; figures in brackets are for Hong Kong Island. ¹ Singapore figures are for CBD. ² Shanghai: first yield is for CBD; yield in brackets is for DBD.

This table is intentionally repeated from Figure 1. Source: Colliers International Research, Bloomberg, as of 6 September 2017.
Industrial and retail property

Yields on retail and industrial property in Asia remain higher than for office property, but as a rule are also stable or falling. The tables below illustrate the cap rates (i.e. gross yields) currently used by Colliers’ valuation teams in appraising office, retail and industrial properties across five major Asia Pacific cities.

Figure 14: APAC region: cap rates used by Colliers’ professional valuers and appraisers

<table>
<thead>
<tr>
<th></th>
<th>Office</th>
<th>Low</th>
<th>High</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>2.75%</td>
<td>3.75%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shanghai</td>
<td>3.75%</td>
<td>5.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>3.50%</td>
<td>4.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sydney</td>
<td>4.75%</td>
<td>5.50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tokyo</td>
<td>3.50%</td>
<td>4.50%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Retail</th>
<th>Low</th>
<th>High</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>2.50%</td>
<td>3.50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shanghai</td>
<td>4.50%</td>
<td>6.50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>4.50%</td>
<td>5.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sydney</td>
<td>4.25%</td>
<td>5.50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tokyo</td>
<td>4.00%</td>
<td>5.00%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Industrial</th>
<th>Low</th>
<th>High</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>3.50%</td>
<td>4.50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shanghai</td>
<td>6.00%</td>
<td>7.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>6.00%</td>
<td>6.50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sydney</td>
<td>5.25%</td>
<td>6.50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tokyo</td>
<td>4.50%</td>
<td>5.50%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Global Cap Rate Report | Q2 2017 | Valuation & Advisory Services | Colliers International

For office property, the cap rates vary between 2.75% and 5.5%, with the trend stable in all markets except Shanghai, where the cap rate is still declining. For retail property, the cap rates vary between 2.5% and 6.5%, and are stable or falling except in Hong Kong. For industrial property, the cap rates vary between 3.5% and 7.0%, and are stable in all markets except Shanghai, where they are falling. We believe that yields calculated from market transactions would generally be lower and show a slightly more consistent downward trend.

Few clear catalysts for yields to rise

As shown in Figure 13, the spread between the net yield on office property and ten-year bond yields has fallen to between approximately 1.7 and -0.2 percentage points in several of the larger Asian cities. Normally one might interpret such narrow spreads as a sign that investment property markets are peaking. However, it is hard to identify obvious catalysts for the direction of property yields to change.

For a start, demand for investment property in Asia remains strong. One of the key drivers of investment demand in Asia this year has been mainland Chinese capital. The Chinese authorities imposed restrictions on outbound flows of capital in late 2016, and strengthened these controls in late August this year. However, these controls have not so far deterred heavy Chinese investment in Asia, especially in Hong Kong but also in Singapore and other South East Asian markets. Chinese demand for Asian property assets may moderate in the near term. However, the strong support from the Chinese government for investment in “Belt & Road” markets (see the following section of this report) suggests that such a slowdown will not last for long.

Furthermore, we expect investment demand to remain firm from non-Chinese sources, including both domestic investors and cross-border investors such as such as large property developers and financial institutions in Hong Kong and Singapore. In addition to improved economic growth prospects, persistent low interest rates are an important driver of confidence for such investors.

We have noted that real interest rates will probably stay negative in Hong Kong until the end of 2018. In Singapore, CPI inflation is picking up gradually after deflation over 2015 and 2016. Since inflation looks set to rise faster than nominal short-term interest rates, this means that real interest rates in Singapore are falling, and will turn negative over 2018 according to Oxford Economics (see Figure 15 below).
For the above reasons, we expect yields on commercial property in Asia to stay low in the near term, and maybe shrink still further. Although prospects for most large centres are favourable, we think that Singapore stands out due to recovering occupier markets, higher yields currently than Hong Kong and a wider spread (1.5-1.7 percentage points) over bonds than Hong Kong or Tier I Chinese cities.
Belt & Road - the future direction of Chinese capital

Chinese property investment shifts from US to Asia in 2017

We have argued in two major reports¹ this year that the focus of Chinese property investment abroad was likely to shift gradually from the US to Asia. One of the chief reasons for our view was, and remains, the change in fortunes of the Chinese renminbi, which is now appreciating rather than depreciating against the US dollar. Another reason is the Chinese government’s political project to increase investment in so-called “Belt & Road” markets lying along the historical overland and maritime trading routes from China to Europe.

Capital flows data so far in 2017 suggest that this shift is well underway. Based on RCA data as of 5 September, Chinese investment in US property assets (completed properties only) amounted to USD1.3 billion in Q2, down by 80% from a peak of USD6.3 billion in Q3 2016.

Figure 16: Chinese investment in US completed properties (Q1 2016 to Q2 2017; USD billion)

Based on completed transactions of over USD10 million
Source: RCA (data downloaded on 5 September 2017)

In fact, however, according to RCA’s Q2 2017 report, Chinese investors committed USD9.5 billion of capital to Asia Pacific real estate markets over H1, an increase of 46% YOY. Hong Kong was the fastest-growing net recipient of Chinese capital, accounting for more than one-half of the USD9.5 billion figure. RCA further suggests that Chinese investment into Japan, Singapore and South Korea grew threefold in H1 2017 compared with H1 2016. The news of increased Chinese interest in Singapore matches Colliers’ observations, as included in our Q2 investment sales report for Singapore.

As we hope we have made clear already, the reason for the discrepancy is the pronounced swing in Chinese property investment in Asia from completed assets to undeveloped land sites. In the case of Hong Kong, we calculate that mainland Chinese purchases of buildings declined by 74% over the first seven months of 2017, to HKD4.5 billion (USD0.6 billion). In contrast, we calculate that over H1 total Chinese investment in land sites in Hong Kong surged to HKD40.2 billion (USD5.2 billion); please see Figure 8 above for details.

As noted earlier, the restrictions on overseas investment by Chinese enterprises announced by the Chinese government in late 2016 have not prevented this heavy investment in Hong Kong and other Asian markets. The Chinese authorities announced stricter capital controls in mid-August 2017. However, these controls appear explicitly to exclude investment targeted at “Belt & Road” markets in Asia. We cite Bloomberg’s report of the new controls on 18 August:

Figure 17: Chinese investment in completed properties in Asia (Q1 2016 to Q2 2017; USD bn)

Based on completed transactions of over USD10 million
Source: RCA (data downloaded on 5 September 2017)

¹ “2017 - the year in which Asian property capital flows reverse - Fact or Fantasy?” (1 March 2017) and “Chinese Investment Property Market: Foundations Still Firm” (22 May 2017)
"China formally laid down new rules on overseas investments, making explicit its de facto campaign against ‘irrational’ acquisitions of assets. The authorities set out three categories - banned, restricted and encouraged. Property, hotel, film, entertainment and sports investments will now be subject to further restrictions. The new rules encourage companies to support the nation’s ambitious Belt and Road Initiative backed by President Xi Jinping. China’s outbound investment slumped 44.3% in the first seven months from a year earlier as policy makers imposed brakes on companies’ foreign acquisitions."

Source: Bloomberg, August 18, 2017. We have added the emphasis.

It is possible that mainland Chinese property investment will moderate in the near term, especially investment in completed assets. Nevertheless, over the next couple of years, we anticipate further Chinese investment in other “gateway” Asia Pacific cities, including Singapore and Sydney. On a two to five year view, we expect material Chinese investment to start in emerging “Belt & Road” markets, with the focus initially on the maritime route to Europe via South East Asia. This implies growing Chinese interest in markets such as the Philippines, Thailand, Cambodia, Indonesia and Pakistan.

Objectives behind Belt & Road project

The ambitious “Belt & Road” project was first outlined by China's President Xi Jinping in 2013. The project can be broken down into two parts: a maritime Silk Route connecting China to Europe via South East Asia, the Middle East and East Africa, and an overland Silk Route connecting China to Europe via Central Asia. The ultimate intention appears to be to create an interlinked economic zone supported by substantial Chinese public investment and special lending schemes. President Xi explained his ideas further at the Belt and Road (B&R) International Forum which closed on 15 May 2017 in Beijing. During this two-day summit, the president pledged that China would commit additional funding to the project, raising combined public support and special lending schemes to RMB480 billion (USD69.5 billion).2

From the perspective of China itself, in our opinion, the Belt & Road project should alleviate two problems: overcapacity in heavy industry and an imbalance of development between the developed eastern coastal areas and the less developed western areas. By exporting labour and knowledge in infrastructure-related industries such as construction, materials and equipment and self-developed technology, the Belt & Road project should help soak up the products of surplus capacity and raise economic output and prosperity in western China.

Possible opportunities from Belt & Road

It is rather early to speculate about opportunities for private enterprise arising out of the Belt & Road initiative. We have mentioned Belt & Road in this report because we take the project seriously, and expect the theme to come up regularly in our research over the next few years. However, in our research this year we have already referred explicitly to the investment potential of industrial property around Chengdu, the Chinese terminus of planned railway connections along the new overland Silk Route.

China - Chengdu

Chengdu is the provincial capital of Sichuan Province, the richest district in West China. We see opportunities in industrial estate arising from China-Europe rail freight, especially in the Chengdu International Railway Port. Currently, the China-Europe rail freight takes around half the time of a similar sea voyage, and costs approximately half of the equivalent air freight journey. Moreover, the Chengdu International Railway Port was established as the China (Sichuan) Pilot Free Trade Zone in April 2017 and should become an important part of the Belt & Road strategy. Since its establishment, 71 companies have entered the free trade zone with total registered capital of RMB2.05 billion (USD298 million).

We should also refer to infrastructure projects linked to Belt & Road in three specific countries - Thailand, Malaysia and Pakistan - which should create investment opportunities over time.

Thailand

After attending the Belt & Road Forum, Thai Transport Minister Arkhom was reported to have confirmed that Thailand would support the construction of the railway linking Bangkok and Kunming in China’s Yunnan province via Laos.3 Meanwhile, a public-private partnership high-speed rail project from Bangkok to Rayong is intended to be linked with the railway project to connect Thailand’s Eastern Economic Corridor (EEC), a planned manufacturing centre and transport hub for the Indochina Peninsula, with China. According to the

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2 See, for example, the report at https://news.cgtn.com/news/3d55444d33677a4d/share_p.html.

3 See, for example, the report at http://europe.chinadaily.com.cn/business/2017-05/17/content_29384276.htm.
Thai government’s Thailand 4.0 Strategy, the country plans to promote high-tech industries including robotics and medicine.⁴

**Malaysia**

Malaysia, South East Asia’s third largest economy, is also among nations which support the initiative. Malaysia has already benefited from substantial Chinese investment in major infrastructure projects, including new ports and a high-speed rail line.

**Pakistan**

Pakistan has been perhaps the most optimistic supporter of the Belt & Road initiative; and the China-Pakistan Economic Corridor (CPEC) is a core component of the plan. So far, aggregate financing for projects included in the CPEC has reached USD62 billion, and the projects encompass railways, roads and energy facilities.⁵ The CPEC is already partly operational with Gwadar Port and Karakoram Highway completed. According to certain estimates, the projects could account for about 17% of the country’s 2015 GDP and boost annual GDP growth by 2 to 2.5 percentage points.⁶

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⁴ See, for example, the report at https://asia.nikkei.com/magazine/20170223/Politics-Economy/Thailand-scrambles-for-tech-investment.


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