Colliers Radar

Property Research | Asia
01 March 2017

2017 – the year in which Asian property capital flows reverse: **Fact or Fantasy?**

Accelerating success.

Accelerating success.

Andrew Haskins
Executive Director | Research | Asia
andrew.haskins@colliers.com

Elaine Lu
Analyst | Research | Asia
elaine.lu@colliers.com

Chinese investment in property in other regions in recent years has been heavily focused on the US. This push to the US has obscured rising intra-Asian property capital flows, which again exceed Asia-to-global flows. Despite firm near-term US economic prospects, we expect slower RMB depreciation and political pressures to cause Chinese investment to shift towards Asian markets from 2017. The continued weight of capital should offset likely rising cost of funds, so that property yields on average stay flat across Asia this year. We remain positive about Asian property, and see particular investment opportunities in China, Hong Kong, Singapore and India.

Executive Summary

Since the GFC, aggregate outflows of capital from Asia to property markets in the rest of the world have risen sharply to reach USD58.9 billion in 2016, while inflows have stagnated at under 30% of this level. This heavy investment outside Asia has been led by mainland Chinese groups, which represented 43% of Asia-to-global flows last year, and has been focused on the US. Over 2013-2016, the Chinese renminbi dropped by 13% against the US dollar; and concern about further depreciation helps explain the popularity of US assets.

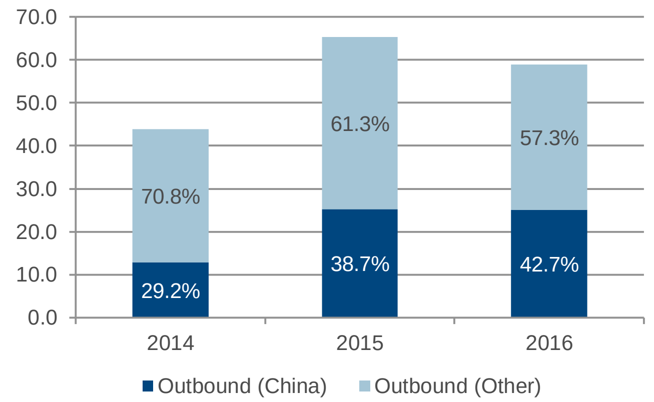
The pattern of rising capital outflows and stagnating inflows obscures the 62% surge in intra-regional property investment to USD69.3 billion over the past three years – a level 18% above aggregate Asia-to-global flows. Mainland Chinese groups are less dominant as a source of intra-regional investment, accounting for 17% of the total. The Chinese have shown interest in certain Asian markets, notably Hong Kong, but they may see Hong Kong as a proxy for the US due to its currency peg.

Firm near-term US economic prospects imply continued dollar strength and may mean US investors keep capital at home. However, Chinese economic data has also been firm, and we think the renminbi will not fall much further. This may lower the attraction of US property to the Chinese. Political concerns may also slow the pace of Chinese investment in the US, especially if the new president translates protectionist rhetoric into reality.

We think Chinese interest in foreign property will shift towards Asian markets from 2017. If so, the continued weight of investment capital should offset rising cost of funds (due to likely upward pressure on interest rates), so that Asian property yields on average at least stay flat this year. We remain positive about Asian property, and see particular investment opportunities in China, Hong Kong and Singapore, and India over the medium term.

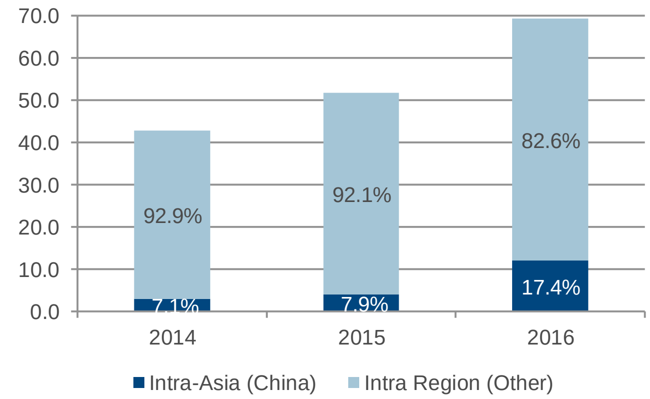
To answer the question in our title, it may be fantasy to expect Asian property capital flows to reverse in 2017: outflows should slow, but inflows may only rise slowly. However, the question is now less relevant. Intra-Asian property investment is strong and rising, with China set to play a greater role. This trend should persist.

China: source of Asia-to-global flows (USD bn)



Source: Real Capital Analytics, Colliers

China: source of intra-Asian flows (USD bn)



Source: Real Capital Analytics, Colliers

Contents

Historic Asian property capital flows

Pattern since GFC: rising outflows, falling inflows, surging intra-regional flows

Asian property has a problem: it has been unpopular ever since the Global Financial Crisis (GFC) of 2008-2009. As shown in Figure 1 below, based on data from Real Capital Analytics (RCA), between 2008 and 2015 outbound capital flows from Asia into property markets in other regions of the world surged 14x from USD4.2 billion to USD58.9 billion, whereas inbound capital flows dropped 35% from USD24.9 billion to USD16.2 billion.

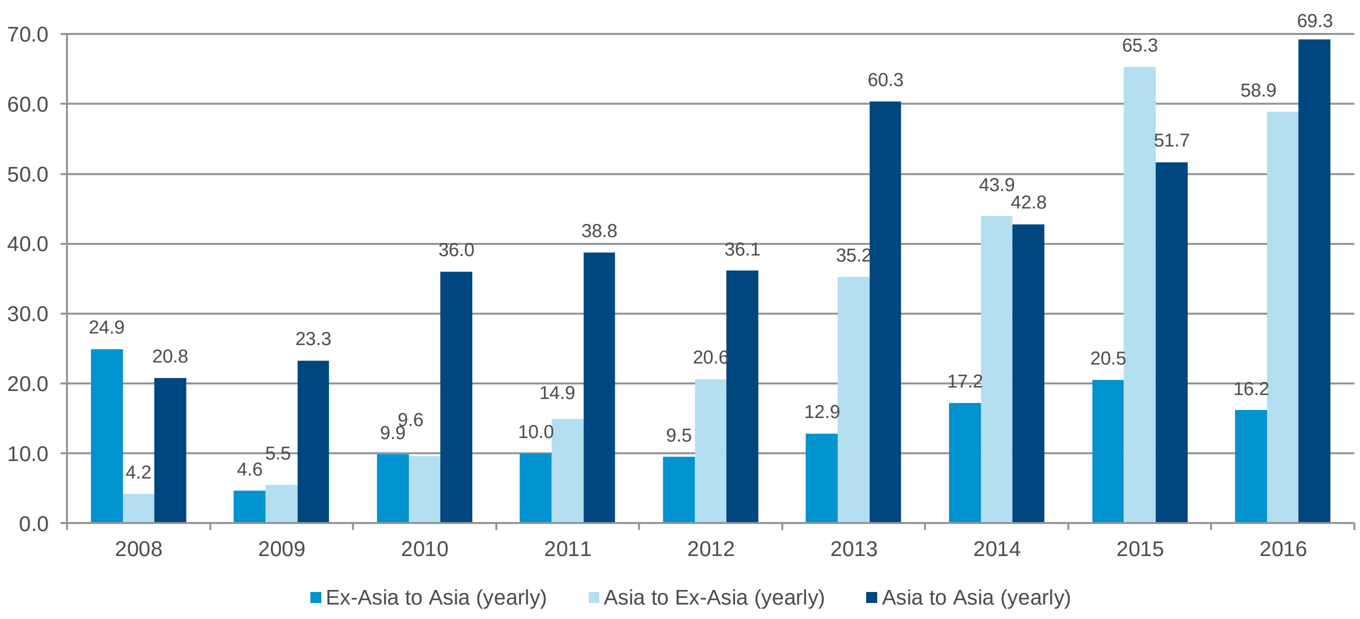
The trend of constantly rising outflows and constantly declining inflows changed slightly in 2016, which saw capital outflows drop by 9.8% y-o-y to USD58.9 billion. However, the slight change in the trend has not made a great difference to the long-run pattern. Importantly, aggregate capital outflows remained significantly greater (3.6x) than aggregate capital inflows.

We believe that the long-run pattern of increasing capital outflows but declining capital inflows reflects general pessimism about emerging markets since the GFC, rather than specific problems in Asian property markets. Perhaps surprisingly (considering that the crisis started there), the US has been the chief engine of world economic growth since the GFC. In contrast, the average economic growth of emerging markets deteriorated sharply over roughly the period 2010-2016. This deterioration partly reflects the end of the period of very rapid expansion in China (roughly 2005-2010) which had fuelled a global boom in commodities markets. However, it also reflects sharp slowdowns in more recent years in emerging markets outside Asia, especially South Africa, Brazil and Turkey.

The deterioration in emerging markets should not be overstated. China has slowed down, but still achieved real GDP growth of 6.7% in 2016, while for India the figure was about 7.1%. It no longer makes sense to view Asian economies as simply a subset of global emerging markets. The concept of very similar BRICS markets has lost meaning when India and China are growing at 6-7% p.a., but Brazil saw growth of about –3% last year.

Reflecting the steady recovery in the US economy since the GFC and the problems in emerging economies, US financial assets have been in high demand and in consequence the US dollar has been strong. The dollar strengthened continuously against the Chinese renminbi over the period 2014-2016, although the renminbi has rallied slightly so far in 2017 (see Figure 2). The US

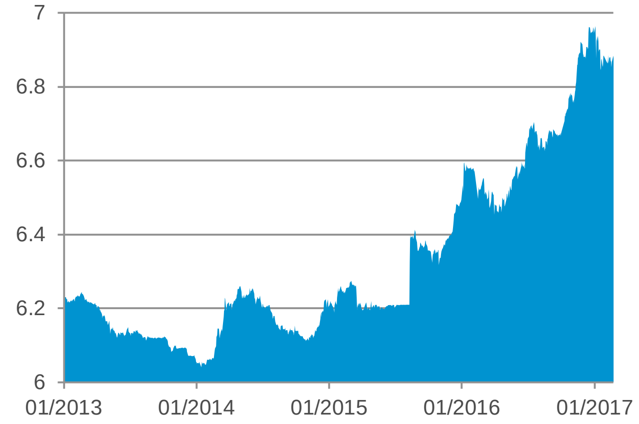
Figure 1: Outbound and inbound real estate investment in Asia (2008-2016, USD bn, including undeveloped land)



NB 1) For deal volumes over USD2.5 mn. 2) Here and throughout this report, RCA data are correct as at 23 February, 2017.Source: RCA

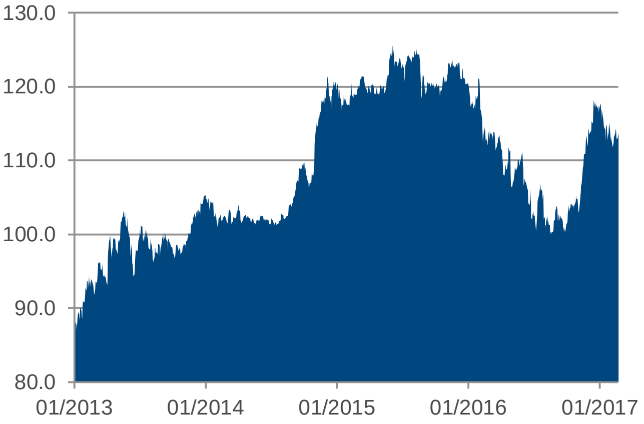
dollar's performance against the Japanese yen, another perceived "safe haven" currency, has been less consistent (see Figure 3).

Figure 2: US dollar vs Chinese RMB (since start-2013)



Source: Bloomberg

Figure 3: US dollar vs Japanese yen (since start-2013)



Source: Bloomberg

While the overall picture of Asian of surging outbound investment versus stagnating inbound investment is not encouraging, it is important to note the 233% increase in aggregate intra-regional capital flows from USD20.8 billion in 2008 to USD69.3 billion in 2016. In fact, aggregate intra-regional capital flows exceeded aggregate Asia-to-global capital flows last year for the first time since 2013, and increased by 34% from the 2015 level. The strength of intra-regional property investment suggests that financial institutions and developers within Asia are more sanguine about prospects for the region than investors based outside it.

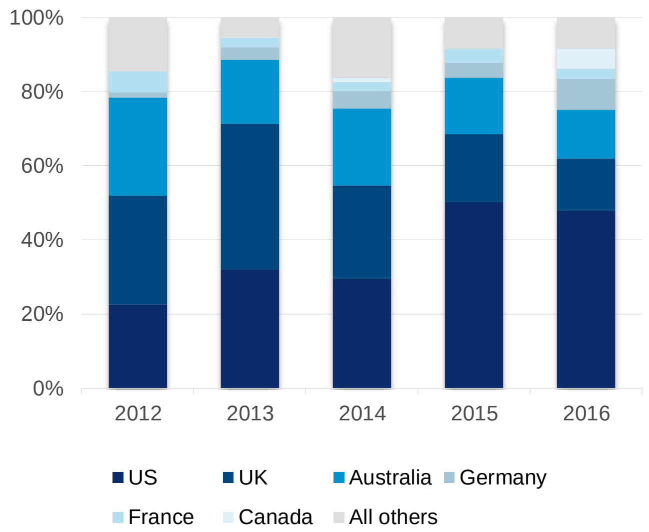
Asian outbound capital shifts to US

Between 2009 and 2013, the UK was the most important destination for Asian investment capital targeting the property sector. Asian investment in the UK peaked at USD13.6 billion in 2013, and accounted for 39% of aggregate property investment outside Asia of USD35.2 billion in that year. Investment in the US remained below USD5.0 billion up to 2012, but jumped nearly 1.5x in 2013 to USD11.3 billion or 32% of the total.

Subsequently, Asian investment in the US surged threefold to a peak of US33.0 billion in 2015, representing 51% of aggregate investment outside Asia in that year. In 2016, Asian investment in the US fell by 12% to USD29.1 billion, representing a very similar proportion (49%) of aggregate investment outside Asia in that year. Mainland Chinese capital accounts for a high proportion of the aggregate Asian investment in the US (43% in 2016), and it is no coincidence that the popularity of the US surged over the years in which the Chinese renminbi was depreciating steadily against the US dollar.

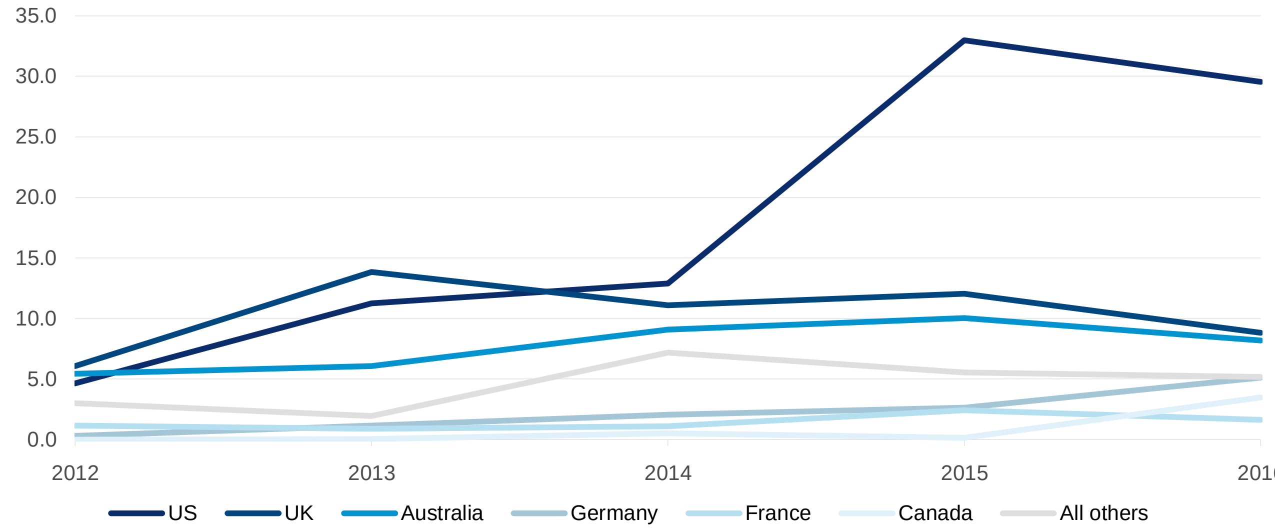
The increasing popularity of the US as an investment destination is illustrated in Figures 4 and 5 below.

Figure 4: Asia to non-Asia property investment by destination country, 2012-2016 (% of total)



Note. These totals include undeveloped land.
Source: RCA, calculations by Colliers

Figure 5: Asian investment in US property surges over 2012-2016 (USD bn)



Note. These totals include undeveloped land.
Source: RCA, calculations by Colliers

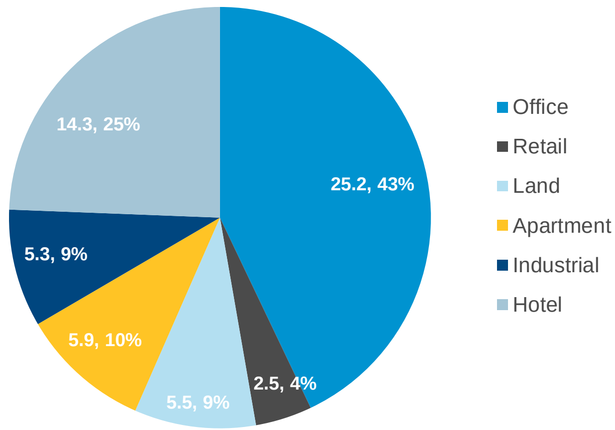
While the popularity of the UK as an investment destination has declined, it has not collapsed. Indeed, the UK remains the second most popular investment destination after the US, accounting for 16% of total outbound investment in 2016. Total Asian investment in the UK dropped by 25% last year, from USD12.4 billion to USD9.3 billion. Considering the political uncertainty after the UK's Brexit vote in June 2016 and the subsequent 20% depreciation of the pound sterling (which affects calculation of the US dollar-based statistics), we see this 25% decline as a more robust outcome than it might have been.

Indeed, as Figure 5 illustrates, Asian investment in many important foreign markets turned down slightly last year, so the decline in investment in the UK does not look so exceptional. As noted above, Asian investment in the US dropped by 12% last year. The third most popular investment target for Asian capital is Australia; in this case, investment dropped by 17% last year, from USD10.5 billion to USD8.7 billion. The only large markets which attracted significantly higher levels of Asian capital in 2016 than in 2015 were Germany (up by 86% to USD5.2 billion) and Canada (up by 21x from a small base to USD3.1 billion).

Asian investors like office property

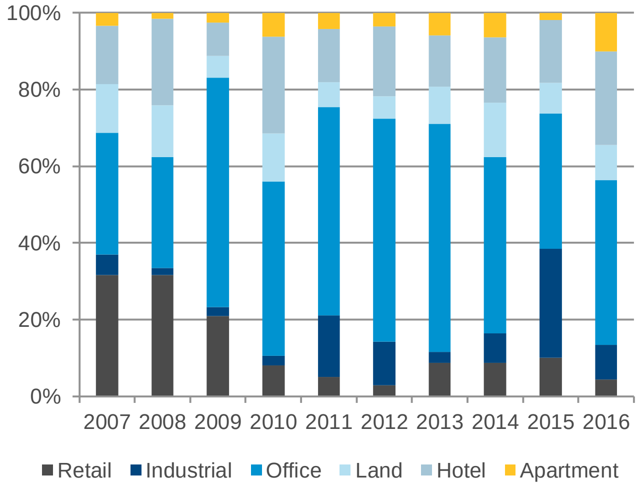
Outside their own region, Asian investors like office property. In 2016, total investment in non-Asian office property amounted to USD25.2 billion, i.e. about 43% of aggregate outbound capital. Moreover, office property has been their preferred segment of the property market for all of the past eight years. Retail property was the most popular segment between 2007 and 2009, but that is now quite some time ago.

Figure 6: Asia-to-global property investment in 2016: market segments targeted (USD bn, % of aggregate)



Source: RCA

Figure 7: Asia to non-Asia property investment 2007-2016: market segments as % of total



Source: RCA, calculations by Colliers

Last year, the second most popular target market segment was hotel property, accounting for 24% of aggregate outbound capital. This is an area which Japanese investors have traditionally favoured. In recent years, however, Chinese groups appear to have assumed the mantle of biggest investors in non-Asian hotels. In 2016, China's Anbang Insurance surprised the real estate investment world by securing a USD6.5 billion deal to purchase Strategic Hotels & Resorts from Blackstone, although it walked away from a planned deal to buy Starwood Hotels for USD14.0 billion.

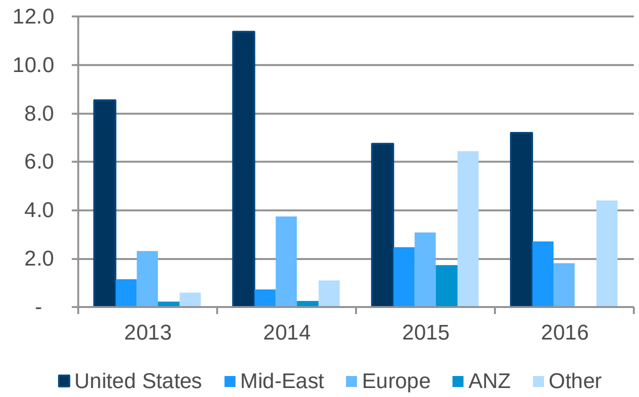
One of the least popular property market segments was undeveloped land, accounting for 9% of aggregate outbound capital. This fact represents a marked contrast with property investment by Asian investors closer to home: in the case of intra-Asian investment, undeveloped land is the most popular property market segment. Undeveloped land purchases account for about 70% of total intra-Asian investment, although they are concentrated in China and Hong Kong.

Undeveloped land is a riskier investment than income-generating property: it requires greater capital, a longer payback period and better project management and execution. However, Asian investors are showing some signs of greater willingness to test their skills outside their home region. For example, China Vanke, one of the largest developers in mainland China, has formed joint ventures with local developers in the Manhattan and London property markets. As they gain experience, Chinese and other Asian developers may prove more willing to engage in development projects outside Asia from start to finish, with or without the cooperation of local property groups.

US and Mid-East dominate inbound capital

While inbound real estate capital flows are still dwarfed by outbound capital flows, it is instructive to examine the chief sources of inbound capital to Asia. US investors have been the largest source of inbound capital for the past four years, investing at least USD5.0 billion in Asia in each year and accounting for 44% of aggregate inbound investment of USD16.2 billion in 2016.

Figure 8: Asia inbound real estate investment capital source by country/region (USD bn)



Note. These totals include undeveloped land.
Source: RCA, calculations by Colliers

European investors have committed US2-4 billion per year to Asian property investment, and there seems little sign that this level is about to pick up sharply in the near term. In 2016, the Middle East overtook Europe to become the second largest source of inbound capital. However, this partly reflected one very large transaction, namely the Qatari Investment Authority's purchase for about USD2.4bn of Singapore's Asia Square in June 2016. Although we expect Middle Eastern investment interest in Asian property to persist, it would be rash to assume that another investment on this scale is imminent.

Non-Asian investors in Asian property have mostly targeted the office segment, which accounted for over 55% of total investment last year. Retail property came in second place, with 17%. Industrial property (9% of investment last year) seems to be increasing from a small base. We expect this trend to continue in 2017, reflecting generally healthy economic conditions in Asia and continued strong expansion in e-commerce, which should support demand for logistics services. Undeveloped land accounted for about 8% of the total.

2016: an active year for Asian investment

China overtakes Japan to become APAC's top investment market

While interest in Asian property from investors based outside the region remains modest, intra-regional investment has been very strong. As shown in Figure 1 at the start of this report, based on RCA data, aggregate intra-regional property investment in Asia reached USD69.3 billion in 2016, a 34% increase from USD52.9 billion in 2015. The statistics from RCA match the evidence from other sources that 2016 was a very active year in Asian property investment markets. Perhaps the chief point to note about 2016 is that property transaction volume in China has strengthened significantly. In fact, as measured by total property transaction volumes excluding undeveloped land (see Figure 9), China has overtaken Japan to become the region's top country investment market.

Japan's status over many years as the Asia Pacific region's top property investment market reflects Tokyo's position as Asia's largest single urban property market. However, as also shown in Figure 9 below, property transaction volumes in Japan fell by 37% in 2016 to USD29.0 billion as a consequence of a sluggish economy (one of the weakest in Asia at present) and the strength of the Japanese yen last year, which deterred foreign investment. The decline in investment activity accelerated in Q4 2016, which saw a 68% drop in investment to USD4.2 billion.

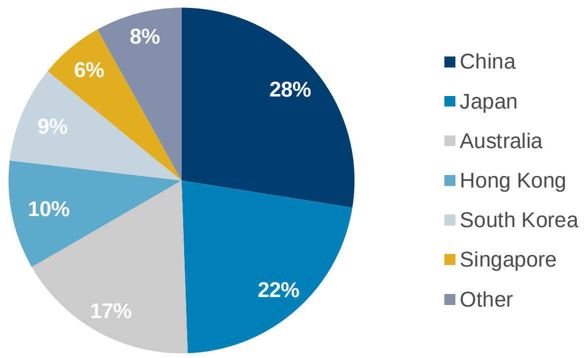
By contrast, over 2016 as a whole total property transactions in China increased by 10% to USD36.5 billion, thereby just exceeding the level in Japan. This strength accelerated in Q4, which saw a 32% y-o-y increase in transaction volumes to USD14.0 billion. For 2016 as a whole, China accounted for 28% of aggregate property transactions in the region (see Figure 10), while for Q4 2016 the proportion was 35% (see Figure 12).

Figure 9: APAC property transaction volumes by country in 2016 (USD)

Position	Market	Value (USD m)	Y-o-y chg. (%)
1	**China**	**36,452**	**10.0%**
2	Japan	29,049	-37.0%
3	Australia	22,823	-32.0%
4	Hong Kong	13,497	15.0%
5	South Korea	11,990	15.0%
6	Singapore	7,964	38.0%
7	India	3,186	7.0%
8	Taiwan	2,513	-18.0%
9	New Zealand	1,960	-37.0%
10	Philippines	903	144.0%
-	APAC Other	2,162	-9.0%
-	**APAC Total**	**132,499**	**-14.0%**

Note. These totals exclude undeveloped land.
Source: RCA

Figure 10: APAC property deals in 2016: market as % of total transaction volume



Source: RCA, Colliers

Besides China, Hong Kong and Singapore enjoyed very active investment interest in 2016. In Hong Kong's case, total property transaction volumes increased by 15% over the year to USD13.5 billion, on which basis Hong Kong ranked as the fourth largest country investment market in Asia Pacific. In Singapore's case, total property transaction volumes increased by 38% over the year to USD8.0 billion, on which basis Singapore ranked as fourth largest country investment market in Asia Pacific.

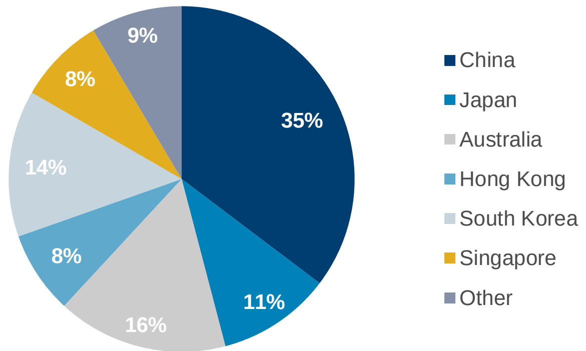
Total investment volumes in Singapore were, of course, boosted by the largest single transaction in Asia last year, the landmark sale in Q2 of Asia Square Tower 1 to the Qatar Investment Authority for SGD3.38 billion (USD2.43 billion). However, as Figure 11 makes clear, investment activity remained strong in H2, with 44% y-o-y growth in Q4 to USD3.2 billion.

Figure 11: APAC property transaction volumes by country in Q4 2016 (USD)

Position	Market	Value (USD m)	Y-o-y chg. (%)
1	**China**	**14,004**	**32.0%**
2	Australia	6,331	-35.0%
3	South Korea	5,444	-19.0%
4	Japan	4,217	-68.0%
5	**Singapore**	**3,229**	**44.0%**
6	Hong Kong	3,066	-1.0%
7	India	1,961	253.0%
8	Taiwan	628	-61.0%
9	APAC Other	558	-49.0%
10	New Zealand	238	-62.0%
-	Philippines	0	0.0%
-	**APAC Total**	**39,676**	**-20.0%**

Note. These totals exclude undeveloped land.
Source: RCA

Figure 12: APAC property deals in Q4 2016: market as % of total transaction value



Source: RCA, Colliers

Strong investment interest in Hong Kong, Seoul and Singapore

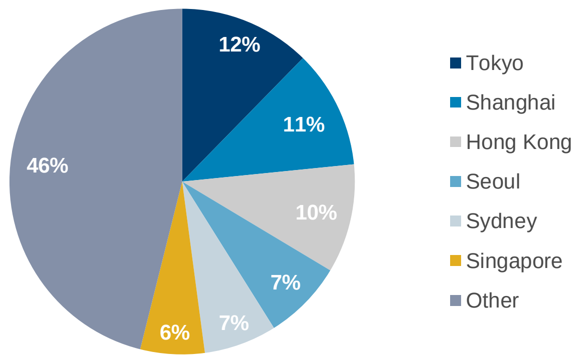
As shown in Figure 13 below, as an urban centre rather than a country, Hong Kong ranked as the third largest investment market in 2016 in the Asia Pacific region after Tokyo and Shanghai, while Singapore ranked sixth. However, perhaps the biggest surprise in the region was Seoul, which saw a 142% increase in total transaction volumes to USD9.92 billion, and on this basis came in fourth place.

Figure 13: APAC property transaction volumes by urban centre in 2016 (USD)

Position	Market	Value (USD m)	Y-o-y chg. (%)
1	Tokyo	16,334	-40.0%
2	Shanghai	14,675	-1.0%
3	**Hong Kong**	**13,497**	**15.0%**
4	**Seoul**	**9,922**	**142.0%**
5	Sydney	9,036	-21.0%
6	**Singapore**	**7,964**	**38.0%**
7	Beijing	6,226	9.0%
8	Melbourne	5,483	-45.0%
9	Brisbane	2,918	-34.0%
10	Osaka	2,913	-35.0%

Note. These totals exclude undeveloped land.
Source: RCA

Figure 14: APAC property deals by urban centre in 2016 as % of total transaction value



Source: RCA, Colliers

Indeed, the office property sector in Seoul was very active last year. The largest buyer was KORAMCO, which acquired eight office and retail buildings. Samsung Life Insurance, AIG and Alpha Asset were the three biggest sellers; Samsung Life Insurance alone disposed of property assets worth about USD1.0 billion.

Since Samsung Life Insurance holds 18 properties across South Korea and plans to continue shedding non-core investments, the investment market in Seoul ought to stay active this year. It is harder to predict to what extent foreign groups may participate in the activity. However, anecdotal evidence suggests that foreign interest in Seoul is increasing. Property yields in South Korea seem to have been rising, perhaps reflecting increased concerns about North Korea; and foreign investors appear to be looking at Seoul again as a market offering good value.

US outlook and impact on Asia

Economic outlook: expansionary in near term, contractionary in medium term

Now perhaps more than ever, it is impossible to form a view on economic prospects for the major Asian countries without a view on economic prospects for the US. Colliers' Chief US economist, Andrew Nelson, and his team outlined their assumptions about the likely development of the US economy in their report "Changes Ahead: Trump, the Aging Economic Cycle and Property Market Impacts" (8 December, 2016)[1].

In summary, the Colliers US research team believes that the new administration of President Trump has inherited a strong economy poised for continued moderate growth. The new president's planned infrastructure spending and income tax cuts should boost both employment and economic growth. However, the impact will likely be limited as the labour force is already near full employment. Gains from the stimulus will be partially offset by greater inflation and higher interest rates.

In contrast to the positive near-term outlook, the medium-term outlook for the US is less rosy. Colliers' US team believes that the new administration's broader economic platform should benefit certain key sectors including energy, finance and pharmaceuticals, but will probably lower growth overall.

There are three reasons for this:

> Firstly, President Trump may try to carry out his campaign pledges to cut legal and illegal immigration and to deport some or all undocumented immigrants. Any programme of mass deportation would directly shrink aggregate demand and slow GDP growth.

> Secondly, the impact of President Trump's commitment to reform US trade policies is highly uncertain until we have clarity around his proposals and about how much the Republican leadership in Congress will approve. The reaction from major US trading partners is unknown, but might range from a limited response to retaliatory tariffs to an all-out global trade war, which would seriously harm the US economy.

> Thirdly, if the US does see a rise in budget deficits, interest rates and inflation, the resulting rise in the dollar could undercut the global competitiveness of US products and reduce exports.

Taking these various effects into consideration, Colliers' US team believes that the new president's broader economic platform raises the odds of a recession by 2019. If a recession does materialise in that year, it will be the first major downturn in the US since the Global Financial Crisis of 2008-2009.

Implications for US dollar: strong in near term, weaker in medium term

As we have made clear, the near-term outlook for the US economy is strong: moderate growth should persist, but inflation and interest rates will probably rise. This scenario supports continued US dollar strength against most Asian currencies over 2017. This, incidentally, was the view of nearly 90% of participants at Colliers' CEO Breakfast, held in Hong Kong on 19 January, at least so far as the Chinese renminbi is concerned: they expect the renminbi to weaken modestly against the US dollar in 2017, but to strengthen over 2018.

However, if the US does go into recession in 2019, the US dollar may then start to weaken against Asian currencies. We would expect the dollar to weaken in particular against the currencies of high-growth Asian nations, notably China and India. This assumption would probably hold true except in the event of a severe global downturn, perhaps a downturn stimulated by self-defeating harsh US tariffs against Asian and other trading nations, in which case the dollar's traditional role as a safe-haven currency might come to the fore again.

From the perspective of US-based investors, the scenario of an accelerating growth and a strong dollar in the near term but slower growth and perhaps a weakening dollar in the medium term has important implications. While growth is strong, it seems reasonable to expect US investors to keep capital at home rather invest it abroad, so it seems unlikely that they will seek to raise their exposure to Asian property significantly over 2017-2018. Over the medium term, capital flows from the US to Asia might start to increase, although this could well depend on political considerations as well as purely economic ones.

[1] Please see http://www.colliers.com/-/media/files/marketresearch/unitedstates/2016-research-reports/2017-market-outlook.pdf?la=en-US.

Chinese interest set to shift to Asia

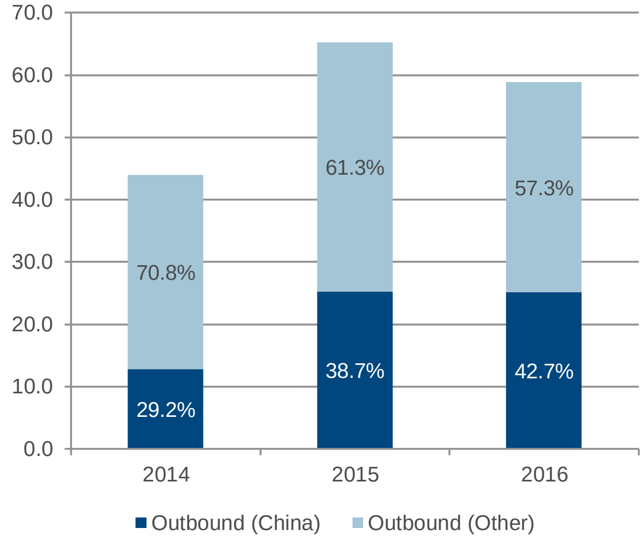
China dominates investment outside Asia, but not within it

Mainland Chinese investors account for a high proportion of aggregate capital deployment abroad by Asian investors. Capital outflows from China to foreign property markets were almost negligible before 2010. Since then, however, Chinese investment in foreign property has grown at great speed, reaching USD37.2 billion in 2016. This total was split between USD25.2 billion invested outside Asia and USD12.0 billion invested within it.

While the 2016 outcome represents a tiny 0.4% decrease from the level of 2015, it is more important to note that 2016 was the fourth consecutive year in which mainland China ranked as the largest source of capital in investment flows from Asia to the rest of the world. Since the US accounted last year for 49% of aggregate property investment outside the region by Asian investors, it is fair to say that mainland Chinese interest in US property assets has been the primary reason for the trebling of property investment outside Asia by Asian investors between 2012 and 2016. Prior to 2013, Singapore was the primary source of capital for real estate investment by Asian financial institutions and property developers outside the region.

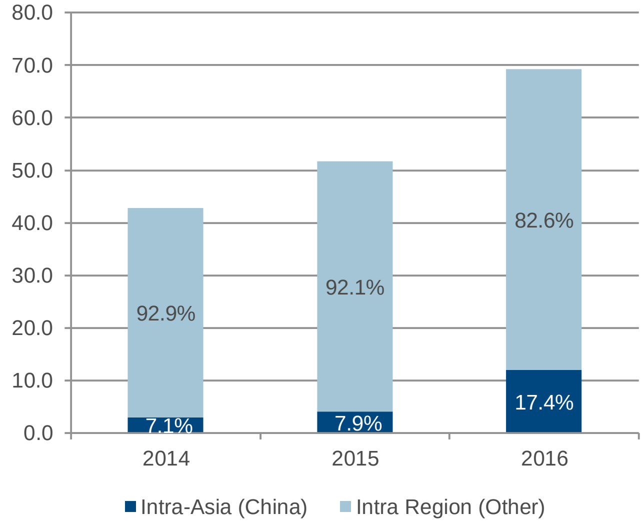
While mainland Chinese groups have been investing heavily outside Asia, they have been less active within the region. The Chinese accounted for 43% of Asia-to-global property investment last year, but for only 17% of intra-regional property investment.

Figure 15: China as source of Asia-to-global property capital flows (USD bn, %)



NB These totals include undeveloped land. Source: RCA, Colliers

Figure 16: China as source of intra-regional property capital flows (USD bn, %)



NB These totals include undeveloped land. Source: RCA, Colliers

One market in which mainland Chinese developers and institutions have shown strong interest in Hong Kong. Indeed, Chinese groups were a major force behind the 15% increase in property transaction volume in 2016 that left Hong Kong as the third-ranked urban investment market in Asia. In 2016, based on the RCA data, Chinese groups invested USD6.6 billion in Hong Kong; and they have clearly continued to invest so far in 2017. The Chinese have concentrated on purchases of en-bloc office buildings on Hong Kong Island but undeveloped land in Kowloon, where the developer HNA Group recently made three successful bids for three large land sites in Kai Tak for residential use.

In our view, there are three reasons why Chinese investors have shown particular interest in Hong Kong:

> Firstly, Hong Kong is on China's doorstep, and is culturally and linguistically similar.

> Secondly, Hong Kong is politically very acceptable as a Special Administrative Region of the People's Republic of China.

> Thirdly, the Hong Kong dollar is pegged to the US dollar. Concern about potential continued renminbi depreciation has clearly been an important factor behind Chinese foreign investment in general. Investment in Hong Kong represents a simple way to hedge against this risk.

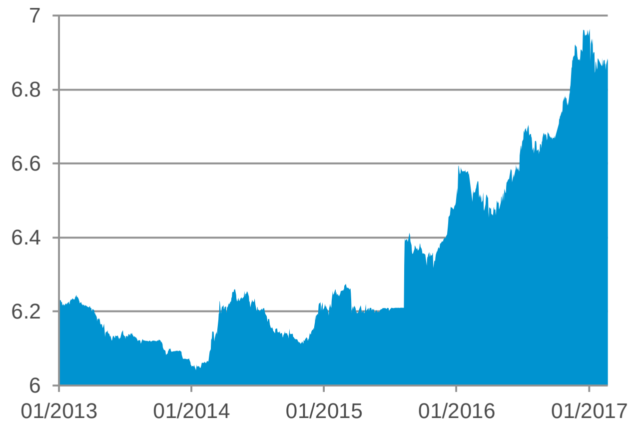
Besides being the largest source of foreign investment in Hong Kong property, mainland China was the largest source of foreign investment in Japan and Malaysia in 2016. In Singapore, Chinese individual investors invested in low to mid-end residential property, while Chinese developers tendered for state and private land for development, mainly in the low to mid-end segment. Some Chinese groups also bought small commercial developments, including the db2Land Building along Robinson Road and the CityVibe retail mall in the Clementi suburb. However, total Chinese investment in Singapore was only USD0.6b billion in 2016, or just 9% of the total for Hong Kong.

Slower RMB depreciation to reduce Chinese investment outside Asia

As we have hopefully made clear, in our opinion perhaps the most important factor behind mainland Chinese investors' rush to purchase property assets overseas, and in particular outside Asia, has been concern about possible further renminbi depreciation. Chinese investors have been especially interested in the US because the economy has been expanding and because the US dollar is the world's most important reserve currency; and to some extent they have probably considered Hong Kong as an extension of the US due to Hong Kong's currency peg.

However, the bulk of renminbi depreciation has probably already happened. Over the three years from January 2014 to December 2016, the US dollar appreciated by 15% against the Chinese renminbi (meaning, to state the situation conversely, that the renminbi depreciated by 13% against the US dollar).

Figure 17: US dollar vs Chinese RMB (since start-2013)



Note. This chart is intentionally repeated from Figure 2 above.
Source: Bloomberg

We agree with the majority opinion expressed at Colliers' CEO Breakfast in Hong Kong in January 2017, i.e. that the Chinese renminbi will depreciate modestly against the US dollar this year. However, the key word here is "modestly". Oxford Economics predicts a USD/RMB exchange rate of 7.15 for end-2017, compared to the rate at time of writing (26 February) of 6.87, implying 3-4% further depreciation this year.

In view of the recent strong economic news from China, we regard Oxford Economics' forecast as a realistic projection. Chinese real GDP growth looks set to reach about 6.3% in 2017; recent trade data have been strong, with exports posting their first increase in January in USD terms since March last year; and China's producer price index (PPI) grew by 5.5% in December, reaching the fastest growth rate in more than five years and continuing the recovery that began in early 2016. While near-term prospects for the US economy are also improving, to state matters simply we believe that one needs to be both rather optimistic about the US and rather pessimistic about China to assume further substantial renminbi depreciation from now on. Please see Figure 18 below for a summary of economic forecasts for China.

Figure 18: China: Recent economic performance and key forecasts

GROWTH RATE (%)	2014	2015	2016	2017	2018	2019
Real GDP	7.3	6.9	6.7	6.3	5.9	5.7
Private consumption	8.2	7.6	7.5	6.9	6.8	6.7
Fixed investment	6.9	7.5	5.6	4.4	4.2	4.0
CPI	2.0	1.4	2.0	2.4	2.5	n/a
USD1.0 = RMB	**6.16**	**6.28**	**6.64**	**7.15**	n/a	n/a

Source: Oxford Economics

There are at least three additional reasons to believe that the bulk of renminbi depreciation has already happened. Firstly, reflecting official concern about high levels of capital outflow from the country, the Chinese government began to impose new capital controls in November, 2016, including strict limits on large corporate investments abroad. In the short term, the restriction will probably slow deal flows originating with mainland Chinese investors to Hong Kong and reducing the run-up in prices there.

However, for companies which have already established a lending platform outside of China, the impact is likely to be much less significant. For example, a joint venture of two Chinese developers listed on the Hong Kong Stock Exchange, Logan Property Holdings of Shenzhen (Stock Code: 3380) and Guangzhou-based KWG Property Holding (Stock Code: 1813), set a new lump-sum sale record of HKD16.86 billion (USD2.17 billion) for a plot of residential land on Hong Kong's Ap Lei Chau island on 24 February 2017, topping market valuations by almost 50 per cent. This demonstrates mainland Chinese companies' strong interest in Hong Kong's property market under the current market and policy circumstances.

Overall, we believe that the long-term trend of mainland Chinese companies investing in overseas real estate will revive once the authorities relax restrictions. After all, internationalisation of the renminbi and expanding China's global influence are two of the priorities of the current administration.

Secondly, and on a related point, we suspect that the Chinese authorities may put quiet pressure on financial institutions to moderate their investment activity outside Asia, notably in the US. This will be especially true if the new US president translates his protectionist rhetoric into concrete measures such as high tariffs on Asia and other imported goods. If political relations between the US and China start to cool down, it may become politically difficult for Chinese groups to continue their heavy investment on the other side of the Pacific. Even if political relations do not cool down, we suspect that in the long run the Chinese authorities would prefer to see a shift in investment to countries closer to home, for example "One Belt, One Road" markets in south-east Asia and central Asia.

Thirdly, quite apart from political considerations, another motivation for the Chinese authorities to press financial institutions to moderate overseas investment may well be the desire to protect them from potential big expensive mistakes. The trophy acquisitions which have been pursued recently by Chinese groups like Anbang Insurance bear more than a passing resemblance to the rash of acquisitions in the US made by Japanese companies in the late 1980s, when Mitsubishi Estate purchased the Rockefeller Centre in New York and the electronics producers Sony and Matsushita purchased Hollywood film studios. Many of these acquisitions proved highly overpriced, and resulted in large write-downs for the acquiring companies.

Focus on China, Hong Kong, Singapore, India

Weight of capital set to balance upward pressure on cost of funds in Asia

In 2016, as we have seen, aggregate investment by Asian investors in property outside Asia amounted to USD58.9 billion. Of this total, mainland Chinese investors represented USD25.2 billion, or 43% of the total. However, at USD69.3 billion, aggregate investment by Asian investors in property within Asia was 18% higher than Asia-to-global investment. Of this total, mainland Chinese investors represented USD12.0 billion, or 17%. Moreover, aggregate intra-regional investment was 62% higher than the figure of USD42.8 billion recorded for 2014. On this basis, there is a good argument that that the biggest story of real estate investment in Asia over the past three years has not been the continuing pattern of rising capital outflows to other regions and stagnating inflows, but strengthening intra-regional investment in which China plays a noticeable but not yet dominant role.

We think it probable that mainland Chinese investment in foreign property will continue at a high rate, but that it will be increasingly directed towards Asian rather than non-Asian markets. This would be in keeping with the Chinese government's long-term "Belt and Road" strategy. If so, the already heavy flow of investment capital into Asian property assets ought to strengthen further.

On the other hand, interest rates in many Asia Pacific markets look set to rise gradually from now on, or at least not to fall further. This is especially true of Hong Kong, since Hong Kong interest rates are effectively tied to US interest rates through the US dollar peg, and US rates seem virtually certain to rise this year. However, most observers also expect interest rates in Singapore to trend upwards from now on, albeit from a low base (the benchmark short-term interest rate was about 1.0% at end-2016). The Reserve Bank of Australia has held interest rates steady since November 2016, and according to Oxford Economics it may not now cut rates further before tightening in mid-2018, although a cut is possible if the Australian dollar continues to appreciate[2]. In India, the central bank now appears focused on keeping inflation close to 4% on a sustained basis, the mid-point of its inflation target range. Reflecting this fact, and given its assumption that CPI inflation will rise back above 5% in H2 2017, Oxford Economics is one forecaster which do not expect any further interest rate cuts in India[3].

If interest rates are set to rise, then cost of funds will rise for investors. This implies upward pressure on property yields as spreads over cost of funds narrow. Anticipation of rising cost of funds probably helps explain the recent decline in property transactions in the two most "core" Asia Pacific property investment markets, Japan and Australia. Over 2017, aggregate property deals in Japan and Australia fell by 37% and 32% y-o-y respectively, as shown in Figure 9 above.

Our opinion now is that the continued weight of investment capital will largely offset upward pressure on cost of funds, meaning that Asian property yields on average at least stay flat this year. We remain positive about Asian property, and see particular investment opportunities in China, Hong Kong and Singapore, and India over the medium term. We highlight these opportunities over the rest of this report, drawing partly on the conclusions from Colliers' 2017 Asia Pacific Property Outlook[4], published in late January.

[2] Source: Oxford Economics, "Country Economic Forecast Australia", 10 February 2017.

[3] Source: Oxford Economics, "Country Economic Forecast India", 24 February 2017.

[4] Please see http://apacpropertyoutlook.colliers.com.au/.

APAC property: Colliers' key views

Asia Pacific: overall conclusions

The economic environment in Asia Pacific looks mostly healthy as we move into 2017. China and India are both achieving real GDP growth of 6-7% y-o-y, and investment demand has been firm in most major Asian centres. Hong Kong's economy has been improving due to strong domestic demand and Australia remains an appealing destination for global investors.

In 2017, the continued weight of investment capital should mean that property yields at least stay flat, and perhaps fall further, across Asia Pacific despite likely upward pressure on interest rates and therefore cost of funding in various markets from now on. We detect signs of increased risk appetite among investors, and therefore expect interest in non-core investment markets to increase gradually. Within Asia, China, Hong Kong and Singapore remain our preferred office investment markets while India has high long-run growth potential and deserves closer attention.

The chief risks for Asia Pacific property markets lie in the US. While the near-term prospect of continued growth, rising interest rates and US dollar strength could well be positive for the region's exporting nations, threatened trade tariffs could be a major danger. Moreover, faster than expected US economic growth could force an early return to positive real interest rates in Hong Kong, hurting confidence. However, we are optimistic about the region's prospects and, bar a few exceptions, think 2017 will be another positive year for Asia Pacific property.

Asia Pacific office property market

Economic conditions in most APAC markets (China, India, Australia, Hong Kong…) are healthy and improving. While this is driving strong demand for leased office space across the region, only a few cities are seeing solid office rental growth – most noticeably Sydney and Melbourne, and to some extent Hong Kong Island. Rental growth is being constrained by significant new supply in various cities including Shanghai, Beijing, Singapore and Jakarta, all of which are likely to see vacancy levels rise over the next few years, while we foresee a further widening of rent levels between prime and non-prime districts in Hong Kong in particular due to uneven demand and supply.

In India, with 10-12% annual growth in the IT sector likely to persist till 2020, demand for office growth should remain strong for the next few years in the technology-driven markets like Bengaluru, Hyderabad, Chennai and Pune. In traditional commercial markets such as Mumbai and New Delhi, we expect average rents to stay stable or decline slightly over 2017. However, rents may still move upwards in prime areas where supply is limited.

Asia Pacific industrial property market

Asian economies look mostly healthy, with the two of the three biggest, China and India, set to grow by over 6% in 2017. Economic growth in Hong Kong has been accelerating, while after a few years of weakness Singapore picked up in late 2016. Among the large markets, the chief weak spot is still Japan, although recent yen depreciation should support the economy this year. This solid background should underpin demand for manufacturing property in Asia in 2017. Meanwhile, continued strong expansion in e-commerce should support demand for logistics property in the more developed Asian urban markets. Over the medium term, the flagship programme of the government of Prime Minister Narendra Modi to boost India's image as a global manufacturing hub, combined with the opening-up or relaxation of barriers to foreign direct investment in several sectors, should create new opportunities in industrial property.

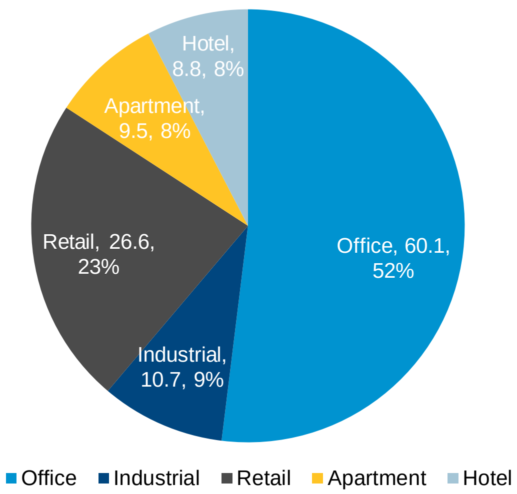
Figure 19: Summary of Asia prime grade office property markets

City	Rent growth (2016-2019 avg pa)	City avg. vacancy (end 4Q 2016)	City avg. vacancy (end-2019E)	Net income yld*	10 year bond yld	Spread
Hong Kong*	3.8% (5.0%)	4.1% (2.2%)	6.2% (3.5%)	3.8% (2.5%)	1.75%	2.1% (0.8%)
Singapore[1]	0.6%	7.0%	9.0%	3.6%	2.29%	1.3%
Shanghai	1.6%	10.2%	10.3%	4.0%	3.29%	0.7%
Beijing	-0.5%	8.0%	13.0%	4.5%	3.29%	1.2%
Seoul	0.9%	10.4%	10.8%	4.1%	2.15%	1.9%
Jakarta	-3.2%	15.0%	25.0%	6.4%	7.46%	-1.1%

Notes. As of Q4 2016 where available or November 2016 where not yet available. * Average for all Hong Kong; figures in brackets are for Hong Kong Island. [1] Singapore figures are for CBD.
Source: Colliers International, Bloomberg

Industrial property only accounts for 9% of total property transaction volumes in Asia (see Figure 20), and we see ample scope for this proportion to increase. Overall we are cautiously positive about prospects for industrial property in Asia in 2017, although the threat of high tariffs on Asian imports by the incoming US administration carries risks.

Figure 20: 2016 investment volume by property market segment in Asia (USD billion, % of total, excluding land sites)



Source: Real Capital Analytics

In Australia, firming rents, rising land values and sharpening yields point to a robust outlook for industrial property in 2017, while industrial investors and developers are set to reap significant capital and land value growth from major transport infrastructure spending projects over the next four years.

Asia residential property market

After a year of strong increases in residential property prices in many markets over 2016, prospects for 2017 look more subdued. In reaction to what has been an over-heated residential market and the cooling measures imposed by numerous city governments in China, we expect that the residential market in Tier 1 cities will experience a mild adjustment in 2017. In Hong Kong, assuming that pace of interest rate increases is only gradual, we think the residential market can resist downward pressures over 2017. However, if faster than expected US economic growth forces an earlier return to positive real interest rates than our current assumption of H2 2018, confidence in the residential market could be hit hard.

In contrast to most other Asian centres, residential prices in Singapore have been falling since late 2013. While prices may still fall further in H1 2017, beyond then prices ought to stabilise; and in the long run we believe that any easing of the government's residential cooling measures should spur investment in the luxury residential sector. In India, in the near term market confidence has been damaged by demonetisation. However, mid-segment projects with realistic pricing are enjoying fair success in both the primary and the secondary markets. Looking ahead, new regulations and probable further cuts in interest rates should allow sentiment to pick up steadily over 2017.

Opportunities in key Asian centres

Hong Kong

> We see opportunities for investors in en-bloc and strata-title offices in decentralised districts especially Kowloon East and West.

> In addition, we see opportunities in upgrading and repositioning the retail podium of buildings in fringe prime locations, and in sub-dividing industrial properties to smaller units.

Singapore

> Despite pressures on both the general economy and office rents in recent years, we continue to see investment opportunities in Singapore office property, given the country's status as a sophisticated market economy with high regulatory transparency.

> Industrial property in Singapore is also becoming more popular with foreigners in general assuming they can overcome licensing issues.

> Residential collective sales offer opportunities for developers, while we believe that any easing of the government's residential cooling measures should provide an impetus for foreign investment in the luxury residential segment in particular. Foreigners should find it attractive to re-enter this segment when the additional buyer's stamp duty of 15% imposed on foreigners is eventually relaxed or removed.

Shanghai

> Driven by yield compression and limited opportunities in prime areas such as Lujiazui, Zhuyuan and Jingan, which are the preferred submarkets for most investors, office properties with value-added potential and a size ranging from 3,000 to 20,000 sq metres (33,300 to 215,300 sq feet) in decentralised areas, e.g. Minghang's Hongqiao Transportation Hub, attract many domestic and overseas buyers for self-use or investment purposes.

- In the logistics sector, driven by strong occupier demand and stable rental values, standard logistics properties on the fringe of Greater Shanghai remain attractive to both developers and institutional investors.

- In the retail sector, properties in prime catchment areas continue to attract overseas investors for stronger asset performance while those in emerging areas tend to be more appealing to some domestic and selected overseas investors for value-added potential and capital value growth.

Beijing

- We see value-add opportunities in upgrading and renovating existing aged office, retail and hotel buildings in core areas as Beijing has banned large-scale new commercial property development in these areas since 2015.

- Business parks in emerging areas offer opportunities as rents in business parks have continued to rise in recent years.

India

- With 10-12% annual growth in the IT sector likely to persist till 2020, demand for office space should remain strong for the next few years in the technology-driven markets like Hyderabad, Bengaluru, Pune and Chennai. These are markets where investors should look for investing in quality buildings; however, as most of the inventory is strata-sold and there is a limited availability of Grade A commercial assets, investors may look to invest at the land stage and build the Grade A assets along with the developer

- With regard to industrial property, the government has recently opened certain sectors to foreign direct investment (FDI) and relaxed FDI barriers for others such as defence. The government has identified five main industrial corridors that are designed to be the epicentre of its industrialisation strategy. The government is planning to create 100 "smart cities" along these corridors to support industrial development

- The Indian government granted infrastructure status to affordable housing in the Union Budget 2016-17. Consequently, this property market segment is eligible for various tax incentives and cheap funding. To give a demand side push, the government has also provided interest rate subsidies to the buyers. Investors may look to enter in this segment to reap an early mover advantage.

- Another opportunity for investors is bulk buying in under-construction residential projects in cities such as Mumbai and Delhi NCR. These cities have high unsold inventory in under-construction projects, so investors may receive attractive discounts.

554 offices in 66 countries on 6 continents

United States: 153
Canada: 34
Latin America: 24
Asia Pacific: 231
EMEA: 112

$2.5
billion in annual revenue

2
billion square feet under management

16,000
professionals and staff

About Colliers International Group Inc.

Colliers International Group Inc. (NASDAQ & TSX: CIGI) is an industry leading global real estate services company with more than 16,000 skilled professionals operating in 66 countries. With an enterprising culture and significant employee ownership, Colliers professionals provide a full range of services to real estate occupiers, owners and investors worldwide. Services include strategic advice and execution for property sales, leasing and finance; global corporate solutions; property, facility and project management; workplace solutions; appraisal, valuation and tax consulting; customized research; and thought leadership consulting.

Colliers professionals think differently, share great ideas and offer thoughtful and innovative advice that help clients accelerate their success. Colliers has been ranked among the top 100 outsourcing firms by the International Association of Outsourcing Professionals' Global Outsourcing for 11 consecutive years, more than any other real estate services firm.

colliers.com

For further information, please contact:

Andrew Haskins
Executive Director | Research | Asia
+852 2822 0511
andrew.haskins@colliers.com

Daniel Shih
Director | Research | Hong Kong
+852 2822 0654
daniel.shih@colliers.com

Tricia Song
Director | Research | Singapore
+65 6531 8536
tricia.song@colliers.com

Ines Li
Associate Director | Research | Beijing
+86 10 8518 1633
ines.li@colliers.com

Carlby Xie
Senior Director | Research | China
+86 21 6141 3590
carlby.xie@colliers.com

Surabhi Arora
Senior Associate Director | Research | Gurgaon
+91 124 456 7580
surabhi.arora@colliers.com

Colliers INTERNATIONAL
Accelerating success.