News Release

Chinese Outbound Real Estate Investment: Changing Currents, Rising Tides

Chinese real estate investment in Australia was down considerably year-on-year, however activity has picked up again in recent months

19 October 2016 (Australia) – Knight Frank has published its third *Chinese Outbound Real Estate Investment Report* titled *Changing Currents, Rising Tides*. Riding on last year's strong momentum, the waves of Chinese outbound capital continued in major real estate markets around the world in H1 2016, with more to come through the rest of the year.

Global gateway locations have seen undiminished interest from Chinese investors, who are driven by Chinese economic and policy factors and are attracted by favourable local market conditions in gateway cities. China's capital outflow control has been a push factor so far, but it could prove to be a double-edged sword. Stringent requirements have made it difficult for some investors to secure foreign exchange clearance.

According to **Knight Frank's Head of Research and Consulting, Australia Mr Matt Whitby**, "The volume of Chinese investment in Australia is down considerably year-on-year because of a lack of mega-deals in the first half, as large deals such as the Investa portfolio dragged the 2015 number higher.

"Amid competition from other Asian buyers, however, there is a strong Chinese appetite for en-block commercial properties in both Sydney and Melbourne, attracted by rental growth supported by strong tenant demand and a supply shortage," said Mr Whitby.

Key trends of Chinese outbound investment:

- Chinese capital outflow continued strongly in H1 2016, with a **total of US$10.7 billion invested.** Although showing a 13.6% drop compared to H1 2015 this should be considered in the context of some of the biggest real estate deals in Chinese outbound investment history early last year, such as the US$1.9 billion purchase of New York's Waldorf Astoria Hotel. While overall investment is somewhat softening, we saw strong growth of Chinese capital inflow in a number of key gateway cities.

- **In Australia**, with the absence of mega-deals such as last year's CIC's record breaking purchase at US$1.8bn for an office portfolio, the volume of office deals dropped 65% and hotel deals dropped 42% YoY. Investment in development sites stabilised. Nonetheless, Chinese and other Asian capital remain drawn mainly to Sydney and Melbourne's office markets given their short supply and rental growth prospects. One important observation is that Chinese developers are now looking to diversify into income producing properties.

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- In **Australia,** Chinese investors and developers spent US$1.7bn in Australia in 1H 2016 – a 37% decline year-on-year. With the absence of mega deals, such as CIC's record-breaking purchase at US$1.8bn for an office portfolio (AUD2.45bn), the volume of office deals dropped 65% and hotel deals dropped 42% year-on-year. Meanwhile, investment in development sites stabilised.

- Chinese outbound investment as a whole was gaining momentum as we crossed the half-year mark, with the biggest push coming from the Chinese economy itself. Global gateway locations have seen undiminished interest from Chinese investors, helped by favourable local market conditions like market depth, rental growth prospects, and in the case of London, a cheaper UK pound.

- However there are challenges ahead. China's capital outflow control was designed to prevent the erosion of the country's vast foreign exchange reserves, but its stringent requirements have made it difficult for some investors, mainly smaller ones, to obtain foreign exchange clearance. Some sizeable investors have invested through overseas subsidiaries, but these subsidiaries may run out of funds if the grip on foreign exchange reserves is not loosened.

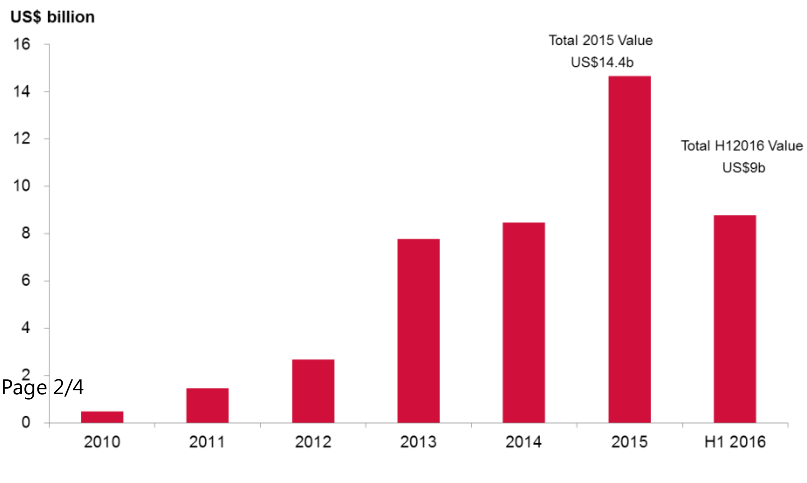
According to **Knight Frank's Head of Asian Markets, Australia Dominic Ong**, "Chinese and other Asian capital continues to be drawn mainly to the office markets in Sydney and Melbourne. Tenant demand from various sectors remains strong, but lack of supply has caused rents in both cities to rise and vacancies to fall. Yields, meanwhile, have been tightening, but are still above long-term bond yields.

"Fewer buying opportunities, coupled with the positive rental outlook, have already attracted large Chinese private developers such as Poly Group and Shanghai Shenglong to the office market. Since June there have been a number of major deals in the making, which will underpin the investment market outlook for 2016.

"Activity has picked up in the past few months. Some of the most recent transactions in Australia from Chinese buyers include 15 Help Street, Chatswood which sold for AUD43.8m to One Pro Investment Group; 20 Bridge Street, Pymble which sold for AUD78m to YuHu; 210 George Street, Sydney sold for AUD160m to Poly Group; and 61 Lavender Street, Milsons Point sold to Aqualand for AUD110m," said **Mr Ong.**

Where and what are they investing?

Chinese investment in major gateway cities



Mr Whitby said, "The US is now firmly established as the most important destination for Chinese capital, having attracted US$5.1 billion worth of Chinese investment in H1 2016, up 21% year-on-year (YoY).

"The Australian market meanwhile showed a 37% YoY decline due to the absence of mega-deals we saw last year."

Paul Hart, Executive Director, Greater China at Knight Frank said, "Meanwhile, Chinese investment in the UK showed an impressive YoY increase of 75% in H1. The interest in the British capital has not diminished even after the Brexit vote as the market saw a number of major transactions taking place since then. Closer to home, Hong Kong saw US$1.68 billion worth of Chinese investment in H1, a minor volume drop YoY. However we have seen a number of large deals since July which will enhance the whole year result."

- **In the US**, New York attracted 80% of Chinese investment in the US. A large share of this (62%) was in office deals, as Chinese institutional capital continued to chase trophy assets. Major hubs on the west coast, such as San Jose and Seattle, also drew interest from Chinese investors. As the Fed-led low interest-rate environment persists, Chinese investors will continue to favour tangible assets such as real estate.

- **In the UK**, the economy's perceived stability and London's status as an international financial centre contributed to the UK's 75% YoY increase in Chinese investment before Brexit. Private banks and conglomerates became a key part of the investment landscape, which was previously dominated by large insurance companies. Chinese investors' interest in the city seemed unabated after Brexit, with a number of major office transactions completing since July.

- **Hong Kong** has attracted Chinese investors thanks to increased financial cooperation and its position as the international financial centre closest to China mainland. Currency and stock connect schemes between Hong Kong and the Mainland attracted new investor and tenant demand. Owning office space is an attractive option due to Hong Kong having the world's highest office rents. Meanwhile, the city's residential land market also offers better value than some hotly-contested Chinese markets.

- Feeling the pressure from the RMB's steady devaluation against the US dollar, Chinese investors, particularly private conglomerates, have tended to invest aggressively in hard assets. The demand for real estate has coincided with strong appetite in other investments.

Forecasts

Bunny Wang, Senior Director, Head of International Capital Markets and International Project Marketing, China, Knight Frank, believes that Chinese investors will continue to be interested in the traditional gateway markets. She notes that the buying spree that resulted from the RMB's steady devaluation against the US dollar bodes well for gateway markets, at least in the short term. Furthermore, despite talk of a prolonged slowdown, China's GDP growth has stabilised at above 6.5%. She believes one of the main ways the central government will achieve its GDP growth target is through infrastructure investment and real estate market-led consumption. Given the highly competitive domestic real estate market, many investors and developers are keen to diversify their investment overseas.

David Ji, Director and Head of Research and Consultancy, Greater China at Knight Frank, believes that China's capital outflow control could present some risks. Stringent requirements for foreign exchange clearance aside, he believes that the prospect of high land prices in the country's major cities would encourage the seeking of overseas opportunities. But the complicated processes and planning issues in gateway markets could diminish the willingness of Chinese investors to explore those markets more deeply.

For further information, please contact:

Matt Whitby, Head of Research & Consulting, Australia
Matt.Whitby@au.knightfrank.com +61 418 404 854

Dominic Ong, Head of Asian Markets, Australia
Dominic.Ong@au.knightfrank.com +61 468 969 298

Rebecca Sands, Associate Director, PR & Communications, Australia
Rebecca.Sands@au.knightfrank.com +61 416 119 858

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Note to Editor:

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