

ACTIVE CAPITAL

THE REPORT 2017



**Connecting
People
& Property,
Perfectly.**

Introduction



Andrew Sim
Head of Global
Capital Markets

We are really excited to present this first edition of Active Capital and to share our experience and views on the latest dynamics in the global real estate capital markets.

At this point in the cycle the increasing challenge for us all is how to generate alluring returns without significantly increasing the asset risk profile. With the global environment for investment shifting, strategies will need to adapt.

So, who will be investing and why? And will the Knight Frank Super Cities remain the hubs of global activity? We share the latest real estate intelligence from across our Global platform and assess its impact.

One thing is certain, despite a reduction from the huge deal volumes of the last few years, the capital chasing global real estate remains very active...

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Overview

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Investment environment

The current global real estate cycle has further to run; the global economy is yet to build up the excesses that typically lead to a downturn. However, we are moving towards a new phase where the strengthening global economy will mean interest rates start to rise and some currencies appreciate; albeit with some significant variations in timings.



Emerging market focus

As economic performance and currencies shift, we expect to see more focus on emerging markets from both global and local players. This should lead to a move towards more opportunistic capital chasing markets such as India, China and parts of Central and Eastern Europe. Nevertheless, the continued momentum of real estate capital globalisation means that the Super Cities and advanced economies will certainly not fall out of focus for core investors.



Increase in lending

We also anticipate that the lending market will open up further in advanced economies as the investors and institutions play the growing interest rate arbitrage between countries.



Chinese capital

China has quickly become one of the most important sources of global capital. While some Chinese investors may find it difficult to obtain foreign exchange clearance for now, those that can plus investors with Hong Kong or Singapore listings will maintain a steady flow.

USD185 bn

Sovereign investors

Sovereign investors will continue to grow assets under management and to build allocations to real estate. The quantum of capital involved will make them major landlords even in the largest markets; forecasts of total AUM increasing by 6% per annum suggest a possible additional allocation to real estate of USD185 billion by 2020.

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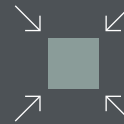
Japanese capital

Japanese investors are increasingly looking overseas as government policy encourages a move from deposits towards investment products and we expect more of this capital to be allocated to global real estate given the low growth rates domestically and relatively illiquid local markets.



Robust transaction volumes

Significant dry powder continues to target global real estate and this, combined with the increasing focus on previously unfavoured markets in emerging locations, will drive robust transaction volumes.



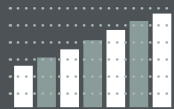
Innovative ownerships

We expect to see a rise in structured deals as both vendors and purchasers look for innovative ways to assemble ownerships.



Private investors

Private investors will play an increasingly important part in the market as wealth creation continues to grow at pace and real estate remains favoured as a store of wealth and source of income and, importantly, a tangible, controllable asset. We predict the global population of ultra-wealthy individuals will rise by 43% over the next ten years.



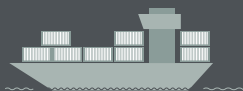
From trading to holding

In many advanced economies we expect a shift from 'trading' to 'holding' strategies as capital becomes harder to redeploy. This will support pricing and, in turn, will drive further sales from opportunistic owners tempted by the yield compression this lack of stock will drive.



M&A to drive sales

It is likely there will be more mergers and acquisition activity in the asset management sector as fee pressures drive consolidation. This will be a source of sales in core locations.



Structural shifts driving occupiers

While increasing development and slowing rental growth is signalling maturing cycles in some markets, momentum will be maintained by structural shifts in a number of sectors including co-working in the office sector, e-commerce in industrial and logistics and the continued growth of operating sectors such as student housing and multihousing.



Risk radar

There are always new risks on the horizon. Our watch list includes energy issues, geo-political risks, interest rate movements, the current dependency on tech occupiers and the ongoing issue of anti-globalisation.

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Many of the trends that shaped the investment landscape in recent years – low inflation, quantitative easing, and weak western economies – are set to go into reverse. Property investors need to separate the economic signals from the political noise and understand these changing dynamics.

The Global Environment for Investment

“ For many of the advanced economies, unemployment rates are low and consumer spending robust, just as we move into this period of rising growth and currency appreciation. ”



In its latest forecasts the International Monetary Fund (IMF) revised its predictions for global GDP to 3.5%; up from 3.1% in 2016. Advanced economies are expected to lead this growth, with a more subdued recovery seen in emerging markets. The G7 leading industrial nations are forecast by the IMF to see 1.8% growth in 2017, compared to 1.4% in 2016, with the US leading the pack. This is because the advanced economies have largely worked out their debt excesses from the 2005-2007 period; whereas emerging markets are still experiencing the consequences of over-investment in 2010-2011.

STRONGER GROWTH

This arguably puts the next cycle for the global economy on a firmer footing. The period 2010-2011, when emerging Asia was performing strongly while the advanced economies struggled, was a time of economic unreality. How could the exporters be booming when the importers they sold to were mired in a slowdown? Effectively, refugee capital from the west was fuelling a bubble that inevitably deflated, resulting in slowdown and currency volatility.

However, the consumer countries of the west are now delivering stronger growth, and the exporter nations will feel the benefits over the long-term. As the

THEMES FOR THE NEXT 12 MONTHS

01

Advanced economy investors use stronger currencies to buy into emerging markets

02

Economic recovery in emerging markets drives domestic focus

03

Lending market opens up further from both banks and alternative lenders

wealthy nations gain economic momentum, and consequently start to raise interest rates, exchange rate movements should boost the exporter nations. Indeed, in the case of the US and its trade relationship with emerging markets, this is already occurring. Over the next few years, other advanced economies will join the US in seeing their currencies strengthen as the interest rate environment begins to normalise.

For many of the advanced economies, particularly the larger and more dynamic ones such as the US, UK and Germany, unemployment rates are low and consumer spending robust, just as we move into this period of rising growth and currency appreciation. So for consumers in these stronger western nations, growing job security and imports becoming cheaper will more than off-set any rise in interest rates, and we can expect continued momentum in consumer spending; ultimately benefiting exporter nations in emerging markets.

Moreover, strong western currencies and weaker commodity prices will influence the cross-border investment

narrative. Between 2010 and 2016, we became very used to emerging market money flowing into the advanced economies, particularly in the real estate world. From 2010 to 2014 this was enhanced by strong emerging market currencies; from 2015 capital flight has been at least part of the motivation.

EVOLVING THEMES

The evolving narrative for 2017 and beyond will have three principal lines. Firstly, advanced economy investors will want to use their stronger currencies to buy into emerging markets.

Secondly, emerging-market capital will steadily find more reason to invest at home; through a combination of overseas markets appearing expensive for currency reasons, and domestic economies moving into recovery.

Thirdly, as economies such as the US raise interest rates, financial institutions in nations with much lower rates, like Japan, will move money to American banks. As the money piles up on the balance sheets of those banks, pressure will grow to lend, so we could see in countries like the US the paradoxical situation of rates rising, but appetite for real estate lending increasing.

BACK TOWARDS A 'NORMAL' CYCLE

As a result, we expect to see the global economy move into its long established cyclical pattern. Low growth, saver nations like Japan

will extend the credit for consumer lending in economies where higher levels of growth and easier attitudes towards spending provide a market for debt. A strong domestic currency makes foreign imports temptingly priced, thus further oiling the wheels of consumerism. Robust cash flow and full order books then encourage companies in both advanced and emerging economies to invest in new capacity.

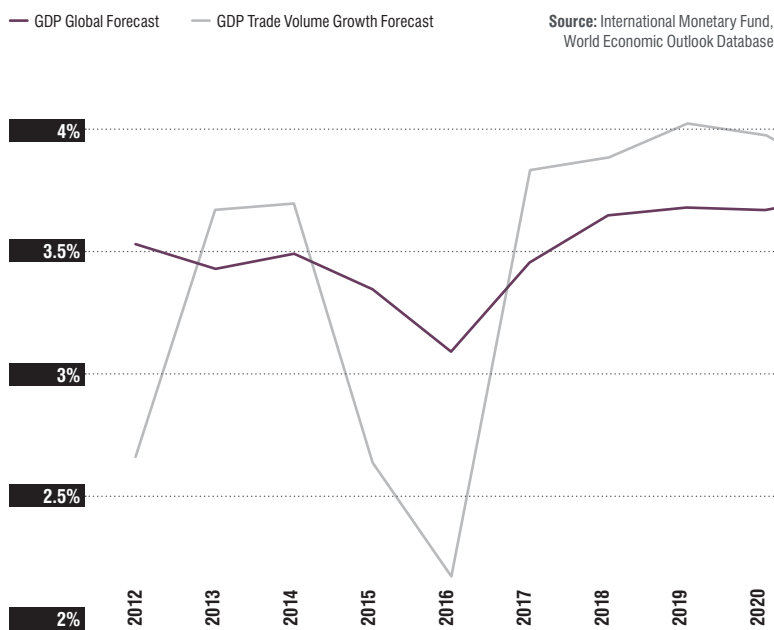
The process starts sensibly, underpinned by conservative regulation. However, as we move further away from the crisis years, and pressures to increase market share increases, less wise decisions are made. Attitudes towards regulation loosen – in fact, we are already seeing this now, with talk of rolling back the Dodd-Frank Act in the US. Five to seven years from now, the global economy will probably be ripe for another downturn.

REAL ESTATE HAS FURTHER TO RUN

However, the key point for property investors is that we see this next correction as being several years down the line. The global economy is moving out of a period of wound-licking, but has not yet built up the excesses that typically lead to a downturn. Given we are, in our view, not at the end of a cycle, in 2017 property investors need to be thinking of growth locations and value-add strategies. These will offer the best means of gaining exposure to this latest evolution of the market cycle.

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GLOBAL GDP AND TRADE GROWTH FORECAST



The world of property is becoming inexorably interconnected across continents as a result of increasing trade and ownership of overseas assets. What trends do we expect next?

Shifting Global Capital Flows

Investors are increasingly searching the globe for yield in this low return environment, but this is only part of the story; the requirements of security of income, liquidity and diversification are equally important, as are the ambitious corporate business plans of those looking to build global platforms. Underpinning this, and a key part of the recent wave of global capital activity, is an increasingly open outlook from a number of governments, such as China and Taiwan, who have loosened restrictions on overseas investment at the same time as many investors have increased target real estate allocations.

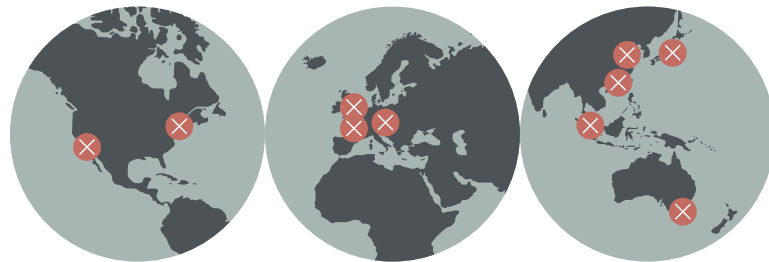
Even as the economic environment shifts, we believe the globalisation of real estate will continue to accelerate. As more deals are completed, transparency is further improved and advisors become more globally connected; driven by property owners and investors requiring guidance for navigating this increasingly complex and growing world of diverse capital requirements and geographies. Plus, the peers of the early-mover investors are enthused and emboldened to transact themselves.

“ The globalisation of real estate is self-perpetuating and is accelerating. ”

The impact of technology as an enabler in this process cannot be underestimated either. Facilitating accelerating transparency through

THE KNIGHT FRANK SUPER CITIES

Los Angeles New York London Paris Berlin Shanghai Hong Kong Tokyo Singapore Sydney



aspects such as the availability of data and deals information, improving global communications, making travel easier plus influencing aspects such as capital raising and fund administration.



of global transactions were cross-border in 2016

THE SUPER CITIES: TRULY GLOBAL ASSET MARKETS

For many gateway cities, and especially our global Super Cities, overseas investment is now a significant part of the transaction flow and ownership structure. For hubs such as London, New York and Paris this is by no means a new trend and cross-border buyers have been active in these markets over a number of cycles. However the sheer weight of global capital and the diversity of buyer types, from institutions to

sovereign wealth, private equity, developers and private individuals is deeper than ever before. Each of these groups have their own specific dynamics including cost of capital, hurdle return rates, hold periods and sector preferences. This can make for a very deep and competitive market and one in which the traditional domestic player increasingly has to adjust its investment mind-set to make the most of the entry and exit strategies of these new pools of capital.

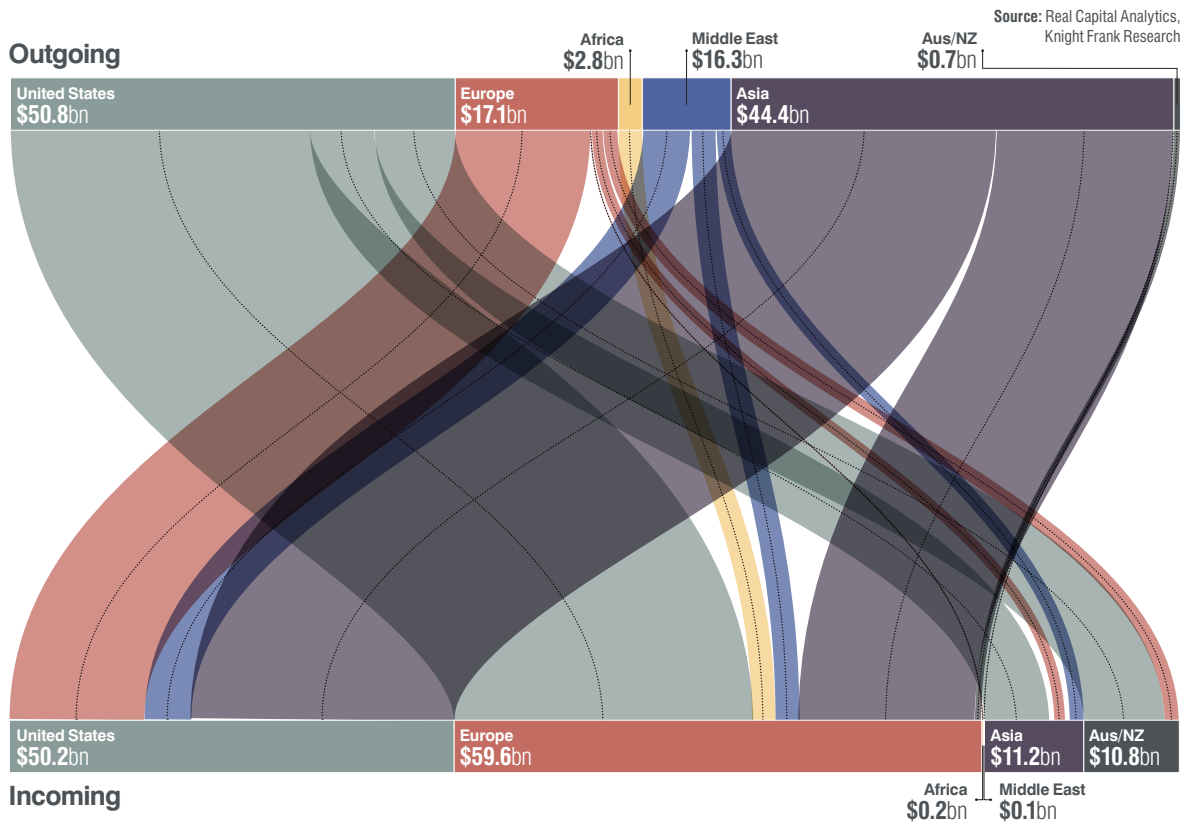
OPPORTUNITIES AND CHALLENGES

This evolution of the global real estate marketplace brings with it a multitude of opportunities both for the investors and the destinations of the capital. Increased funding, improved liquidity, greater transparency and innovations across both the capital stack and the assets themselves can all be driven by incoming investment.

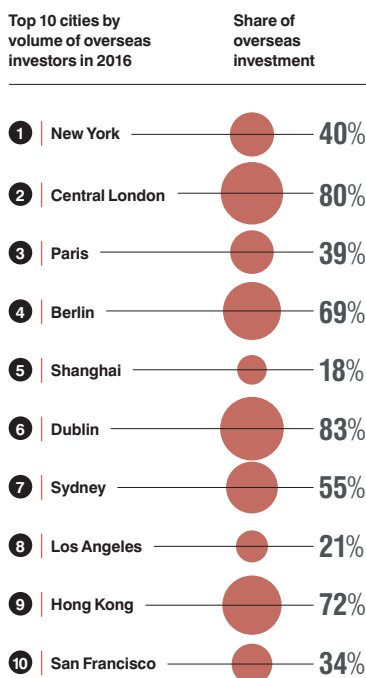
However, global investment and ownership of commercial assets are not without their challenges and opposition. While overseas

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GLOBAL CROSS BORDER CAPITAL FLOWS TO REAL ESTATE IN 2016



TOP GLOBAL CITIES BY VOLUME OF INBOUND CAPITAL



Source: Real Capital Analytics, Knight Frank Research

residential property ownership captures the public zeitgeist and therefore much political attention, increasing commercial ownership and capital flows (both inbound and outbound) are also in focus across some geographies. This opposition can manifest itself in many ways including taxes on transactions and ownership, structuring rules and, as we have seen in the case of Chinese outbound investors, capital controls. With these issues increasingly on many investors' radars we continue to monitor both the regulatory environment and the potential market implications including a slowing of trading volumes as complexity and friction costs of dealing increase.

DIRECTION OF TRAVEL

As we enter what we see as a new stage of the global economic cycle, active capital flows are likely to change direction and emphasis. We expect more interest in emerging market locations as mature locations see performance moderating and opportunities becoming harder to find with

owners moving from a 'trading' strategy to holding assets for longer.

At the same time, investors from emerging markets that have been attracted to developed economies by the positive currency arbitrage or due to weak performance in their own markets are more likely to be persuaded to stay nearer home as domestic conditions improve and foreign exchange movements shift out of their favour.

Overall, whilst we believe that the weight of capital from a particular geography will ebb and flow depending on domestic market and economic conditions, we remain confident that there will be additional educated and well-travelled investors from other locations that have the ability and appetite to take their place in the search for appropriate risk and return in the global real estate marketplace. The Super Cities and other gateway locations will continue to attract significant capital but domestic players may, for the first time in a while, get to play ball as some global investors shift their focus.

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Cross-border volumes recovered rapidly following the global financial crisis. However, the pattern has changed somewhat from the trends seen in the previous cycle and new entrants have emerged.

Capital Exporters: Breadth and Depth

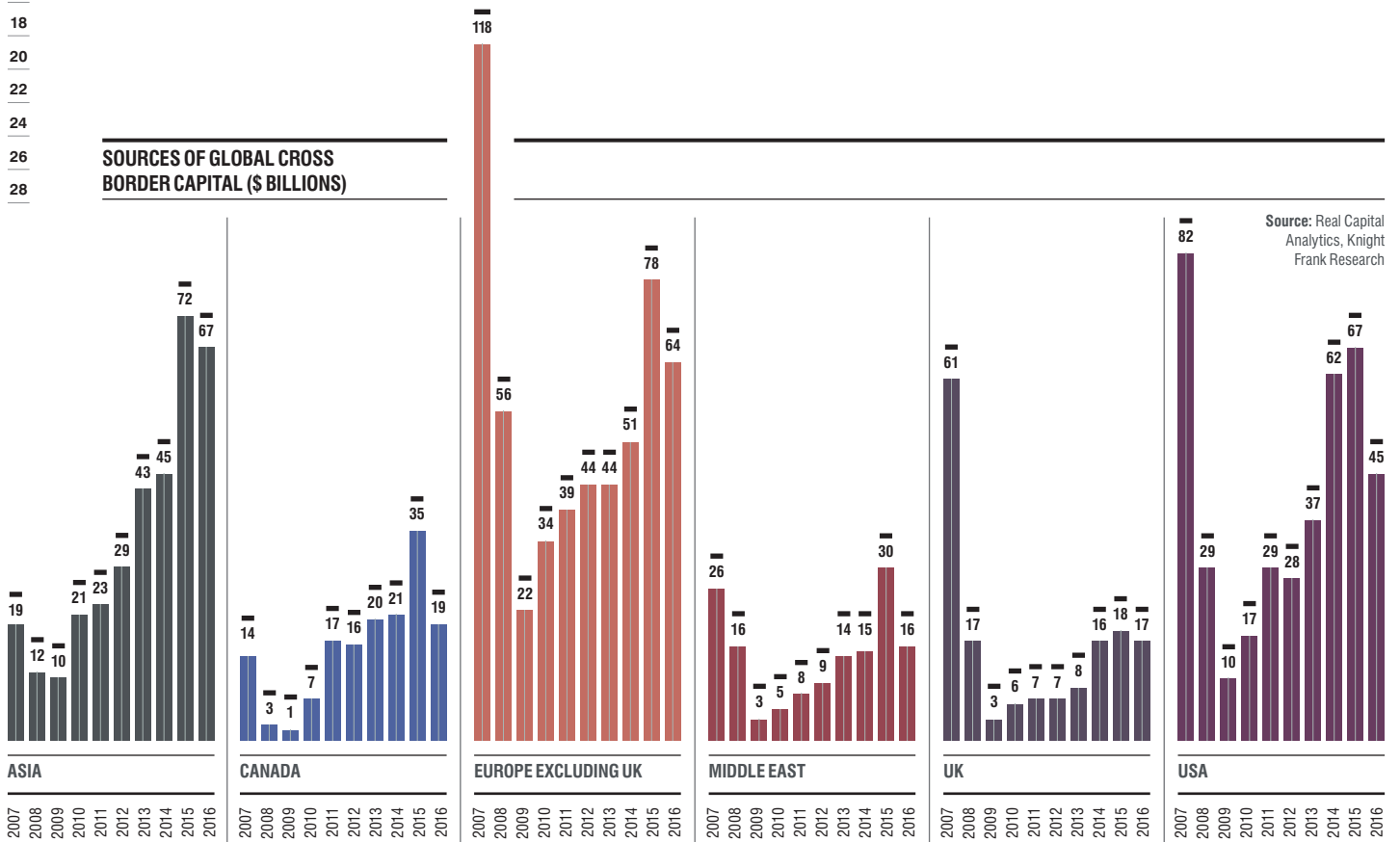
While some sources, such as the UK, have remained largely domestically focused so far this cycle, preferring to concentrate on the improving occupier and capital markets locally, others have looked further afield. The clear stand-out are investors from Asia who have launched themselves onto the global stage over the last few years to become one of the most important global capital exporters and, increasingly, owners of real estate in gateway cities.

CHINESE CAPITAL

Chinese capital has been a key driving force behind global real estate transaction volumes over the past few years, especially across our Super City markets. Despite recent geo-economic uncertainties around the world, Chinese appetite for mega-assets seems insatiable. However, some target locations are beginning to feel uneasy around the sustainability of Chinese investment as questions are being raised on the government's latest capital outflow controls and the health of the domestic economy.

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SOURCES OF GLOBAL CROSS BORDER CAPITAL (\$ BILLIONS)



Source: Real Capital Analytics, Knight Frank Research

**OBSERVATIONS FROM DAVID JI,
HEAD OF RESEARCH,
GREATER CHINA**

01

The latest Chinese GDP growth figure, 6.9% YoY growth in the first quarter this year, seems to have dispelled doubts on the country's overall economic health. Some of the previous concerns, such as the domestic home inventory glut, paled in comparison with impacts of external surprises like Brexit and the US election result. Even those shocks have now been gradually digested as investors have taken advantage of factors such as exchange rate dips.

“ We expect to begin to see less of a rush for trophy assets and more methodical behaviours that are commonly observed from mature players. ”

02

Only a couple of years ago the global marketplace was crowded with big name Chinese insurance firms, large developers and State Owned Enterprises (SOEs). However, since 2015 we have seen more determined advances, even dominance in some markets, by private conglomerates or developers including HNA, Fosun, R&F etc. Compared to their SOE counterparts, this group of investors and developers are far more nimble and are able to make decisions more quickly. Instead of heeding a coordinated national drive as with the SOEs, they have grown more sophisticated in their own strategies and calculations for projects. We expect to begin to see less of a rush for trophy assets and more methodical behaviours that are commonly observed from mature players.



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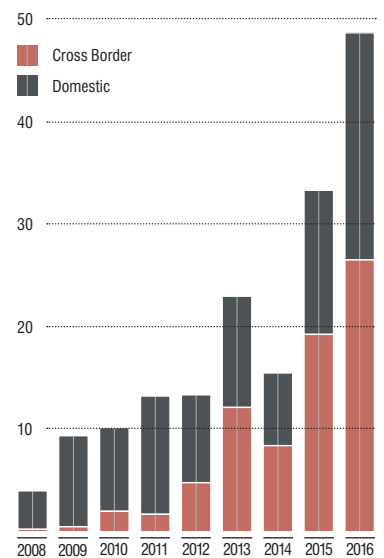
Currency fluctuations including the appreciation of the dollar, yield shift, as well as recent significant asset price inflation will be amongst the risks they consider. And as the Chinese capital outflow controls persist, companies that lack previous overseas exposure and those with core business not in property will find it difficult to obtain foreign exchange clearance from the authorities. However, firms with Hong Kong or Singapore listings or subsidiaries have been able to raise funds as well as launch their bids from these financial hubs. Despite this, we may see transaction volumes from China reducing in some markets in the short term.

This reduction may well prove to be temporary as we expect that the capital controls will be loosened as the Yuan exchange rate improves and GDP growth continues on a steadier path. The government policy conference later in the year will also reaffirm the country's expansion strategies. Indeed, there are signs of this happening already. It was reported in April that the required balancing of inflows and outflow of cross-border Renminbi payments by financial institutions has been verbally lifted.

As for key markets to look out for, Chinese investors still focus on gateway cities such as London, New York and the other Super Cities given their stability and depth. Other key locations including cities on the “Belt and Road” route, e.g. Singapore and key Southeast Asian hubs, will also attract significant investor interest.

CHINESE INVESTOR TRANSACTION VOLUMES (\$ BILLIONS)

Source: Real Capital Analytics, Knight Frank Research



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“ We are following increasing activity from locations such as Japan, Taiwan, Korea, Singapore, France, Africa, Latin America and from investor groups such as Sovereign Funds and Private Wealth. ”

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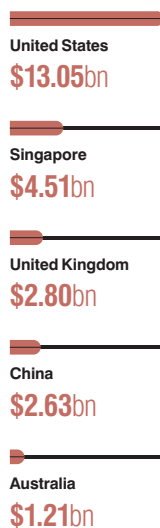
While North America, parts of Europe, the Middle East and more recently China are dominating global outbound flows, we are following increasing activity from locations such as Japan, Taiwan, Korea, Singapore, France, Africa, Latin America and from investor groups such as Sovereign Funds and Private Wealth.

JAPANESE CAPITAL

We expect that Japanese investors will be an important part of the market over the next two years. Outbound M&A investment from Japan has seen a significant increase recently as Japanese companies look to diversify away from a mature domestic market. High profile deals such as SoftBank Group's



JAPANESE CROSS BORDER REAL ESTATE INVESTMENT (10 YEARS)



Source: Real Capital Analytics, Knight Frank Research

acquisition of ARM Holdings, the UK-based chip design firm, capture the headlines but there is a deep pool of capital and deals, both corporate and real estate, underway. We are seeing increasing activity from groups such as Mori Trust, Japan Post Bank, Takenaka and GPIF, the world's largest pension fund, who have recently set out a global real estate investment strategy following a major shift in policy in late 2014 that allows the fund to include alternative assets as part of its portfolio.

Drivers of this recent push into global real estate include low economic growth rates and a falling and aging population at home as well as negative interest rates and significant cash reserves. Japanese investors, both retail and institutional, are broadly seen as conservative and currently have more than 50% of financial assets in deposits and just 5% in investment trusts but government policies are encouraging investors to shift to investment products. Recent



data from AMP Capital estimates that Japanese institutions have approximately USD4.4 trillion under management; a 5% allocation would see USD230 billion of capital directed towards global real estate. In addition, the vast majority of corporate pensions, public pensions and financial institutions are arranged as defined benefit schemes which favour higher yielding real assets such as real estate.

Given all of these factors plus a relatively illiquid domestic market, especially in core locations such as Tokyo, we see compelling reasons to expect cross-border flows to pick up further.

SOVEREIGN INVESTORS

Sovereign funds continue to build allocations in global real estate. Data from Prequin shows how Sovereign Wealth Funds' total assets under management now exceed USD6.5 trillion having risen from USD3.1 trillion as recently as 2008 as governments continue to drive funding as well as from returns generated from the rising AUM. This rises to over USD11 trillion if you include assets managed by Public Pension Funds.

At an individual level, many of these investors have huge volumes

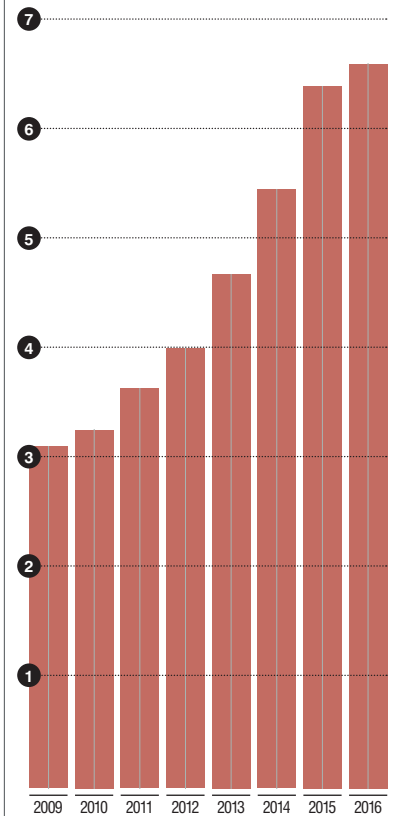
of assets under management, either from raw material reserves or pension funds, but historically have had very limited exposure to real estate. With such large funds, just a small change in allocation can create requirements of significant scale. In many cases the volume of transactions and subsequent asset management can quickly necessitate building local market expertise and management functions.

Despite uncertainty over oil prices, many of these funds are expected to continue to grow. PwC are forecasting sovereign investors' assets to reach over USD15 trillion by 2020 reflecting a CAGR of 6.2% and also believe a number of new funds will be set up. Calculating a 5% allocation suggests a possible additional allocation to real estate of USD185 billion by 2020 without factoring in the current underweight position.

This combination of increasing capital under management plus bigger target weightings towards real estate translates into very significant dry powder searching for suitable global prime real estate opportunities and will make them increasingly important landlords in even the largest markets.

SOVEREIGN WEALTH FUNDS AUM (\$ TRILLIONS)

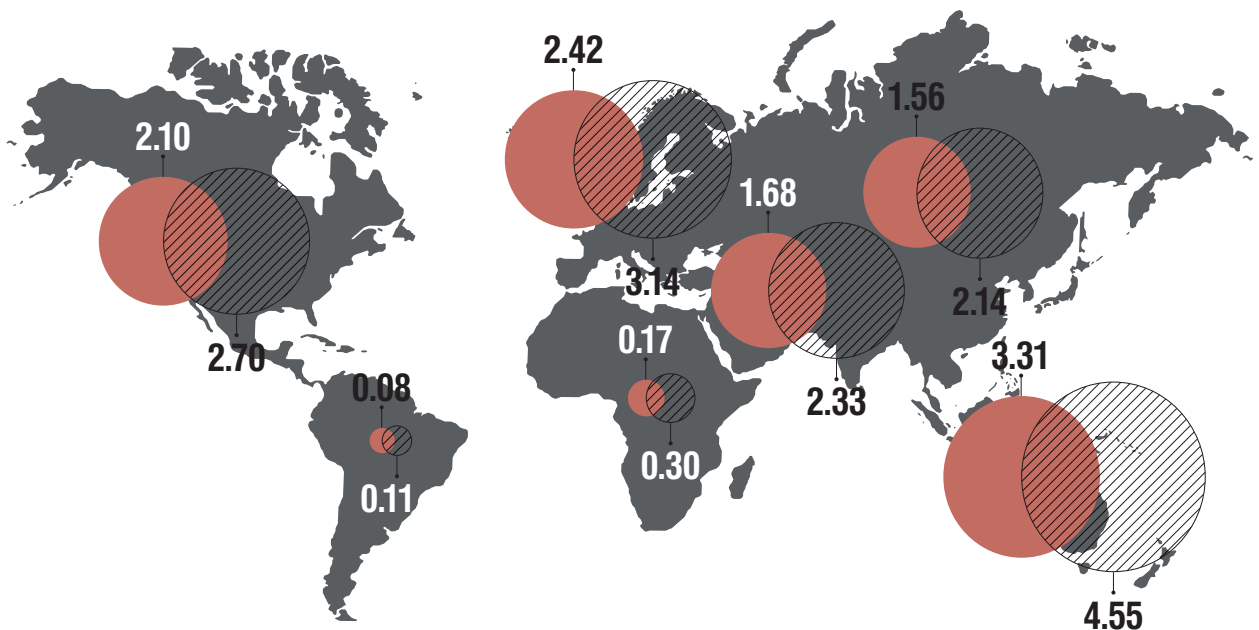
Source: Prequin



SOVEREIGN INVESTORS (SWF AND PUBLIC PENSION FUNDS) CONTINUED GROWTH IN AUM

■ 2015 Asset Size in USD tn
 ▨ 2020 Asset Size in USD tn

Source: PwC



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Real estate continues to attract private investors and so understanding their drivers and requirements is increasingly important for all investor types.

The Rise and Rise of Private Investors

PORTFOLIO MANAGEMENT UHNWI PORTFOLIO ASSET ALLOCATIONS

Source: The Wealth Report Attitudes Survey

A. Investments 28%	D. Personal Business 16%
B. Real Estate 24%	E. Collectables 6%
C. Primary Residences and Second Homes 23%	F. Other 6%



Private investors are an increasingly important cog in the global real estate marketplace. As our latest Wealth Report notes, 27% of all global commercial property transactions in 2016 involved a private buyer. And a quarter of private wealth is held in real estate investments of some kind (excluding primary residences and second homes).

As private investors grow in importance, institutional investors are realising that they are a key buyer type whose drivers are often very different to their own and need to be understood; as they are likely to either be competing against them in a purchase negotiation or trying to sell to them as part of an exit.

43%

Amount the world's population of ultra-wealthy individuals is set to rise to by 2026

AROUND THE WORLD

Countries private property investors are most likely to invest in

1. UK
2. USA
3. GERMANY
4. FRANCE
5. SINGAPORE
6. SPAIN
7. SWITZERLAND
8. AUSTRALIA
9. CHINA
10. HONG KONG

Source: The Wealth Report Attitudes Survey

GROWTH IN PRIVATE WEALTH

Our prediction is that private investors will continue to take global market share as both the number of wealthy individuals and their assets grow.

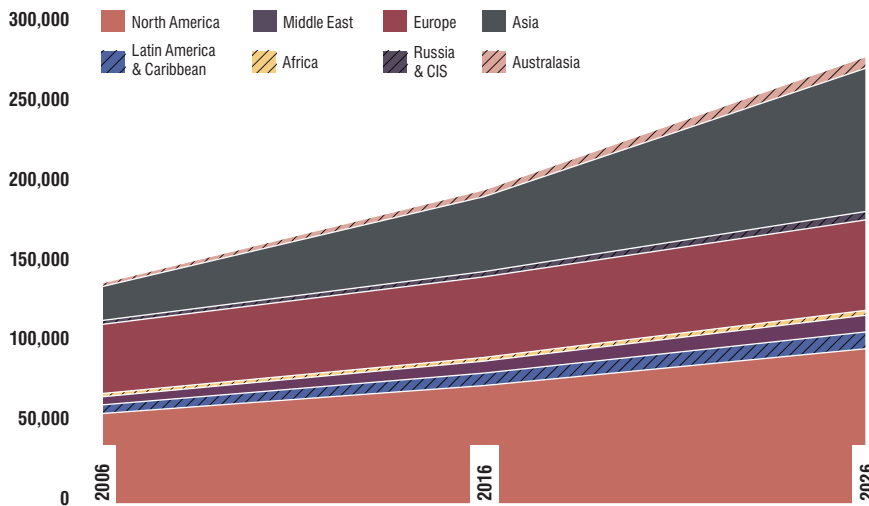
- The number of Ultra-High-Net-Worth Individuals (UHNWIs) – those with \$30 million or more in net assets – rose by 6,340 in 2016 alone, taking the total to 193,490.
- Looking forward, the world's population of UHNWIs is set to rise by 43% by 2026 to over 275,000 people.
- As you would expect, within this number there are considerable variations in the growth rates in different regions and countries with local factors driving wealth creation and the mobility of UHNWIs.
- Asia is starting to challenge the US in terms of the largest regional population of UHNWIs. At present, Asia is

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GLOBAL WEALTH

Historical and predicted UHNWI population growth trends

Source: Knight Frank Wealth Report



home to 27,020 fewer ultra-wealthy people than the US, but by 2026 this difference will have shrunk to just 7,068.

- However, while North America may not top the growth rate charts it will stay the largest hub of UHNWIs in 2026 and growth will continue to outstrip many other developed economies.
- While China will continue to lead the way in Asia, places like Vietnam, Sri Lanka and India will also see substantial expansion.

“ The number of global billionaires now totals 2,024 – an increase of 45% in the past decade. ”

ALLOCATIONS TO REAL ESTATE
We fully expect that the appetite from private investors for commercial property will continue to increase. Indeed, our Wealth Report research shows that 32% of UHNWIs will invest in cross-border real estate deals in the next two years. While the drivers behind these purchases will vary greatly depending on the motivations of the individual, there are a number of investment themes we are seeing in the market:

Risk mitigation: Risk, especially political and economic, will continue to be high on investors’ agendas in 2017. Individuals are looking to diversify at both a portfolio and geographical level. Real estate provides the ability to achieve targeted investment decisions in terms of location, sector and tenant components as well as provide regular income and an underlying asset with residual value.

Control: One of the consequences of the global financial crisis was that many investors looked for more control over their assets. Real estate, with its direct ownership structure, diversity of lot sizes and choice of asset management approaches is attractive to those not

wanting to pass decision making to third-parties or to be constrained by the closed-end fund model of transacting at specific times plus the need to reach an alignment of views between the investors.

Currency diversification: While foreign exchange returns are not generally a driver for property investment, currency movements and capital controls have, in some instances, been a trigger for investors looking to externalise capital from locations implicated.

Portfolio globalisation: Many UHNWIs have, either directly or indirectly allocated part of their asset portfolio to real estate and, as they accrue more wealth, they increasingly become fully exposed to their domestic market and look to new markets to diversify their portfolios.

STRONG DEMAND

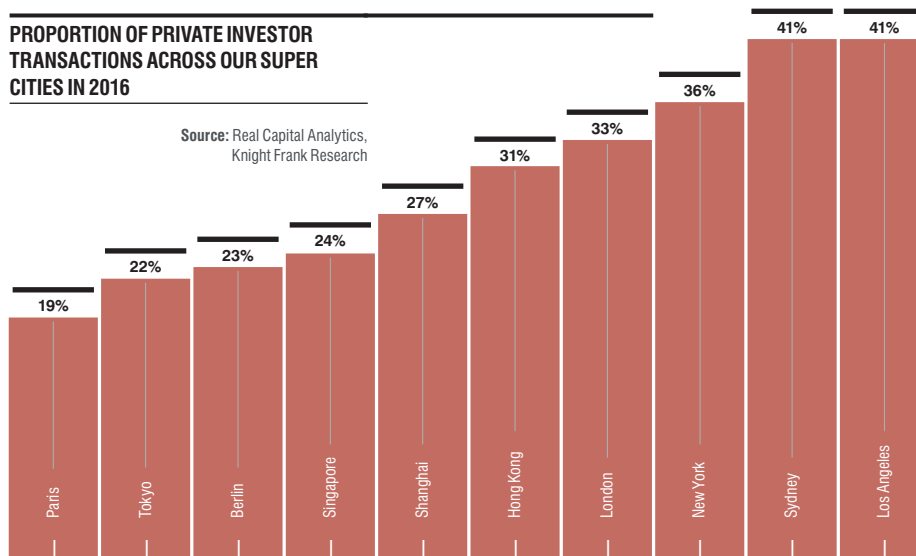
These themes, plus individual investor specific drivers, will continue to attract private investors towards global real estate. The top markets targeted will primarily be those exhibiting solid fundamentals including tenant demand, liquidity and transparency; with the Super Cities top of the list. However, increasingly we are advising clients not only on prime office, retail and hotel assets in these cities but also strategic investments in growth sectors such as urban logistics, leisure and specialist operating assets including student housing and multihousing.

Overall, property as an asset class will remain high on the agenda of private investors in 2017.

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PROPORTION OF PRIVATE INVESTOR TRANSACTIONS ACROSS OUR SUPER CITIES IN 2016

Source: Real Capital Analytics, Knight Frank Research



While markets such as the US and Germany have had deep and liquid multihousing markets for some time, other countries are beginning to catch up as global investor appetite increases.

A Coming of Age for Global Multihousing

The institutional multihousing sector varies across the world from the mature North American and German markets to the emerging locations, such as the UK and Australia, which are currently dominated by small individual landlords.

In the US, capital is spread across the leading cities with the South Eastern states accounting for the largest share. Yields remain robust at 5.4% as pricing remains stable and the availability of good sales stock limited. Foreign capital continues to target the sector, and in particular the secondary markets of Atlanta, Charlotte and Phoenix. Indeed, in the past 12 months, more than three-quarters of international investment has been into the US secondary and tertiary market.

Across the US, over 370,000 multihousing units are expected to be delivered into the market in 2017. The majority of the new supply is in the top 15 markets where 56% of multihousing was delivered in 2016. Employment growth nationally has accelerated, highlighting positivity in the economy and a solid demand backdrop.

The German residential market is stable and is supported by structural trends such as the low cost of renting in cities such as Berlin compared to other European cities. Markets to watch include Munich which has very low vacancy rates, averaging 0.4%, which is expected to remain static as a result of significantly low supply in relation to the predicted growth

in the number of households. We continue to monitor solid demand from institutional investors across the world.

In the emerging markets, such as Australia and the UK, interest and activity in the multihousing sector is growing rapidly. Following the expansion of purpose-built student accommodation as an established investment asset class, institutional investors are now actively looking at the multihousing sector.

In Australia, the current economic climate and housing market environment suggests that the proportion of privately rented households will only increase. Knight Frank Research projections indicate that NSW, Victoria and Queensland will have approximately 31%, 30% and 33% of households in the private rented sector by 2019/20. Key Australian cities for investors are those with employment growth and low vacancy rates such as Perth, Brisbane and Melbourne.

In the UK, the multihousing sector has grown significantly in recent years and is currently estimated to be worth around £25 billion. This is projected to reach £70 billion by 2022. This level of growth is sustained by the proportion of households estimated to be living in private rental accommodation which is expected to reach 24% over the same time period.

Purpose built PRS accommodation is spread across the UK: focused on city centre locations in the regions





and well-connected transport hubs in London. The sector has mainly been driven by young professionals looking for high quality, well connected, flexible accommodation. The most active investors seeking residential income in the UK are diverse geographically and in terms of the source of capital. We are monitoring strong demand from UK, North American and Asian markets, with interest also being shown by Australian Superannuation funds and by sovereign funds from the Middle East.

Importantly, the UK Government has shown support for multihousing to help solve the national issue of housing supply; especially in London. Recent policy changes such as additional stamp duty on buy-to-let investments and the curbing of mortgage interest reliefs have opened the opportunity for large scale investors and operators.

Interestingly, across the globe the highest growth in demand for rental accommodation was observed in Middle Eastern countries, namely Qatar, where over the last five years the number of households in the rental sector has increased by 35%. Alternatively the most significant reduction in rental households was observed in Eastern European countries, for example Hungary, where the number of households has shrunk by 28% over the last five years.

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“ In the emerging markets, such as Australia and the UK, interest and activity in the multihousing sector is growing rapidly. Institutional investors are now actively looking at the sector. ”



As the economic and investment environment shifts, new opportunities and challenges will be created. How should investors navigate through this period?

Strategic Direction



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TRANSACTION VOLUMES TO REMAIN ROBUST

It appears likely that global transaction volumes have peaked, at least for the next couple of years. However, while we might not reach the levels seen in 2015, we expect activity to remain at or above the long term average; driven by investor dry powder at record highs and undiminished appetite for real estate across a deep pool of buyer types.

Given this picture of strong demand, the key determinant of transaction volumes will be the availability of suitable assets on the

market. As returns have moderated across many markets following the strong appreciation in values over the last few years, many owners of real estate have moved away from a trading mind-set and towards a long-term hold strategy. Increasing frictional costs of completing a transaction, such as rising taxes and tighter ownership restrictions across a number of markets, has exacerbated this trend. This movement in strategy can quickly slow a market as investors are further persuaded against selling by the increasing difficulty in redeploying the capital.

“ We expect activity to remain at or above the long term average; driven by investor dry powder at record highs and undiminished appetite for real estate across a deep pool of buyer types. ”

OPTIMISTIC ON PRICING

However, further compression of yields, particularly for prime assets with reversionary potential, will shake out more stock over the next 18 months. In particular, opportunistic funds and developers will be tempted to exit as the price inflation caused by this shortage of opportunities means that many will realise their business plans ahead of time.

The varying pace of economic growth since the global financial crisis has led to a multi-stage tenant market and improving fundamentals in those markets that have been slower to recover are now recording stronger occupier dynamics that will drive positive rental value growth and capital value outperformance.

Other markets are later in the cycle but will continue to be supported by strategic global trends that will drive occupier requirements and, therefore, support rental growth and values. Office market demand will

continue to be buoyed by the rise of co-working operators, industrial has much further to run as the e-commerce revolution evolves and various specialist sectors such as student housing and multihousing are at still at an early stage of maturity in many geographies.

CAUTIOUS ON LONG-TERM INCOME

While we remain positive on pricing for many asset types and geographies, we are also hitting a point in the global cycle where fewer key locations look attractively priced for long-term income. With the increasing globalisation of investor requirements comes a wide pool of buyers with similar requirements for bond-type income and these narrow-focused mandates have squeezed pricing hard. However, any unsated demand will be funnelled towards markets outside of core locations that will now appear to be offering the most value; here pricing should move rapidly.

\$4,900

\$3,700

\$2,500

\$2,450

\$2,000

\$1,900

\$1,700

\$1,600

\$1,400

\$1,250

\$1,200

\$1,100

\$1,050

\$1,050

\$950

\$900

\$900

\$700

\$650

\$600

Hong Kong

Tokyo

New York (Manhattan)

San Francisco

London (City)

Sydney

Singapore

Boston

Taipei

Frankfurt

Shanghai

Paris (La Défense)

Melbourne

Chicago

Toronto

Beijing

Los Angeles

Madrid

Seoul

Dubai

Mumbai

SKYSCRAPER INDEX CAPITAL VALUES Q4 2016

Indicative values calculated using our latest SkyScrapper index rents and the prime yield for each location. Used to show relative positions only.

LOCATIONS TO WATCH

As the economic environment for real estate investment starts to shift, emerging market locations will start to attract the attention of global investors. However, this will not be at the expense of our Super Cities and other gateway locations. New global or regional entrants, investors still looking to achieve target allocations and those looking for a secure home for their money will continue to focus on core locations and the depth of capital chasing these markets will support pricing.

A DEEP POOL OF BUYERS FOR US REAL ESTATE

Investors will continue to target the US but we note an increasingly cautious attitude as issues such as policy uncertainty, rising borrowing costs and increasing construction activity in both the mainstream commercial and multihousing markets rise up the watchlist. We expect that transaction volumes will be lower than the last few years but should remain steady with a deep pool of buyers from across the world including, but not limited to, China, Korea, Japan, Canada, Qatar, Saudi Arabia, UAE and Norway. The 'Core Coastal Cities' will continue to be driven by this demand.

In addition, we expect a strong performance from the 'Momentum' cities that have an attractive mix of attributes for creative and tech industries and the associated real estate asset classes, including Austin, Miami and Denver.

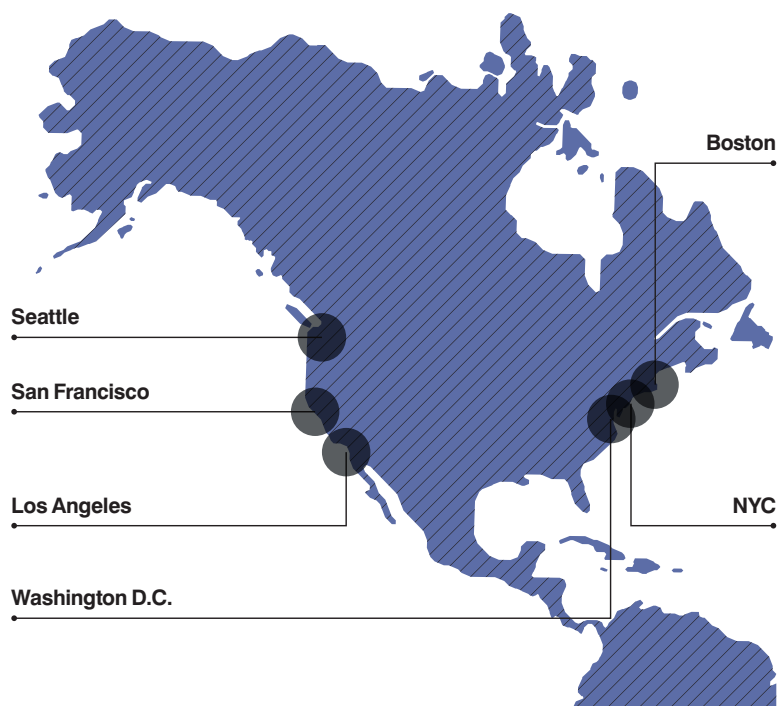
INCREASING INTEREST IN WIDER EUROPE

In Europe, the European Union revolution is over and the threats of collapse are now fading into the distance. The region is beginning to show wider and more stable economic growth and along with modest inflation expectations and a low interest rate environment, investors are increasingly looking wider than the core locations of London,

Paris and the main German and Nordic cities. Gradually more global investors will be looking to Central & Eastern Europe as these markets look more attractive not only on a relative pricing basis but also due to improving fundamentals. We continue to like the Super Cities and in particular look to the new neighbourhoods being created by limited core stock and tenants looking for value and 'interesting' locations. However, given the maturity of the cycle, we are watching closely for signs of overdevelopment. Looking to the UK, it appears that many investors have, for now, shrugged off the results of the European referendum. In reality, Brexit means different things to different groups and some investors are looking to Europe but are actively excluding the UK while others such as many Chinese and Hong Kong investors appear laser-focused on UK real estate.



KNIGHT FRANK US CORE COASTAL CITIES



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“ The combination of strong demand, lower levels of supply and higher frictional costs of trading and/or holding real estate will lead to growing instances of structured sales. ”

MOMENTUM IN ASIA

In Asia, economic conditions are stabilising with commentators expecting China to show moderating rather than collapsing growth and Australia recording continued progress in transitioning away from a mining led economy. Indeed, the Australian market remains a favourite with investors looking for exposure to the region with low vacancy rates in Sydney offices driving rents forward and spurring increasing interest in value-add opportunities and Melbourne maintaining significant momentum. The main Indian cities are also seeing increasing interest from global investors and commercial developers driven by improving occupier markets. The recent liberalisation of several provisions of Indian REIT regulations means that we could see the first listings soon; a development that would greatly augment transparency and governance in the country. We also see possible early signs of some market turning points such as in Singapore where the residential market and in particular the outlook for collective sales appears to be improving.

In China, we expect robust domestic investor demand as capital controls keep some of the cash at home. In addition, we continue to see increasing interest in China from larger global investors attracted by the increasing liquidity and transparency of the real estate sector and economy with the core cities and sectors the primary beneficiary; although it remains too early for many.

EVOLVING APPROACHES TO INVESTMENT

STRUCTURED DEALS

A theme we expect to see evolve in the new investment environment are increasing instances of structured sales as both vendors and purchasers look for innovative ways to assemble ownerships. While this is fairly commonplace in some markets due to dynamics

such as lot size, development expertise or taxation rules (such as FIRPTA), we expect it to become more widespread across investors, locations and lot sizes. The combination of strong demand, lower levels of supply and higher costs of trading and/or holding real estate will lead to growing instances of these structured sales i.e. institutions and other investors selling parts or shares of assets in order to release capital while retaining exposure to the asset and at the same time protecting their asset management fee. This process also allows a buyer to gain exposure to assets and sectors that may ordinarily be outside of their fund size or sector skill set.

CONSOLIDATION OF MANAGERS

While the pool of investors in real estate continues to grow as new market entrants appear, we also see further consolidation of existing investor types. In particular, the fund management community is seeing continuous margin pressure due to issues such as the increasing popularity of cheaper passive vehicles and this is likely to lead to further M&A activity in the sector. In addition, those that have merged over the last few years will continue to restructure their portfolios and this ‘housekeeping’ is likely to be a source of some asset sales.

LOCAL/GLOBAL APPROACH

We also expect to see more local developers and asset managers leverage their expertise to support global investors that do not have the required local-market skills. This will both be the new market entrants who are looking to this expertise to guide them through a purchase and/or development process or, increasingly, investors who have bought secure-income properties over the last 10 years who are now facing shorter leases and an aging asset.

There are always new risks on the horizon for the global property investor to monitor, or on-going issues that could boil over. Here are our top five:

Risk Radar

01

GLOBAL ENERGY SOURCES

News that the US discovered its largest ever oil field in 2016 was largely overshadowed by the election of Donald Trump. However, it highlights the growing energy self-sufficiency of the US, which, via shale gas and renewables, will spread to other nations in the coming decades. This will have a huge impact on global investment and trade flows, and we see more energy economies looking to diversify their future revenue streams; with implications for global real estate. Some property markets should gain from the changes, while others will have to re-invent themselves to face new economic realities.

LIKELIHOOD – 4.5/5. ●●●●○



02

GEO-POLITICAL RISKS

Recent tensions over North Korea have reminded us that some of the world's centres of prosperity are located near diplomatic flash points. Conflict on the Korean peninsula would have huge implications for China, Japan, and South Korea. Moreover, the lesson of history is that when a radical threat is suppressed in one part of the Middle East, it tends to re-emerge elsewhere. Increasingly, that threat is as likely to reappear in Africa, or even Europe, as any other Middle Eastern nation.

LIKELIHOOD – 4/5. ●●●●○

03

RISING INTEREST RATES

The US Federal Reserve is already raising interest rates, and were it not for Brexit, the Bank of England would probably be increasing rates as well. While other central banks in advanced nations are still pursuing loose policy, government bonds are generally drifting higher. Property investors need to review the type of asset targeted, with more of a focus on asset management opportunities, where the yield can rise in a positive way.

LIKELIHOOD – 3.5/5. ●●●●○

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TECH DEPENDENCY

In many of the more vibrant property markets, whether it be New York City offices or distribution warehouses in the UK's West Midlands, big name technology firms are driving occupier demand. Property markets are gaining increased exposure to the digital juggernaut, and would be hit if there were a sharp slowdown in activity by tech firms. At the time of writing, there is little sign of any deceleration from the technology sector, but such rapid expansion cannot be sustained indefinitely.

LIKELIHOOD – 3/5.



05

ANTI-GLOBALISATION

This threat has partially receded in 2017, following election setbacks for the Party for Freedom in The Netherlands, and France's National Front. In contrast to the tough talk in the 2016 election campaign, President Trump appears to have built a dialogue with China. Time will tell whether the anti-globalisation threat is now in retreat, or if 2017 marks a temporary setback for populist politics. Nevertheless, immigration is a 'hot potato' in many nations now, and if people cannot move to where the jobs are, in the future more jobs may need to go to where people are.

LIKELIHOOD – 2.5/5.



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About The Knight Frank Global Capital Markets Business

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GLOBAL CAPITAL MARKETS.

Knight Frank is an independently owned real estate consultancy, operating globally, advising on both residential and commercial real estate. Our Global Capital Markets Group has a reputation for acting on the most high profile property transactions around the world.

The group acts for institutional, private equity, family offices, sovereign wealth and real estate companies in the cross-border acquisition and disposal of international property. Our services cover the office, residential, retail,

industrial, leisure and hotel sectors, as well as the specialist areas of student property and healthcare.

Excellent information sharing and market intelligence ensure clients receive the optimum advice. Establishing good relationships is absolutely essential. Rapport and trust are crucial.

We believe the principal drivers of our success are our access to stock, the right client base and a highly collaborative network of global teams.

We look forward to working with you.

HOW WE CAN HELP YOU.

The Global Capital Markets Group operates strategically from four global hubs: London, New York, Singapore and Dubai.

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Joint ventures

Land sales

Debt advisory

Evaluation of assets within Non-Performing Loans

Post purchase asset and property management



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Winner
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Of The Year
Estates Gazette 2016

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“ The pillars of people and partnership made Knight Frank an outstanding winner in this category. Strategic appointments in key roles have helped this agent to complete market-leading deals across the globe. ”

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office is 55 Baker Street, London, W1U 8AN, where you may look at a list of members' names. This report was researched and written during the period April to June 2017, based on evidence and data available to Knight Frank LLP and Newmark Knight Frank at the time. Rents quoted in the reports are in US dollars, but growth rates are in local currencies to remove exchange rate effects. Americas rents quoted in this report are prime average asking rents, whereas rents in other geographies are quoted normal prime achieved. Forecasting is an inherently uncertain activity and subject to unforeseeable changes in the external environment, and we note the particularly high level of geopolitical, financial market, and economic risks facing the global economy at the time of publication. These present downside risks to the forecasts in this report.

The Americas

15 Countries

Argentina / Brazil
Canada / Chile / Colombia
Costa Rica / Dominican Republic
Mexico / Peru
Puerto Rico / The Caribbean (4)
USA



United Kingdom



Africa

10 Countries

Botswana / Kenya / Malawi
Nigeria / Rwanda / South Africa
Tanzania / Uganda / Zambia
Zimbabwe

413 OFFICES

60 COUNTRIES

Continental Europe

16 Countries

Austria / Belgium / Cyprus
Czech Republic / France
Germany / Ireland / Italy / Monaco
The Netherlands / Poland / Portugal
Romania / Russia / Spain
Switzerland



The Middle East

2 Countries

The Kingdom of Saudi Arabia
The United Arab Emirates

Asia Pacific

14 Countries

Australia / Cambodia
China / Hong Kong
India / Indonesia
Japan / Malaysia
New Zealand / Philippines
Singapore / South Korea
Taiwan / Thailand

