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Global | Q1 2014

25 Predictions for 2014

International capital will seek property returns around the globe

Global

1. Much of the World Will See Slow Growth

Our global economic expectations for the coming year are muted. For much of the world, even in many emerging economies, GDP growth below 5% in 2014 will be the norm. Global central banks will wait and see what moves the U.S. Federal Reserve makes. As the Federal Reserve reins in quantitative easing, the higher cost of capital would only slow growth in many emerging markets. Property investors would see more risk in those places and instead more would turn their funds in chase of yields in secondary markets in primary countries.

2. Global Investors Will Push into New Property Markets

Around the world, investors will move into second-tier cities in pursuit of yield. European investors will also expand into new areas such as the German 'Alternative Twenty,' the Polish 'Big Six,' Spain and Ireland. Chinese investors, who have the potential to invest billions in Europe and the Americas, will diversify further into global markets. Global gateway cities will see 100% growth or more in real estate transactions from Chinese buyers in 2014. In the USA, investors will move out on the risk curve to secondary and

tertiary markets and riskier assets amid a broadening economic recovery and search for higher yields. In Australia, where offshore property investors have been capturing a growing share of total sales volume for the past five years, a domestic investment resurgence has come onto the scene, driven by private companies and investment groups.

Europe, Middle East & Africa

3. Second Tier Cities Will Be Back on the Radar

Cross border capital flows from Asian and MENA countries will continue to find their way into core European markets, pressuring yields and putting upward pressure on capital values. Lack of institutional grade stock and keen competition in core markets will drive renewed investment and development activity in peripheral markets and second tier European cities EMEA-wide, but especially in the German 'Alternative Twenty', the Polish 'Big Six', Spain and Ireland. Pension funds and insurers are set to take on a much greater volume of real estate loans and debt placements as bank balance sheets continue to shrink.

London, England

4. European Economy to Emerge from Recession

The European economy will emerge from recession, driven by stronger domestic demand and capital investment in Germany, household spending and financial services recovery in the UK and further improvement in the Spanish and Italian economies. There will be stronger inward investment into Europe as the Eurozone sovereign debt crisis retreats further and controversial EU regulatory reforms are scrapped due to national challenges to 'treaty overreach,' resulting in greater political certainty.

5. UK Economy Will Strengthen Through Further Government Stimulus

UK consumer confidence and economic recovery will strengthen in 2014 with real GDP likely to rise by 2.5% as the government continues to stimulate the economy through policies aimed at supporting house prices and increasing household spending in the run-up to the 2015 election. Increased business confidence will lead to rental growth UK-wide as occupier markets strengthen and business expansion gains traction. Government macro-prudential initiatives may delay any interest rate rise beyond 2015.

"UK consumer confidence and economic recovery will strengthen in 2014 with real GDP likely to rise by 2.5% as the government continues to stimulate the economy."

6. UK Regional Markets and Secondary Assets Will Be Back in Play

Property investment transactions will grow beyond the £40bn recorded by year-end 2013, but will fall short of the 2006 peak level of £58bn. In the absence of quality supply and with keen competition from international cash buyers, domestic investors will look beyond core markets and assets to regional and secondary assets requiring capital expenditure and refurbishment into institutional grade product. This demand will result in lower yields in London and moderate yield compression across secondary asset classes.

7. Large-scale Infrastructure Investments Across the GCC

Despite continued political instability in some areas and global petroleum supply and demand uncertainties, the Middle East economies will see further non-oil economic growth. Unemployment, though, will remain high and provide scope for further political turbulence. Nonetheless, a gradual normalization is expected in Egypt throughout the year. 2014 will also be the year of significant spending across Gulf Cooperation Council (GCC) member countries on both social infrastructure (housing, hospitals and schools) and primary economic infrastructure (roads and rail). Completion of large-scale mixed-use development projects particularly will contribute to on-going urbanization in the region.

8. Foreign Companies Will Expand to South Africa and Beyond

Increased political stability in some countries, infrastructure investment, continuing urbanization and healthy economic growth rates will create new opportunities across Africa for corporations looking for new markets to improve margins and revenues. The active companies will largely come from the energy, telecom, low-cost consumer goods and banking sectors. While South Africa will remain the preferred destination for many established players and new entrants, other countries will be increasingly on the radar, particularly Angola, Namibia, Botswana, Uganda, Ghana, Kenya and Nigeria.

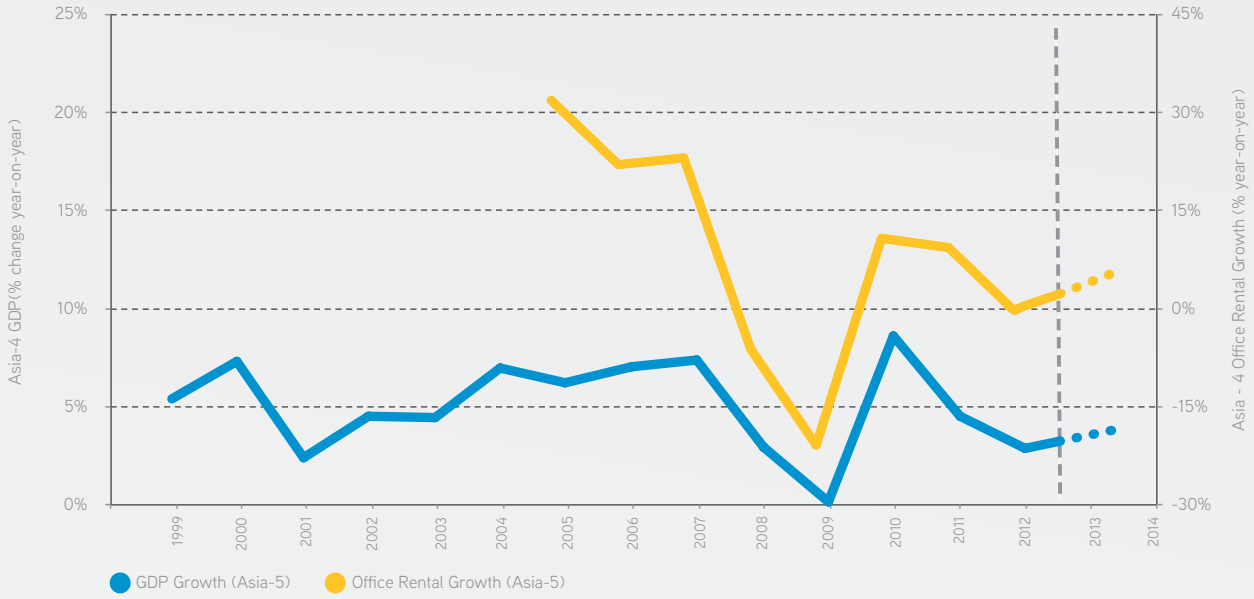
Asia

9. Modest growth in Office Rentals in Asian Financial Centers

The high volatility (±20% p.a.) of rents in Asia's office sector is now a thing of the past, even in very cyclical markets like Hong Kong. Due to a structural change in the financial sector over the past five years, banking and finance companies – the key office tenants in Asia – are expected to remain cost-conscious in 2014. Our research suggests office rents in the region's five main financial centers (the so-called Asia 5: Hong Kong, Shanghai, Singapore, Seoul and Tokyo) will fare better than in 2013, with growth in 2014 at around 5%. That is roughly in line with aggregate GDP growth and consistent with the current trend in leasing demand in these five centers. There has been no major retrenchment in the financial sector, despite the challenges in the external environment. Even so, existing multinational corporate tenants have been trying to save costs and become more cost-efficient by every means, including space rationalization, relocation and consolidation. This will continue in 2014.

"Chinese investors will be the most determined buyers, seeking growth and diversification opportunities in key gateway cities like London, New York, Sydney and Singapore."

Asia Office Rental Trend



Source: Colliers International

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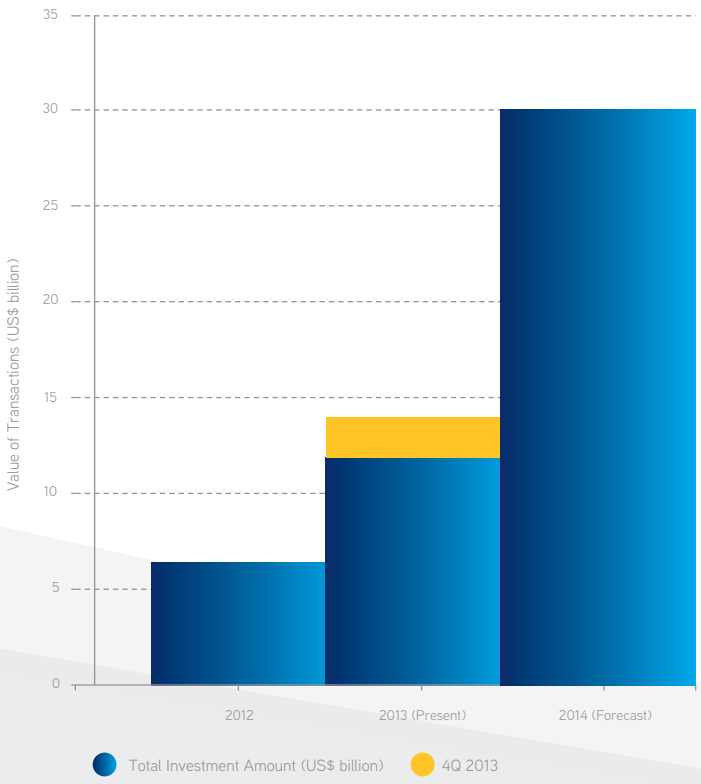
Outbound Real Estate Investment by Chinese Buyers



Source: RCA; Colliers International

10. Chinese Investors Will Buy Overseas in a Big Way

Given Asia's solid economic prospects, there is no doubt long-term capital will continue to flow into the region. However, Asia is currently in a very different property cycle compared to the US and Europe. More real estate investors in the region are being prompted to look overseas for opportunities to gain better yields. Among them, Chinese investors will be the most determined buyers seeking growth and diversification opportunities in key gateway cities like London, New York, Sydney and Singapore. Statistics provided by Real Capital Analytics suggest the total value of outbound Chinese investment in the first three quarters of 2013 was 83% higher than the total in 2012. London, for example, saw a threefold increase. Looking ahead, Chinese investors will make more capital ready for overseas investment in 2014. If the top 10 Chinese developers were to allocate 50% of their annual sales revenue for overseas investment, this would amount to US$60 billion – 10 times the total value of their outbound investment in 2012. It is therefore our view that these gateway cities will see a quantum leap (100% or more) in real estate transactions by Chinese buyers in 2014.

11. JREITs Will Expand

Japanese Real Estate Investment Trusts (JREITs) sales transactions have made up over 60% of total sales transactions in Japan, resulting in an acceleration of IPOs beginning in late 2012. There were six IPOs in 2013. The JREIT market capitalization of JPY 7.4 trillion in March of 2013 was the highest since its inception. The property types and locations targeted for acquisition include logistics facilities and retail properties in Tokyo, Osaka and Nagoya and residential properties in all major cities. The government plans to establish clear guidelines for the structuring of health care JREITs in 2014. We foresee continuous sales growth led by JREITs, with yield compressions for all property types in most major Japanese cities.

India

12. More Supply Deferrals in 2014

Our expectations for office space demand in 2014 are marginally higher than last year, as are our expectations for the Indian economy. Corporate occupiers of office space will remain cost-conscious until there are more concrete signs of recovery in global demand. We anticipate stability in rental values, primarily due to limited new construction as developers will hold off on completing projects and starting new ones.

13. Regulatory Changes Will Boost Investments

The Indian government has announced new policies including the revision of the Land Acquisition Act, Registration Act and the introduction of the Real Estate Regulation and Development Bill. These changes aim to bring much needed transparency to the sector. The Securities and Exchange Board of India (SEBI) has also come up with guidelines for REITs in India. REITs in India would change the real estate sector dramatically by institutionalizing real estate and bringing in more transparency.

Singapore

14. Singapore's Prime Office Rents Will Jump By 10-16%

The sustained economic growth in Singapore will continue to support job creation and fundamental real estate leasing demand, particularly for office space. The nascent office property market recovery will gain further traction, with Grade A and Premium Grade Central Business District office rents potentially increasing by 10% to 16% year-on-year in 2014.

Perth, Australia

Australia & New Zealand

15. Domestic Property Investors Will Take Back Australia

The buyer group experiencing the strongest growth over the past five years has been offshore investors. In 2013, this began to change. Domestic investors re-entered the market at a rapid rate. When this report went to press, our data showed that they accounted for more than 70% of total direct sales in 2013. It isn't that offshore investors have exited the market, but rather they are now under increased competition. Local investors entering the market are primarily major property institutions with unlisted funds. However, offshore buyers are still active, with most offshore money coming from Singapore, Hong Kong, Europe and North America. Other waves of capital we are seeing are from South Korea where the nation's huge pension system is actively investing in property globally. It is likely that there will be more money flowing from other pension funds to Australia, both from local superannuation funds, as well as offshore groups. Malaysian investors are also expected to become more active, particularly from the huge amounts of personal wealth in that country.

16. Leasing Conditions Will Improve in All Sectors

The last two years have been characterized by poor leasing conditions in all sectors with net effective rents dropping in most markets. However, we are cautiously confident that we will see a recovery in rents and are predicting modest rental growth across all sectors. This will primarily be as a result of improved business confidence following better economic conditions offshore, an improving housing market and a return of consumer confidence.

Ownership patterns are also predicted to lead to changes to rental growth levels. Westfield's historical dominance over the retail sector has meant that they have exhibited a higher control over rental rates in shopping centers in Australia. It is possible that Dexus' takeover of CPA will have the same impact on office rents, particularly in the premium sector, as they become the biggest landlord in Australia.

17. New Zealand Development Activity Will Rise

All main centers in New Zealand will receive commercial construction activity uplift, but not for the same reasons. Both the Auckland and Wellington CBD's will face a critical shortage of prime office space, triggering more speculative

development than we have seen for many years. Auckland will see more decentralized office space and malls constructed due to limited development opportunities in the core CBD for a growing occupier and customer base. Wellington will see refurbishment and re-strengthening activity at an unprecedented level to counteract earthquake concerns for ageing stock. The earthquake-created rebuild activity in Christchurch is the catalyst for all types of activity, but risks of a glut in supply will temper the pace of growth. Wellington and Christchurch's markets will fully absorb and price in seismic implications, while Auckland still hopes it will all go away.

New Zealand will move from a stable investment destination to growth destination as the population grows and the economy performs strongly. This will lead to more confidence in business, consumer and investment attitudes. Office space at the prime end of the sector is already below long-term averages with more employment and business growth in 2014 placing further pressure on occupiers. More shoppers and the consumer confidence boost, particularly in Auckland, will result in a rise in retail activity.

Rio de Janeiro, Brazil

Latin America

18. Mexican Investment Will Be Driven By New REITs

The Mexican government's push for economic reform promises to boost economic growth in the medium and long term, but a climate of uncertainty persists in the short term, largely caused by fluctuations in the U.S. economy. Vacancy rates and rents in major Mexican cities like Monterrey, Guadalajara and Mexico City will remain stable. National rates of commercial construction and absorption will also persist in 2014.

The Mexican real estate market has begun to embrace FIBRAS (Mexican REITs) in the past two and a half years. The investment market will be dominated by the public markets in 2014, with a huge amount of activity from these buyers.

19. More Foreign Investors Will Target Colombia

In Colombia, an economic stability will persist as it hasn't been seriously affected by the North American and European economic crises. The unemployment rate will decrease, while GDP will continue to increase in a year during which a polarizing presidential election will present two different paths for the country's future. Colombia's status as an ideal target for foreign direct investment (FDI) was recognized in 2013 by the Foreign Direct Investment Association which chose Colombia as a "future investment destination."

"Vacancy rates and rents in major Mexican cities like Monterrey, Guadalajara and Mexico City will remain stable."

USA

20. U.S. GDP Growth Will Struggle to Average 2%

Slow economic momentum will continue, thanks in part to Congressional dysfunction, the problematic launch of Obamacare and the likelihood that a Sequestration II will be the compromise made to avoid a second government shutdown. Job growth will be below 200,000 per month.

21. QE Will End and Interest Rates Will Rise

U.S. unemployment seems to be falling, albeit unevenly. This means that the Federal Reserve will have some tough calls to make in 2014. In December, the Fed announced that it will start to taper Quantitative Easing (QE) beginning in January 2014, initially reducing monthly Treasury and MBS purchases by $10 billion per month and tapering further during the year if the economic recovery remains on track. The Fed left the door open for adjustments to bond purchases depending on the progression of the recovery, and also has expressed a willingness to hold off on increasing the key benchmark discount rate above 0.25% until well after the unemployment rate decreases below the previously announced 6.5% threshold. Unfortunately, the Fed cannot control long-term interest rates without QE. As a result, the FED is in a bit of a pickle. Does it let the market begin to move long-term interest rates up to a more normal level without QE, or does it continue to intervene and keep long-term mortgage rates and the 10-year Treasuries artificially low? We expect Janet Yellen to err on the side of keeping QE in place for too long. With the QE taper, the market will push 10-year Treasury yields to between 3.75% and 4.25% by the end of 2014. This will have global implications, especially in emerging markets where interest rates take their cue from the U.S.

22. U.S Home Prices Will Rise as Much as 9%

The housing recovery will continue. Home prices will rise in the high single-digit range (6%-9%) due to constrained new supply. A dearth of acquisition, development and construction financing from banks who are now suffering from more punitive capital regulations, coupled with the failure by Congress to reform Freddie Mac and Fannie Mae and bail out FHA will mean that less than one million new housing units will be built, compared to 2007's peak of 1.8 million units.

23. Secondary U.S. Markets Will See Expanded Demand

Demand for U.S. commercial real estate will finally move out to strategic secondary markets. For industrial property, this will mean places aligned with the new post-Panamax supply chain. Secondary metro economies with an ICEE (Intellectual Capital, Education & Energy) focus will see the most office demand. These markets will see capital migration and resulting cap rate compression from 8.5% and higher to 6% or even lower. They will include Charlotte, Raleigh, Charleston, Greenville, Tampa, Grand Rapids, Indianapolis and Memphis.

Chicago, United States

The liquidity and safety of the U.S. market as well as still-attractive risk-adjusted returns on most commercial real estate types will sustain both domestic and foreign investment flows in the U.S., supporting increases in transaction volumes.

24. Industrial Will Be Top U.S. Performer in 2014

Industrial will remain the star performing real estate property type as U.S distributors, manufacturers and retailers scramble to remake their supply chains just in time for the onset of the first post-Panamax decade. With the continued growth of e-commerce and impending opening of the Panama Canal expansion in 2015/2016, the remaking of the global supply chain will have a profound impact on the U.S. industrial and retail markets. East and Gulf Coast ports equipped to handle the increase in cargo flows, such as Baltimore, Charleston and Norfolk, as well as inland ports and intermodal markets are well-positioned to benefit from this change.

Canada

25. The Prairie Provinces Will Be Real Estate Hot Spots

With a softening Canadian dollar and a rebounding United States economy, the export of raw materials is driving growth in the Prairie provinces. Alberta and Saskatchewan are slated for investment of billions of dollars into oil and potash mining, which in turn will have significant influence on the growing residential and non-residential construction industry. Through 2014, expect the Prairie region to be a hot spot for commercial real estate, while natural resource production and exports continue to grow and provide spin-off employment opportunities, attracting national and international residents.

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