

June 2007

# Asia Pacific Property Cycle Monitor

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## Introduction

Despite a mild mid-cycle global economic slowdown in 2007, the Asia Pacific region remains the world's strongest economic performer. Yet within this region, significant economic diversity persists across the spectrum from relatively mature (Japan) to newly emerging (China, India). The region's real estate markets also show significant variations in maturity, performance and movement through their real estate cycles. This diversity across markets, combined with limited transparency in many countries, poses obstacles for tracking and forecasting market performance. As explained in previous reports, RREEF Research mitigates these obstacles by employing a combination of top-down and bottom-up, quantitative and qualitative techniques. This process enables us to make a series of credible forecasts for rental values in the region's office, retail and industrial sectors.

The aggressive expansion of financial and professional services firms is driving demand in the core submarkets in many of Asia's major cities in 2007 and pushing up rents. Most of the region's office markets are in growth mode, but with notable exceptions. Unique local circumstances have weakened the office rental growth in Beijing (due to supply surge in certain sub-markets) and Bangkok (due to recent political instability). In Japan, the epicenter of office demand still lies in Tokyo's five central wards, but the country's sustained economic revival has also moved regional cities like Yokohama, Osaka, and Nagoya into a nascent recovery mode. Looking ahead over the forecast, speculative supply spikes are in the pipeline in Hong Kong, Shanghai's Pudong district and the major Indian cities (Mumbai, New Delhi and Bangalore) that could push them all into post-growth or contraction between now and the end of the decade.

Asia's retail property market continues to be a favourite for investors. Positive demand drivers, including vibrant economic and job growth, an expanding middle class population, increasing volumes of retail sales and tourists, and strong interest of chain retailers have all converged to make retail property an attractive investment. Led by Shanghai, shopping centre rents rose across key Asian markets in 2006, and the outlook for the retail sector remains positive over the forecast period. New deliveries of retail space in Hong Kong, Beijing and Kuala Lumpur could disrupt rental growth.

A milder than expected downturn in the global economy in 2007 bodes well for the Asian warehousing and logistics sector. The recent and continuing strong pace of growth and lack of quality products mean the outlook for the Asian warehouse and logistics market remains positive. The region's strong and growing manufacturing base and its vigorous export activity help boost demand while a relative shortage of good quality supply provides a constraining effect on the market. The result is a robust outlook for rental growth in the short and medium term across most markets. Demand for distribution and logistics is strong throughout Asia with important warehouse and logistic hubs centred on the region's largest seaports and the airports in Hong Kong, Singapore, Shanghai, and Tokyo.

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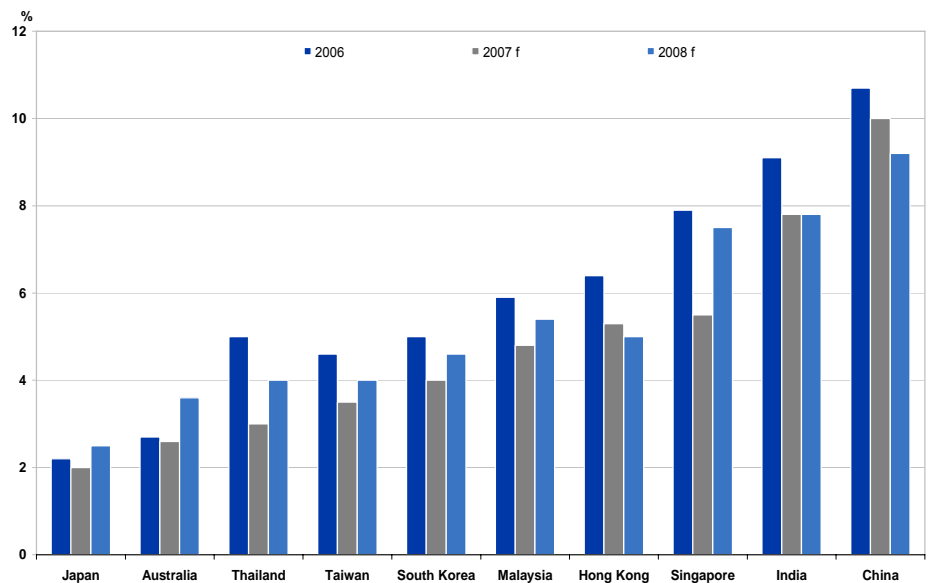


## Property Cycle Monitor: Economic Context

*A mid-cycle “soft landing” for the global economy in 2007...*

A mid-cycle soft landing is in progress in the global economy. GDP growth during the first half of 2007 has exceeded expectations in many countries. Though the mildness of this slowdown positively impacts property markets around the world, it does little to ease inflationary pressures in some emerging markets and thus may delay the prospect of reductions in interest rates. Several countries may see further hikes in official rates over the remainder of 2007. Despite this, and although the spike in interest rates during the early part of June increases risks of a more sustained economic slowdown, most Asian economies are expected to experience a moderate acceleration in growth during 2008.

**Chart 1: GDP Growth Rates**



Source: Global Insight, Deutsche Bank (World Outlook Q2 2007), F= Forecast

*...has been a positive development for Asia's export-oriented economy.*

Asia's export-oriented economy is sensitive to external developments, so the current soft economic landing in the US and Europe is reverberating positively throughout most of the region. Asia's export growth slowed to 17.5% in Q1 2007, down only slightly from 18.7% in the last quarter of 2006.

China experienced real GDP growth of 10.7% in 2006. The much anticipated cooling of the Chinese economy has yet to materialise in 1H 2007. Amid a surging bull market for securities, China reported GDP growth in Q1 of 11.1%. This heightens concerns that the economy has overheated. Although inflation remains below 3%, retail sales and fixed investment are still growing at double-digit rates. This has led the authorities to introduce new monetary and administrative measures to tighten the economy. The latest administrative measure – a new stamp duty on securities transactions – was introduced in late May with the aim of restraining the stock market's recent volatility. Given the momentum behind the growth of China's economy, we anticipate further tightening measures to be introduced over coming months.

India followed closely behind China in 2006 with Asia's second-fastest economic growth rate (9.1%). Defying most forecasts, the country's economy remained strong in early 2007 with a brisk 9.1% growth rate in the first quarter that was led by a swift expansion in the manufacturing sector. As 2007 progresses, India's GDP growth is forecast to slow, and

indeed, recent increases in interest rates have already begun to tighten credit in the housing market.

Japan's economy has been only marginally affected by the world's mid-cycle slowdown. Economic growth was a steady 2.2% in 2006 and will closely match that rate again this year. Productivity, real wages, and consumption are expanding amid a healthy rate of job growth. Meanwhile, Japan's inflation and interest rates remain the lowest in Asia.

In the rest of Asia, economic growth is moderating, though less than originally expected. Real GDP growth should hold above 5% in Hong Kong, Singapore, and Malaysia. In Hong Kong, export and retail sales growth have slowed, but other key indicators point to an overall healthy economy. Singapore's GDP expanded at a resilient 6% rate in the first quarter, with an economic acceleration still forecast for 2008. In Taiwan and South Korea, GDP growth will fall short of 5% in 2007 and 2008. In both countries, a degree of political uncertainty precedes upcoming national elections. South Korea's economy grew at a solid 4.0% in the first quarter, buoyed by strong export growth. Of Asia's emerging markets, Thailand will post one of the slowest GDP growth rates this year. The Thai economy will expand by just 3% in 2007 as capital outflows still remain a threat amid recent political upheaval.

Further south in the Asia Pacific region, Australia's economy expanded by 2.7% in 2006 and growth this year is expected to hold closely in line with that rate. The government recently lowered its forecast for inflation in 2007, decreasing the near-term likelihood of monetary tightening. Australia's economy overall remains sensitive to global commodity price fluctuations.

## Property Cycle Monitor: Office

*Many Asian office markets are approaching the peak of their growth cycles...*

The Asian office market is currently experiencing a robust growth cycle. Over the next three years, significant supply will be completed first in Hong Kong, Shanghai (Pudong), and the major Indian cities and next in Singapore, Sydney and Melbourne. With little uncommitted new supply in the pipeline, Tokyo and Seoul are best positioned to hold onto their growth cycles through the end of the decade.

*...led by strong demand from financial and professional services firms in the core submarkets of major cities.*

Two inter-related trends characterise the major Asian office markets in 2007. First, the region's sustained economic momentum is pulling in external capital. This has spurred the aggressive expansion of financial and professional services firms in many of the region's major cities. Hong Kong and Singapore both aspire to be Asia's undisputed financial capital on par with New York or London. Other cities including Tokyo, Shanghai, and to a lesser extent, Kuala Lumpur, Seoul, Mumbai, Sydney, and Taipei all aspire for a position within the financial hierarchy as well – if not the dominant regional capital, then at least a pivotal international role or niche. Japan, Korea, Singapore, Malaysia, and Taiwan have all considered or pursued policy options toward achieving this goal. Meanwhile, the expansion of financial services firms has become a major driver of office market demand in the region, placing several of the cities with the highest aspirations at the top of their growth cycles.

The second related trend relates more to location-specific, or geographic, variations. Unlike IT firms or other MNCs, financial and professional services firms are more likely to cluster in CBDs or prestigious core submarkets. This has funnelled demand into the most supply-constrained submarkets. In Hong Kong, Mumbai, and Delhi, substantial new construction will soon be delivered, though almost all of it lies in the less constrained peripheral areas.

*Rental growth is already slowing in Hong Kong...*

Among the **Mature Asian Markets**, rental growth in Hong Kong will moderate to 16% in 2007 after topping 90% in 2005 and 28% in 2006. While financial and professional services firms are still providing steady demand for space in Hong Kong Central, absorption in other submarkets is moderating. More than 900,000 sqm will be added in the submarkets outside Central by 2010. The combined effect of moderating demand and an onslaught of new supply will bring Hong Kong's overall rent growth to a halt within the next year.

*...but the slowdown in Singapore is another two years out...*

Rental growth in Singapore overtook Hong Kong in 2006 to lead the Asian office markets. Singapore should hold onto this lead through 2008. Financial services firms are providing steady demand that is expected to hold vacancy rates under 2% in 2007 and 2008. By 2009, the market should begin to loosen as new supply reaches the market.

*...and in Tokyo, the end of this rental growth cycle is not yet in view.*

Japan's sustained economic growth has contributed to tightening office markets in its major cities. The vacancy rate hovers just over 4% in Tokyo and is tighter still in the three central wards. In the three largest regional cities – Yokohama, Osaka, and Nagoya – the vacancy rate is forecast to fall steadily through the end of the decade. Rental growth for renewals should peak at 10% in Tokyo in 2007 but a moderate stream of new supply will hold the growth rate to single digits for the remainder of the decade. Yokohama, Osaka, and Nagoya will see rental growth in 2007 as well, though not nearly to the same degree as Tokyo, which is responding to vigorous pre-leasing of new construction, limited availability in prime locations, and a strong inflow of foreign capital.

While demand for office space in Seoul has been less robust than some of the other Asian markets, a limited supply of quality office space keeps the vacancy rate (currently under 2%) among the lowest in the region. An ample amount of new office supply is expected by 2010, but until then Seoul's rental growth for renewals should hold steady through the decade at 3-4% pa, while rental growth for new leases will be substantially faster.

Solid economic growth in Australia is providing a boost to office demand in both Sydney and Melbourne. Rental growth should maintain momentum until 2009 in both markets. By the end of the decade, a surge of supply in both cities should bring an abrupt end to this sustained period of rising rents.

*The majority of Emerging Asian office markets are transitioning from growth to post-growth.*

Most of the **Emerging Asian Markets** are near the transition from growth to post-growth. A notable exception is Beijing. A moratorium on construction during the 2008 Olympics is contributing to the current building surge that will add 2 million sqm in 2007 and another 1 million in 2008 with very little pre-leased so far. Most of the new supply will be delivered in the CBD and to a lesser extent the Financial Street submarket. Both of these districts will be the most affected by the fallout. An opposite cycle characterises Shanghai's Pudong area. With a limited amount of quality office space available, rents climbed more than 20% pa over the past two years and are forecast to rise another 15% in 2007 amid strong take-up from MNCs. As a wave of new supply hits the market beginning in 2008, rental growth may quickly dissipate, sending Pudong's office market into a cyclical trough.

*Ample new construction will knock India's rent growth out of the double-digits for the rest of the decade.*

Surprisingly swift economic growth in India has spurred a vibrant demand for the limited supply of high-quality office space in the major cities. Financial services firms drive the market for prime space in Mumbai's core while IT is a leading driver of demand in Bangalore and Delhi's National Capital Region (NCR). Rents rose in all three cities at double-digit levels in 2006 but an increasing amount of new construction will hold rental growth down through the end of the decade. According to DTZ, new office supply in 2007 will tally to 640,000 sqm in Mumbai, 1 million sqm in Bangalore, and 1.5 million sqm in NCR.<sup>1</sup>

Political uncertainties have stalled business expansion plans in Thailand for now. Rental growth – which had been notable in the past few years – will be flat-to-weak in the medium-term as business confidence remains tepid.

In Kuala Lumpur and Taipei rental growth in 2006 was moderate relative to most other emerging Asian markets. In the central areas of both cities, the supply of good quality space is limited and tenant demand is moderate. Modest rental growth will be accompanied by relatively stable vacancy rates (12-13% in Taipei and 8-10% in Kuala Lumpur) over the forecast period. Malaysia's recent capital reforms – including a recently announced plan to repeal the property gain tax – could trigger more investor interest.

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<sup>1</sup> DTZ, "Commercial Real Estate, Norwegian Wood (This Bird Has Flown), India 2007," pp. 16-18.

## Office Market Cycle

### Emerging Markets

### Forecast Years

YE06		YE07	YE08	YE09	YE10	YE11
GRW	PGW		PGW		PGW	
REC	CON				REC	
GDP Growth*	9.4%	8.5%	8.1%	7.6%	7.5%	7.3%
% Vacant	8.4%	12.6%	12.2%	11.9%	10.6%	8.3%
Rent Momentum	Increase +	Increase	None	None	Increase	Increase

### Mature Markets

### Forecast Years

YE06		YE07	YE08	YE09	YE10	YE11
GRW	PGW	GRW	GRW	GRW		PGW
REC	CON					
GDP Growth*	2.9%	2.5%	3.1%	2.5%	3.0%	3.0%
% Vacant	3.9%	3.9%	3.7%	4.0%	4.3%	4.5%
Rent Momentum	Increase +	Increase +	Increase	Increase	Increase	None

\* Weighted by the size of GDP at the national level in US dollar

**Key:** REC = Recovery      GRW = Growth      PGW = Post Growth      CON = Contraction

Source: RREEF Research, Deutsche Bank Research, and Global Insight

## Office Sector Outlook

### Drivers

- Sustained economic growth throughout the region continues to spur office demand in most major cities of Mature and Emerging Asia.
- Financial and professional services firms continue to expand swiftly in Asia, creating demand for high-grade office space in core areas of major cities.

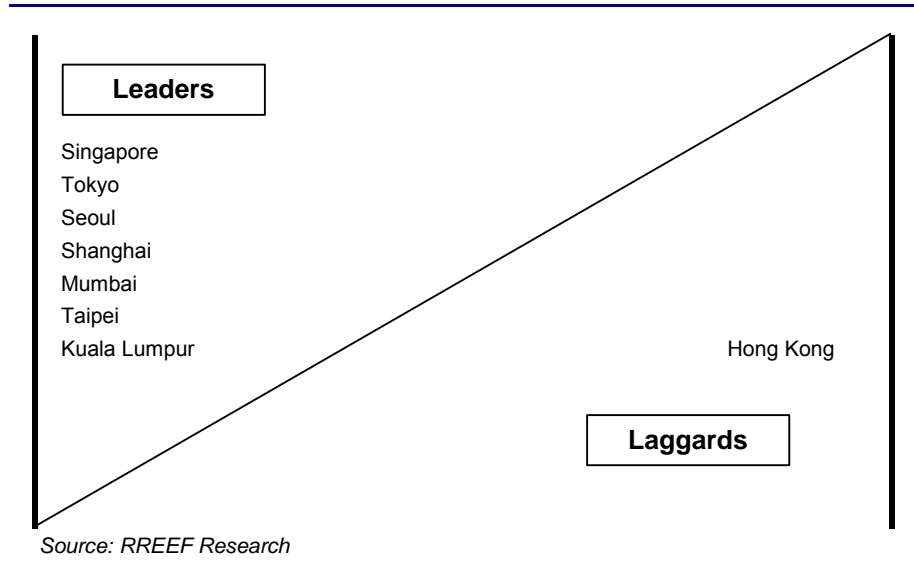
### Constraints

- High levels of new construction already constrain rental growth in Beijing and will soon have the same effect in Hong Kong, Shanghai (Pudong district), and the major Indian cities, followed by Sydney, Melbourne and Singapore later in the decade.
- Political uncertainty dampens the current outlook for Thailand and serves as a timely reminder of the risks that still exist in Emerging Asia.
- The pace of economic growth in Asia is susceptible to broader macro economic factors, including higher interest rates and oil prices, or subdued external demand for Asian exports.

**Implications: Timing of changes**

- Rental growth has peaked and has already begun to slow across many of Asia’s major cities. Notable exceptions are Singapore, Sydney, and Melbourne where rental growth continues to grow swiftly with anticipated supply spikes still at least two years away. Modest upside potential in the near term is also realistic in Japan’s regional cities.

**Office Leaders/Laggards**



			Forecast				
YE 2006			2007	2008	2009	2010	2011
Emerging Markets	Stage	Growth	Post Growth	Post Growth	Post Growth	Recovery	Growth
	Vacancy	8.4	12.6	12.2	11.9	10.6	8.3
	Rent Momentum	Increase+	Increase	None	None	Increase	Increase
Beijing	Stage	Post Growth	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	12.9	26.0	23.0	20.0	15.0	12.0
	Rent Momentum	None	Decrease+	Decrease+	None	Increase	Increase+
Shanghai (Pudong)	Stage	Growth	Growth	Post Growth	Post Growth	Contraction	Recovery
	Vacancy	2.0	4.0	9.0	12.0	20.0	12.0
	Rent Momentum	Increase+	Increase+	None	None	Decrease+	Increase+
New Delhi	Stage	Growth	Growth	Growth	Post Growth	Post Growth	Post Growth
	Vacancy	0.5	0.5	0.5	0.5	0.5	NA
	Rent Momentum	Increase+	Increase+	Increase+	Increase	Increase	None
Bangalore	Stage	Growth	Growth	Growth	Post Growth	Post Growth	Post Growth
	Vacancy	0.1	3.0	1.0	1.0	1.0	NA
	Rent Momentum	Increase+	Increase+	Increase+	Increase	Increase	None
Mumbai	Stage	Growth	Growth	Growth	Post Growth	Post Growth	Post Growth
	Vacancy	10.3	10.7	10.8	10.8	10.7	NA
	Rent Momentum	Increase+	Increase+	Increase+	Increase	Increase	None
Kuala Lumpur	Stage	Growth	Growth	Growth	Post Growth	Post Growth	Growth
	Vacancy	10.5	9.0	9.0	10.0	9.0	8.0
	Rent Momentum	Increase	Increase	Increase	None	Increase	Increase
Bangkok	Stage	Post Growth	Contraction	Recovery	Recovery	Recovery	Recovery
	Vacancy	12.9	15.0	14.0	13.0	12.0	12.0
	Rent Momentum	Increase	None	None	None	None	None
Taipei	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	13.9	13.5	12.5	13.2	12.7	12.0
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
Mature Markets	Stage	Growth	Growth	Growth	Growth	Post Growth	Post Growth
	vacancy	3.9	3.9	3.7	4.0	4.3	4.5
	Rent Momentum	Increase+	Increase+	Increase	Increase	Increase	None
Hong Kong	Stage	Growth	Growth	Post Growth	Post Growth	Recovery	Recovery
	Vacancy	4.2	4.1	4.2	4.5	5.0	5.0
	Rent Momentum	Increase+	Increase	Decrease	None	None	Increase
Seoul	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	1.7	1.8	1.8	2.3	4.0	4.3
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
Tokyo	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Vacancy	2.9	3.5	3.2	3.6	3.2	3.5
	Rent Momentum	Increase+	Increase+	Increase+	Increase	Increase	Increase
Yokohama	Stage	Recovery	Recovery	Recovery	Recovery	Recovery	Recovery
	Vacancy	3.4	4.0	3.8	3.8	2.7	2.5
	Rent Momentum	None	None	None	None	None	None
Nagoya	Stage	Recovery	Recovery	Recovery	Growth	Growth	Growth
	Vacancy	5.9	6.5	6.4	6.3	6.2	6.0
	Rent Momentum	None	None	None	Increase	Increase	Increase
Osaka	Stage	Recovery	Recovery	Recovery	Recovery	Recovery	Recovery
	Vacancy	6.2	6.9	6.7	6.6	6.4	6.2
	Rent Momentum	None	None	None	None	None	None
Singapore	Stage	Growth	Growth	Growth	Growth	Post Growth	Contraction
	Vacancy	2.3	1.5	1.2	2.0	3.0	3.0
	Rent Momentum	Increase+	Increase+	Increase+	Increase	None	Decrease
Sydney	Stage	Growth	Growth	Growth	Growth	Post Growth	Contraction
	Vacancy	9.1	6.9	5.9	5.4	7.2	8.7
	Rent Momentum	Increase+	Increase+	Increase+	Increase+	None	Decrease
Melbourne	Stage	Growth	Growth	Growth	Post Growth	Post Growth	Contraction
	Vacancy	6.5	6.3	6.4	6.5	6.8	6.8
	Rent Momentum	Increase	Increase	Increase	None	None	Decrease

Source: RREEF Research

## Property Cycle Monitor: Shopping Centres

*Shopping centre rents rose across major Asian markets in 2006.*

Vibrant economic and job growth, an expanding middle class population, increasing volumes of retail sales and tourists, and strong interest of chain retailers have all converged to make Asia's retail property market a favourite of investors. Led by Shanghai, shopping centre rents rose across key Asian markets in 2006, and the outlook for the retail sector remains positive over the forecast period.

*New construction in Kowloon has contributed to slower retail rental growth in Hong Kong...*

Of the **Mature Asian Markets**, Hong Kong is the only market to have slipped from growth into a post-growth phase in 2007. Its near-term retail rent levels will plateau following a surge of new construction delivered to market in Kowloon this year. The vacancy rate will rise modestly to 4% by 2009. Robust rental growth should return by the end of the decade as solid fundamentals on the demand side – a forecast GDP growth rate of at least 5% pa combined with steady tourist arrivals from the Chinese Mainland – provide long-term strength to the retail market.

*...but retail rents in other Mature Asian Markets will expand steadily in the near term.*

Except for Hong Kong, the remaining mature Asian retail markets are firmly entrenched in their growth cycles. Singapore's robust economic growth forecast of 5-7% over the next few years underpins a generally positive retail market. The opening of two new malls in the Orchard Road area over the next two years is unlikely to nudge the market's vacancy rate any higher than 1.5%. New resort/casino developments due to open in Singapore by the end of the decade should draw more international tourists to the island and may add a new dimension to the retail market. Rent levels will grow at a fairly steady 3-5% pa through 2011.

In both Tokyo and Seoul, "turnover" rents are typical for shopping centres. Because this reduces the incentive for landlords to seek significant increases in base rental levels, significant annual rent hikes are unlikely in markets such as these with a relative shortage of modern shopping centre space. Not surprising then, the forecasts for both Tokyo and Seoul indicate relatively stable annual rental growth of 3-4% pa. A regulatory change on new retail developments in Japan goes into effect in 2007 and will restrict the development of suburban shopping centres over 10 000 sqm.

Australia's forecast GDP growth for 2008-2011 exceeds 3.0%, a solid level of economic growth that will support an expansion of consumer spending. Retail rents in both Melbourne and Sydney are forecast to reach 3-4% pa through 2011.

*Rising affluence in Asia's emerging markets, particularly in China, boosts consumer spending*

Rising levels of affluence drive retail sales growth in the **Emerging Asian Markets**. Nowhere is this more apparent than in China's major cities. Of the 11 Asian retail markets that RREEF forecasts, Shanghai was the only one to experience double-digit retail rental growth in 2006. Even with an expected deceleration in rental growth going forward, Shanghai should still lead the other Asian retail markets through the remainder of the decade. Shanghai remains a must-enter market for many Western retail chains and demand created by this foreign influx is exceeding supply. In advance of the 2008 Olympics, international retailers are flocking to Beijing as well. As with any city hosting an Olympic event, the mismatched timing of supply and demand that precedes and follows the games can destabilise fundamentals. Unlike Shanghai, Beijing's ample retail completions more than match its current demand requirements. Prospects for rental growth in the years through the Olympic period remain modest. Robust rent growth will be absent in this market until at least 2011 when Beijing's retail fundamentals once again regain balance.

A moderate amount of new supply is likely to be added to central Kuala Lumpur's retail property stock in 2007, but the effect on the vacancy rate will be minor. Demand in this market is steady and by 2008, rents should recover to modest gains of 2% pa.

Bangkok's retail market struggles to overcome a series of misfortunes. On the demand side, the country's political instability has deterred tourism, undermined business

confidence, and encouraged capital flight. Meanwhile, the retail stock will be boosted by 130 000 sqm of new supply in 2008-2009. Rental growth will be muted for 2007 but should ease back up to 2% pa over the remainder of the decade.

Retail rents shot up a robust 8% in Taipei in 2006, but a national crisis involving credit card debt has had a recent impact on shopping centre sales. The possibility that improving bilateral ties will allow more Mainland visitors to the island is a much anticipated development in Taiwan but has not yet materialised. The outlook for retail rents should be a tamer but still respectable 3-4% for the remainder of the decade.

Retail Market Cycle						
Emerging Markets						
	Forecast Years					
YE06	YE07	YE08	YE09	YE10	YE11	
GRW	GRW	GRW				GRW
PGW			PGW	PGW		
REC						
CON						
GDP Growth*	9.4%	8.5%	8.1%	7.6%	7.5%	7.3%
GDP Per Capita **	2,914	3,265	3,741	4,229	4,687	5,168
Rent Momentum	Increase +	Increase	Increase	Stable	Stable	Increase

Mature Markets						
	Forecast Years					
YE06	YE07	YE08	YE09	YE10	YE11	
GRW	GRW	GRW	GRW	GRW	GRW	GRW
PGW						
REC						
CON						
GDP Growth*	2.9%	2.5%	3.1%	2.5%	3.0%	3.0%
GDP Per Capita **	32,006	33,643	37,198	40,459	43,218	45,641
Rent Momentum	Increase +	Increase	Increase	Increase	Increase	Increase

\* Weighted by the size of GDP at the national level in US dollar  
\*\* Weighted by the size of GDP at the national level in US dollars

**Key:** REC = Recovery    GRW = Growth    PGW = Post Growth    CON = Contraction

Source: RREEF Research, Deutsche Bank Research, and Global Insight

## Retail Sector Outlook

### Drivers

- Strong GDP growth in China, Hong Kong, and Singapore.
- A milder-than-expected mid-cycle dip in the global economy in 2007.
- A rapidly expanding middle-class population in Emerging Asia.
- Intra-regional tourism developing: Shoppers from China boost Hong Kong's retail sales. Taipei hopes for the same effect, but looser restrictions on visits from the Mainland still unfilled. Resort/casino tourism expected to boost Singapore by end of decade. Kuala Lumpur is trying to promote itself as the major shopping destination for Middle East tourists.
- 2008 Olympics and 2010 World Expo in Beijing and Shanghai preceded by relaxations on foreign retail investments in China.

- New planning regulations in Japan limit the size of suburban retail development.

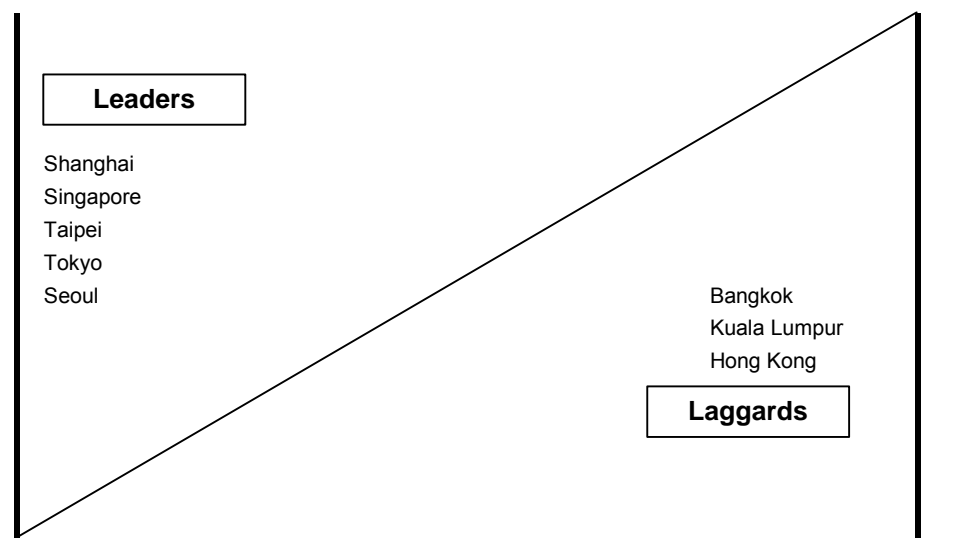
### Constraints

- Political instability in Thailand deters tourists and investors.
- Macroeconomic factors that could constrain growth include higher interest rates, oil price spikes, and slower demand for Asian exports.

### Implications: Timing of changes

- With the exception of Hong Kong, most of the Mature Asian Markets are well positioned in their growth phases through the rest of the decade.
- With the exception of Bangkok, retail demand looks positive across most Asian markets in the near term. On the supply side, Hong Kong, Beijing, and Kuala Lumpur are the markets coping with near-term construction spikes.

### Retail Leaders/Laggards



Source: RREEF Research

Forecast

		YE 2006	2007	2008	2009	2010	2011
Emerging Markets	Stage	Growth	Growth	Growth	Post Growth	Post Growth	Growth
	Rent Momentum	Increase+	Increase	Increase	Stable	Stable	Increase
Beijing	Stage	Growth	Post Growth	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Increase	Decrease	Stable	Stable	Stable	Increase+
Shanghai	Stage	Growth	Growth	Growth	Growth	Growth	Post Growth
	Rent Momentum	Increase+	Increase+	Increase+	Increase+	Increase+	Increase
Kuala Lumpur	Stage	Post Growth	Contraction	Recovery	Recovery	Recovery	Recovery
	Rent Momentum	Stable	Decrease	Stable	Stable	Stable	Stable
Bangkok	Stage	Post Growth	Contraction	Recovery	Recovery	Recovery	Recovery
	Rent Momentum	Increase	Decrease	Stable	Stable	Stable	Stable
Taipei	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase+	Increase	Increase	Increase	Increase	Increase

Mature Markets	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase+	Increase	Increase	Increase	Increase	Increase
Hong Kong	Stage	Growth	Post Growth	Contraction	Recovery	Recovery	Growth
	Rent Momentum	Increase+	Stable	Decrease	Stable	Increase	Increase+
Seoul	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Stable	Increase	Increase	Increase	Increase	Increase
Tokyo	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
Singapore	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase	Increase+	Increase	Increase	Increase	Increase
Sydney	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase+	Increase	Increase	Increase	Increase	Increase
Melbourne	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase

Source: RREEF Research

## Property Cycle Monitor: Industrial

A milder than expected downturn in the global economy in 2007 bodes well for the Asian warehousing and logistics sector. The recent and continuing strong pace of growth means the outlook for the Asian warehouse and logistics market remains positive. The region's strong and growing manufacturing base and its vigorous export activity help boost demand while a relative shortage of good quality supply provides a constraining effect. The result is a robust outlook for rental growth in the short and medium term across most markets. Demand for distribution and logistics is strong throughout Asia with important warehouse and logistic hubs centred on the region's largest seaports and the airports in Hong Kong, Singapore, Shanghai, and Tokyo.

Most of the **Mature Asian Markets** have moved (or are close to moving) from the recovery to the growth phase of their industrial property market cycles. Tokyo is well into its growth phase, with rising rents and solid demand for distribution space. Developers – both domestic and foreign – are actively delivering build-to-suit and speculative distribution properties, according to CBRE.<sup>2</sup> Capital is flowing into Japan's industrial property market, and Tokyo's industrial rents are forecast to rise by 3.0-3.5% pa through the remainder of the decade.

*As Asia's gateways for world trade, booming port cities like Singapore...*

Singapore's industrial property market is booming. Of the 11 Asian markets in RREEF's forecast, Singapore is the only one in which the five-year rent forecast averages at least 10% pa. New supply is limited, as the government controls the release of new land parcels for industrial development. Tight supplies of office space in Singapore have forced some companies to opt for high-tech properties as an alternative and this has further tightened the broader industrial market. While it poses no immediate competitive threat to Singapore, Malaysia's long-term plans to boost investment in Johor (across the Strait) will be a development to monitor over the long-term.

*...Hong Kong...*

Hong Kong's industrial fundamentals are robust. As one of the world's major ports and a re-export gateway for China's rapidly expanding economy, demand for industrial space from major retailers and logistics providers holds steady despite Hong Kong's high costs. New industrial supply has been limited. Rents surged more than 12% in 2006 and should settle to an average growth rate of nearly 5% pa over the 2007-2011 forecast period.

Seoul and Australia's main industrial markets in Sydney and Melbourne are transitioning from the recovery stage of their cycles into the growth phase. Rental growth for industrial properties in these markets should check in at 2% or less this year.

*...and Shanghai are all experiencing rising rents in their industrial property markets.*

Among the **Emerging Asian Markets**, Shanghai's industrial property market is one of the most robust. Rents rose nearly 16% in 2006 and should rise another 12% this year. Double-digit rental growth should last until the end of the decade. New government policies on the transfer of industrial land, a fast-expanding tenant market, surging international trade, and its status as the leading city in the Yangtze River Delta (YRD) have all converged to make Shanghai's industrial property market one of Asia's most dynamic in 2007. In Beijing – the national administrative capital – rents are about half that of Shanghai (US\$54 psm pa vs. US\$104 psm pa). Beijing's rental growth should average over 7% pa during the next five years – well ahead of most other Asian cities, though still short of Shanghai's forecast.

Bangkok, Kuala Lumpur, and Taipei are at various stages of recovery and growth in their industrial market cycles. Of the three countries, Malaysia's economy is currently expanding the fastest, and it is more progressed into the growth phase of its industrial cycle. Taiwan's export-oriented economy is forecast to accelerate over the forecast period. This should give the industrial market – which is transitioning from recovery to a growth

<sup>2</sup> CBRE Research, "Asian Industrial Property Market Flash, Q1 2007," p. 2.

phase this year – an additional boost. Rental growth will average 2.5% this year, rising to 3.5% pa by the end of the decade. Bangkok's industrial market is still teetering in a recovery mode. Thailand's GDP will rise just 3% this year – far short of the 6.8% weighted average rate of growth in Emerging Asia. In addition to recent political instability that has disrupted the economy, Bangkok's new US\$3.7 billion Suvarnabhumi Airport which opened in late 2006 has been beset by operational problems that have affected air logistics. As the Thai economy revives, the Bangkok industrial market will follow, though its recovery phase will probably stretch longer than most.

Industrial Market Cycle							
Emerging Markets		Forecast Years					
	YE06	YE07	YE08	YE09	YE10	YE11	
	GRW	PGW	GRW	PGW	GRW	PGW	
	REC	CON	GRW	PGW	GRW	PGW	
GDP Growth*	9.4%		8.5%	8.1%	7.6%	7.5%	7.3%
Industrial Production Growth **	11.0%		9.9%	8.9%	7.9%	7.5%	7.50%
Rent Momentum	Increase +		Increase +	Increase +	Increase +	Increase	Increase

Mature Markets		Forecast Years					
	YE06	YE07	YE08	YE09	YE10	YE11	
	GRW	PGW	GRW	PGW	GRW	PGW	
	REC	CON	GRW	PGW	GRW	PGW	
GDP Growth*	2.9%		2.5%	3.1%	2.5%	3.0%	3.0%
Industrial Production Growth **	4.5%		3.5%	2.5%	2.5%	2.1%	1.80%
Rent Momentum	Increase		Increase	Increase	Increase	Increase	Increase

\* Weighted by the size of GDP at the national level in US dollar  
\*\* Weighted by the size of GDP at the national level in US dollar, and data is not available for Hong Kong

**Key:** REC = Recovery GRW = Growth PGW = Post Growth CON = Contraction

Source: RREEF Research, Deutsche Bank Research, and Global Insight

## Industrial Sector Outlook

### Drivers

- Double-digit industrial production growth in China boosts major logistics markets, including Shanghai, Beijing, and Hong Kong.
- Limited supplies of industrial land – whether government controlled (Shanghai, Beijing, Singapore) or more market oriented land constraints (Tokyo, Hong Kong) – buoy rental growth in major markets.
- Lack of good quality warehouse and logistic centres will push rental values upwards in most cities.

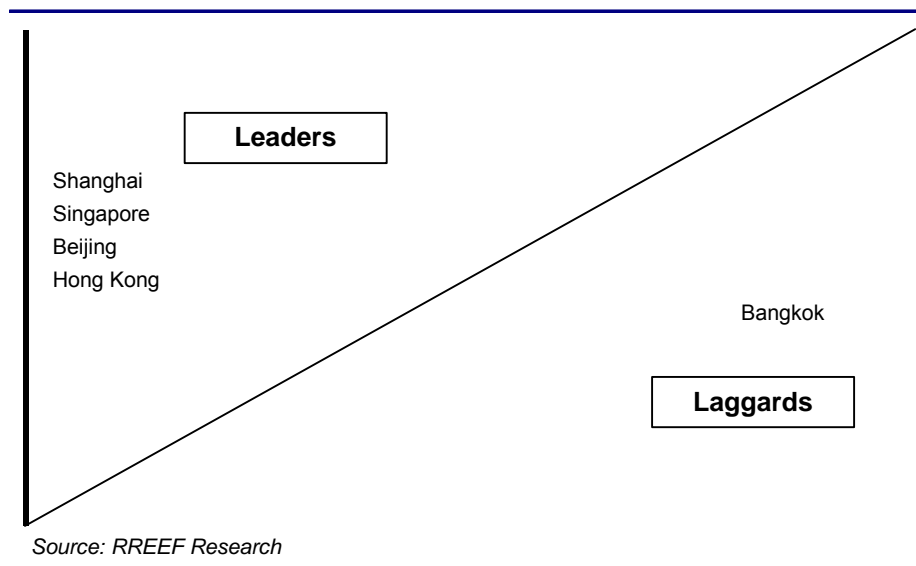
### Constraints

- An unexpected slowdown in the global economy could moderate potential rental growth across the region's export-oriented economies.
- At a time when the Japanese government is under pressure to raise interest rates, a surge of foreign capital into the Japanese industrial market could squeeze cap rates and limit spreads to unacceptable levels.

### Implications: Timing of changes

- Severe operational constraints and high costs in major logistics markets could force activity to secondary locations.
- Asian industrial markets are in either growth or recovery phases in 2007. The growth phase is expected to hold across almost all markets until late in the decade.

### Industrial Leaders/Laggards



**Forecast**

		YE 2006	2007	2008	2009	2010	2011
Emerging Markets	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase+	Increase+	Increase+	Increase+	Increase	Increase
Beijing	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase	Increase+	Increase+	Increase+	Increase+	Increase+
Shanghai	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase+	Increase+	Increase+	Increase+	Increase+	Increase+
Kuala Lumpur	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
Bangkok	Stage	Recovery	Recovery	Recovery	Recovery	Recovery	Recovery
	Rent Momentum	Increase	Stable	Stable	Stable	Stable	Stable
Taipei	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Stable	Increase	Increase	Increase	Increase	Increase

Mature Markets	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
Hong Kong	Stage	Growth	Growth	Growth	Growth	Post Growth	Post Growth
	Rent Momentum	Increase+	Increase+	Increase+	Increase+	Increase	Increase
Seoul	Stage	Recovery	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Stable	Increase	Increase	Increase	Increase	Increase
Tokyo	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase	Increase	Increase	Increase	Increase	Increase
Singapore	Stage	Growth	Growth	Growth	Growth	Growth	Growth
	Rent Momentum	Increase	Increase+	Increase+	Increase+	Increase+	Increase+
Sydney	Stage	Recovery	Recovery	Growth	Growth	Growth	Post Growth
	Rent Momentum	Stable	Stable	Increase	Increase+	Increase	Stable
Melbourne	Stage	Recovery	Recovery	Growth	Growth	Post Growth	Post Growth
	Rent Momentum	Stable	Stable	Increase	Increase	Increase	Stable

Source: RREEF Research

## Appendix

*Existence of property cycles facilitates forecasting but...*

The existence of property cycles provides an opportunity to forecast performance based on fundamental demand and supply drivers. As with other regions, our forecasting process in Asia Pacific is based on a thorough “top-down” and “bottom-up” approach. However, data limitations and the immaturity of many markets means less reliance can be placed on econometric techniques than in the more mature markets of the US and Europe.

*.... data limitations and market immaturity reduces reliance on econometric techniques*

In addition to the limited amount of consistent, reliable market information and the low level of market maturity, the fundamental structural changes occurring in many markets also limit the relevance of econometric techniques. For these reasons, our top-down approach is based on a combination of quantitative and qualitative assessments to provide an initial projection of demand and supply drivers, vacancies and rents.

These top-down forecasts are discussed in detail with our local experts and advisors to arrive at a well-grounded “real world” view of market prospects. Such a “real world”, rather than a purely “econometric” approach, is entirely appropriate for these opaque and less mature markets. The systematic analysis of the fundamental drivers of performance for such markets produces a series of forecasts which are helpful in understanding broad trends in relative performance.

*Individual forecasts for 17 cities for the office sector and 11 cities for the retail and industrial sectors*

The analysis reveals that different cycles pervade across geographies in terms of degree and timing. These reflect the economic fundamentals driving demand and specific supply characteristics at the local level. This Asia Pacific Property Cycle Monitor includes forecasts for 17 cities across 10 countries in the region in the office property sector and 11 cities in each of the retail and industrial sectors. These markets are classified according to their respective stages in the cycle and their prospects over the coming four years.

*Two distinct cycles in Asia-Pacific across “mature” and “emerging” markets*

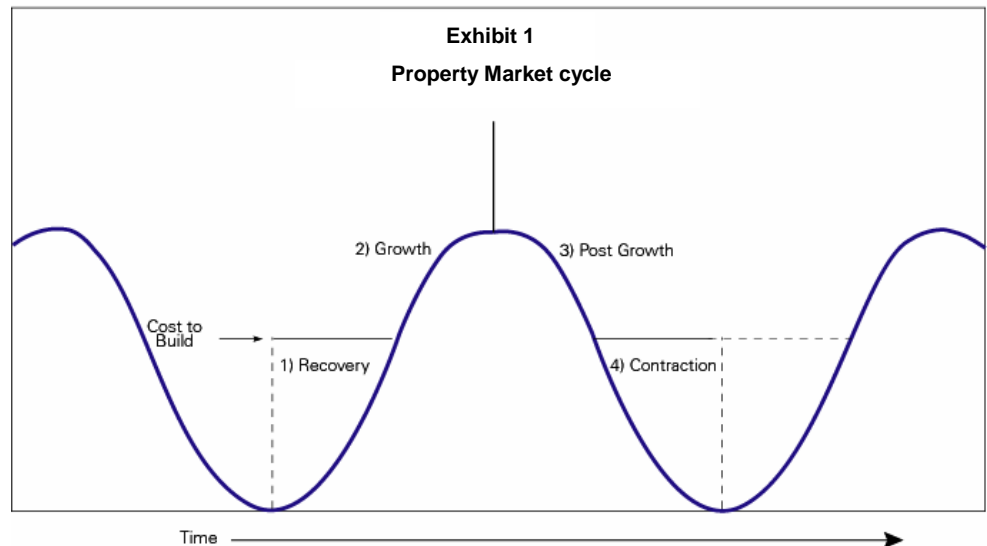
In our European Property Cycle Monitor, geographic location is the main criteria used in distinguishing broad trends in market performance, with significant differences being experienced in “Western” and “Central/Eastern” Europe. In Asia-Pacific, this approach is less suitable given the wider range in levels of market maturity across the region. As a consequence, we distinguish broad trends in performance according to the level of market maturity rather than geography.

On this basis, the “Mature Asian Markets” group covers Australia, Hong Kong, Singapore, South Korea and Japan. It is clear that South Korea and Japan fall well short of the other markets in terms of their maturity, but recent changes in both markets and improvements in the institutional environment mean they are more similar to the “Mature” markets than the “Emerging” ones across the rest of the region. In contrast, China, India, Malaysia, Taiwan and Thailand are clearly emerging markets and their behaviour, as well as the confidence that can be placed on any forecasts, need to be distinguished from the Mature group.

Given the different levels of economic maturity in Asia Pacific, two distinct market cycles are apparent. A separate cycle and overview is presented for mature and for emerging markets, together with an economic overview of the current and future prospects for each market.

## Classifying the markets

Each property sector has a clearly identifiable cycle with four main phases: Recovery, Growth, Post Growth and Contraction (see Exhibit 1). The office market has the greatest volatility of the three main commercial sectors. The retail and industrial sectors are less volatile due to the relatively high levels of owner-occupation with less investment activity and limited modern supply, particularly in the industrial sector.



Source: RREEF Research

### Property market cycle

#### Stages

- 1) Recovery
- 2) Growth
- 3) Post Growth
- 4) Contraction

#### General conditions

- High but declining vacancy rates – stable to rising rents
- Low and declining vacancy rates – rising rents supportive of construction
- Low but increasing vacancy rates – rising/flattening rents
- High or increasing vacancy rates – falling rents

The position in the property market cycle is based on a combination of factors including the vacancy rate relative to the individual market's historical average, change in vacancy rate and rate of rental growth. It is important to recognize that our analysis is based on movements in "headline" prime rents as data limitations prevent the systematic comparison of effective rents across markets. In general terms, effective rents will lead the recovery of headline rents, as a reduction in incentives tends to occur a number of months ahead of any movement in headline rents.

### Rent Momentum

In addition to its stage in the cycle, a "rent momentum" category is assigned to each of the markets for every year of the forecast period. This rent momentum, which helps establish the rate of growth at different stages of recovery, is based on the typology displayed in Exhibit 2. It is intended to show the general momentum behind potential changes in rent, not an absolute variation in rates.

---

**Exhibit 2 Rent categories and the property cycle**
**Offices**

Momentum Category	Cycle Stage			
	Contraction	Recovery	Growth	Post Growth
Increase+		√	√	
Increase		√	√	√
None	√	√		√
Decrease	√			
Decrease+	√			

**Shopping Centres**

Momentum Category	Cycle Stage			
	Contraction	Recovery	Growth	Post Growth
Increase+			√	
Increase		√	√	√
None		√		√
Decrease				
Decrease+	√			

**Industrial**

Momentum Category	Cycle Stage			
	Contraction	Recovery	Growth	Post Growth
Increase+			√	
Increase		√	√	√
None	√	√		√
Decrease	√			
Decrease+	√			

*Source: RREEF Research*

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ANALYST CERTIFICATION

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst. In addition, the undersigned lead analyst has not and will not receive any compensation for providing a specific recommendation or view in this report.

(Signed) Peter Hobbs

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