

AEW RESEARCH

ASIA PACIFIC
MARKET PERSPECTIVE

Q2 2017



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Chinese economic growth has surprised to the upside so far this year.

General Economic Overview

In its July update, the IMF noted that the pick up in global growth anticipated in their April outlook remains on track. Global growth is projected to be 3.5% in 2017 and 3.6% in 2018, a reasonable pick up from the 3.2% expansion in 2016. The outlook is unchanged from the April edition. While they slightly revised down U.S. growth on the view that fiscal policy will be less expansionary than previously anticipated, growth has been revised up for Japan, China and the ASEAN-5 nations (Indonesia, Malaysia, Philippines, Thailand and Vietnam).

World trade volume has improved, and projections indicate global trade volume growth of 3.8% to 4.0% over 2017 and 2018. Regional PMI surveys indicate continued strength in the manufacturing sector, linked to the positive trade flow growth.

Chinese economic growth has surprised to the upside so far this year with Q2 growth of 6.9%. The global trade pick up was a factor in this, but internal conditions have been a key driver. Strong real wage growth and a resilient labor market along with high government spending are lifting household living standards and feeding through to robust spending. Household consumption is forecast to increase by 7.5% this year, outstripping GDP and fixed investment growth, as it has done for several years.

Since November 2016, China's retail sales have ranged between 10.5% and 11% year-on-year, with June growth 11% year-on-year. China's housing market held up better than expected with most of the activity concentrated in smaller cities where policy remains accommodative. Monetary policy across the region remains broadly accommodative. While the U.S. Federal Fund Target Rate increased 50 basis points this year, most central banks in Asia continue to keep their policy loose. CPI inflation pressure remains muted as is throughout PPI inflation. The Bank of Korea (BOK) kept its policy rate at a historically low 1.25% in July. Inflation and consumer confidence have been low in recent months, reflecting political uncertainty that is now largely resolved. That said, forecasts are for the BOK to remain in an accommodative stance through this year and most likely all of next year.

Consumer inflation in Australia has been under the Reserve Bank of Australia's (RBA) 2% to 3% target and there is considerable spare capacity in the economy, particularly in the labor market. As a result there is little reason the bank will lift its policy rate from the current 1.5% for some time ahead.

As expected the Monetary Authority of Singapore (MAS) kept its neutral policy stance unchanged in the April policy statement. MAS Core Inflation is likely to rise gradually and demand-driven inflationary pressures are expected to be restrained. The statement indicated the current neutral policy stance is anticipated to be appropriate for an extended period.

During the course of the year there has been a general strengthen of several key currencies against the USD. There was some AUD weakness in March and April but since May it has appreciated to be about 9% higher than the start of the year to end July. Similarly, the CNY has been stronger from mid-May to end July. The SGD steadily appreciated over the first seven months while the KRW has exhibited its more volatile nature but has generally showed a similar appreciating trend. The HKD countered these trends though, moving from the lower end of its band, 7.75 HKDUSD, to close near the upper limit of 7.85.

The major office markets in the region continue to be well balanced.

Property Market

The major office markets in the region continue to be well balanced. The recent pick up in overall economic activity and upward revisions to the near-term outlook will likely feed through into additional confidence for a number of key occupier categories. Expansion demand is expected to remain muted for the time being in all but a few markets. However, with improved macro conditions landlords should be able to achieve higher rents upon lease expiry, depending on the local supply cycle.

Office net absorption in several of the regions key gateway markets dipped slightly over the quarter, to just under one million square feet. However, with a strong first quarter, first half net demand was greater in 2017 than 2016. In addition, supply slowed during the second quarter to the lowest it has been since March 2016. The average vacancy rate of several of the regions key gateway markets was broadly unchanged at around 8.3%. Rents continue to grow, up on average 1.2% quarter-on-quarter, and 5.2% year-on-year. Estimates of capital values are growing in excess of rental growth and yields gradually fell over the quarter, led by Sydney CBD and Hong Kong where a recent, rare, land sale re-rated valuations.

In the retail sector, the trend is mixed. Markets such as Hong Kong and Singapore are being supported by tourist arrivals, and while both have seen a pick up in headline retail sales, Hong Kong has the better domestic consumption support. Some well-located malls in Shanghai are able to increase rents but operator experience is fundamental to outperformance in a challenging market. Rents are stable in Sydney and Melbourne where demand from F&B operators have provided support. Negative rental reversions are being reported by many institutional landlords as contractual escalations have exceeded market rental growth during the lease term.

Tightening measures in the Greater China residential sector remained in the spotlight. In Hong Kong, the 15% stamp duty levy was extended to first-time buyers of multiple properties and some financing criteria for developers and select homebuyers were tightened. In China, new policy measures were rolled out and/or existing restrictions adjusted in many cities during the quarter. In Singapore, sales transactions in the prime districts are likely to show further gains from last year, reflecting healthier levels of demand and a return of confidence.

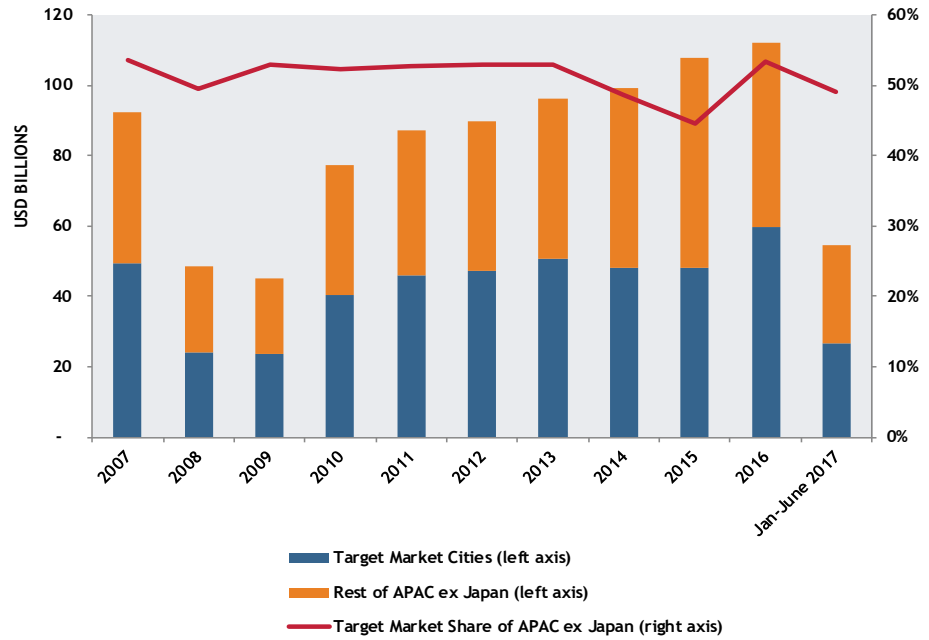
Investment demand remains very strong. The extended low interest rate environment that has prevailed for many years is providing dual support to real estate. Global capital is attracted to property's income return in excess of long government bonds. In addition, low interest rates have kept debt financing costs low, making debt accretive.

The largest non-development site sale during the quarter was a suburban mall in Singapore, Jurong Point (\$1.59 billion, \$2,415 per square foot, 4.2% yield). The transaction was highly competitive with local insurance firm NTUC Income ultimately being the chosen to be the purchaser.

Following Jurong Point, the next largest sale was Hana Bank HQ in Seoul's CBD for \$803 million, \$998 per square foot. The asset transacted between two domestic investors. It was sold by Hana Group, a domestic financial institution, to a local investor, Booyoung Group.

Lastly, in Sydney's CBD, two 25% interests in MLC Center were purchased by Australian-based investor Dexus-controlled entities for about \$534 million, \$1,350 per square foot, 4.7% yield.

GATEWAY MARKET TRANSACTION VOLUME



Source: RCA

Hong Kong

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	1.9%	↑	↑	↓	↔	↓
Retail (Shopping Center)	1.8%	↑	↓	↑	↑	↔
Residential	3.8% ^A	↑ ^A	↑	↑ ^A	↑ ^A	↓

^A As at December 2016, the latest period reported

Source: JLL, Hong Kong Rating and Valuation Department

Note: For the vacancy rate, rents and cap rates the arrows reflect the trend for the current quarter compared with the comparable quarter one year earlier. For absorption and completions the arrows reflect the 12-months through to Q2 2017 trend compared with the 12 months through to end Q2 2016. For vacancy rates, a down arrow indicates declining vacancy rates or an improvement in market fundamentals. For cap rates, a down arrow indicates lower cap rates.

Goods export growth moderated in April and May, after a strong pick up in Q1. However, it is expected this will be partly offset by improving services exports underpinned by stabilizing retail and tourism sector performance, and strong financial markets. Private sector business conditions improved in Q2, with the PMI trending higher.

Domestic demand remains buoyant and is likely to maintain solid momentum throughout the rest of the year. In particular, private consumption should grow steadily in the second half of the year as firmer asset prices this year have boosted consumer confidence, while a strong labor market is also providing support.

Full-year GDP growth is forecast to be 2.8%, an improvement on the 2.0% growth in 2016. Hong Kong's economy will be helped by improving external demand and a solid labor market, which will boost consumption. Positive real income growth and stable asset prices should both support household spending.

On July 1, Carrie Lam was sworn in by China's President as the new leader of the Special Administrative Region (and its first female leader). Lam has launched a HKD 5 billion education policy package and taken measures to soothe executive-legislature relations. She has pledged to focus more on growth over other controversial political issues.

The sustained weakness in HKD (July 14, 7.82 HKD-USD) since the beginning of this year has been driven by a widening interest rate gap with the U.S. As the Fed has been raising its policy rates, interest rates in Hong Kong have actually fallen. This is because of ample domestic liquidity in the interbank market keeping the HIBOR low and creating the differential.

So far, the currency has moved within the policy band, 7.75 – 7.85 HKD-USD. However, should it start to push the weak/lower limit (7.85), the Hong Kong Monetary Authority will be required to intervene and support the HKD by buying the currency. This runs the risk of an increase in interest rates and subsequent negative impact on asset prices. However, forecasts are for the HKD to end the year at 7.80 to the USD.

Occupier demand in the city's office market gathered momentum during the quarter, with the number of new lettings up 4.5% quarter-on-quarter. Pre-commitments amounted to about 191,000 square feet as an increasing number of MNCs sought out more cost-effective options, especially beyond Central. Upcoming buildings in core office areas outside of Central, namely

The high price of the Murray Road carpark sale mentioned last quarter, effectively a rare Central land sale, repriced valuations.

Lee Garden Three in Causeway Bay and Atelier K11 in Tsim Sha Tsui secured a total of about 162,000 square feet of pre-commitments. Leasing demand in Central was largely supported by banking and finance tenants and was concentrated in the top-end of the market. During the quarter PRC tenants remained a major source of demand, accounting for 63% of new lettings in terms of floor area.

There was no new construction over the quarter, similar to Q1. Although the preleasing market was active, these commitments will not be reflected until the new construction is completed later in the year. As a result, overall net demand was negative. Part of this contraction in occupied space is due to the withdrawal of Cornwall House (234,000 square feet) in Hong Kong East in conjunction with a redevelopment of the area.

Office rents continued to grow, led by Central up 1.5% quarter-on-quarter. The high price of the Murray Road carpark sale mentioned last quarter (HKD 50,500 per square foot, USD 6,500 per square foot), effectively a rare Central land sale, repriced valuations. Capital values were up 10% quarter-on-quarter and yields were down from about 3.1% to 2.9% in Central.

Hong Kong retail sales were flat in June, rising a mild 0.1% year-on-year. This marks the fourth month of stability or growth after sales started to contract back in Q1 2015. With supportive domestic conditions, forecasts are for retail sales to continue to pick up over 2017, growing 1.7% over the full year. This momentum is anticipated to continue into 2018 with growth of 4.2%. Also supporting the retail sector is a recovery in inbound tourism, with visitor arrivals increasing 2.4% year-on-year in April and May.

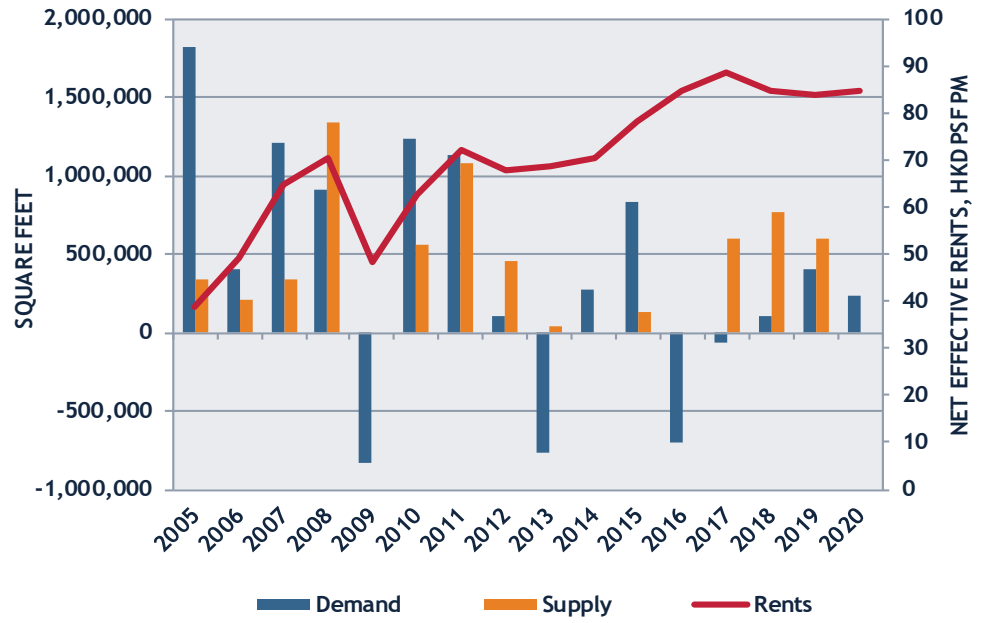
The improvement in retail sales drew retailers back to the market, especially offshore brands from Japan, Korea and Taiwan. Net absorption in prime shopping centers was a positive 113,000 square feet in Q2, an improvement on the net loss of almost 3,000 square feet a quarter earlier. Reports are a number of retailers have resumed their expansion plans. In addition, F&B operators remain active with new store openings and lifestyle and entertainment retailers continue to expand.

Shopping center rents were flat over the quarter, declining by a very small 0.3%, bringing the year-on-year change to a fall of 1.6%. High street rents continued to fall at a faster rate, down 2.7% quarter-on-quarter, a slight improvement on the 3.7% decline over Q1. Year-to-date high street rents are down 6.4%. The forecast is for high street rental declines to continue to moderate, with a full year decrease of 8% (they fell 18% in 2016). Thereafter, they are forecast to gradually recover over the next several years.

The Hong Kong residential sector remains strong. Chinese developers have shown an increased appetite for development sites, securing a number of land sales recently. Pricing continues to grow, up 5% over the second quarter. Hong Kong is flush with liquidity, and banks are being highly competitive in the mortgage market and not raising borrowing costs as might have been expected.

On a rolling twelve months, excluding land sales, Hong Kong's transaction volume as of the end of June was up 11%. This is an improvement on the Q1 7% decline on the same basis. Office sales were lower but volumes were supported by strong activity in the retail, apartment and hotel sectors. Significant sales during the quarter included a partner buyout of a partial interest (20%) in the InterContinental Hong Kong.

HONG KONG ISLAND DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

Singapore

KEY REAL ESTATE INDICATORS

	VACANCY RATE	RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	6.8%	↑	↓	↑	↔
Retail (Shopping Center)	3.6%	↑	↓	↑	↔
Residential	8.1%	↓	↓	↑	↔

Source: JLL, Singapore Urban Redevelopment Authority

Note: For the vacancy rate, rents and cap rates the arrows reflect the trend for the current quarter compared with the comparable quarter one year earlier. For absorption and completions the arrows reflect the 12-months through to Q2 2017 trend compared with the 12 months through to end Q2 2016. For vacancy rates, a down arrow indicates declining vacancy rates or an improvement in market fundamentals. For cap rates, a down arrow indicates lower cap rates.

Singapore's economy has responded positively to the coordinated pick up in global growth and world trade. Projections indicate world trade growth to be 3.8% to 4.0% per annum over 2017 and 2018. This is good for Singapore's economy, which is small, open and highly dependent on global trade activity.

In Q2 2017 Singapore's economic growth was 2.9% year-on-year, an increase on the 2.5% in Q1. On a quarterly basis, the economy expanded 0.6% compared to a 1.9% contraction in Q1. Forecasts are for externally orientated sectors such as manufacturing and export-dependent service sectors to outperform domestic focused sectors. Positively, non-oil domestic export volumes picked up strongly in June while regional PMI surveys for the same month continued to point to reasonable demand.

External demand may be inconsistent as exports ease back during the second half of the year, moderating from the strong start to the year, but they should continue to be positive for the economy. Forecasts are for full year GDP growth of 2.7% this year, rising to 3.4% next year.

Office demand is building in the CBD. For example, slightly over half of the deals done by JLL were for expansion and/or relocation purposes in the CBD. This was an improvement over the first quarter when slightly over a third of the deals were for such purpose. Office demand has been broad-based, as an oil and gas company signed up for space in Marina One (1,880,000 square feet), whose completion was delayed to the third quarter 2017, and a number of smaller tenants signed up for space in the newly renovated UIC Building (285,000 square feet). As of the end of Q2 2017, pre-commitments in both Marina One and UIC Building were around 60%.

After excluding the vacant space in the newly completed UIC Building, the vacancy rate in the core submarkets of Marina Bay, Raffles Place and Shenton Way decreased over the quarter and range from 2.8% to 10.4% (later is Shenton Way which has a vacancy rate of 13% when the new construction is included). In the Marina submarket, the vacancy rate rose slightly too, from 3.2% to 4.9%.

As pre-leasing of new supply has progressed above expectations, demand forecasts have risen. Rental declines have been easing over the past several quarters and rents were essential flat during Q1 (0.7% quarter-on-quarter). After falling 20% from their March 2015 peak, no further declines are anticipated. The current outlook is for rents to be up 2% for the full year. This suggests they will have increased more than 3% from their Q1 trough.

Singapore investment volumes (excluding land sales) were up 5% on a 12-month rolling basis in the second quarter.

There continues to be steep competition among retailers to drive sales in an environment where consumers remain cautious with their spending and e-commerce is rising. In particular, the value of location is being recognized, with retailers focusing expansion or relocation activity on shopping centers in key locations, adjacent to major transport hubs, or newer malls that are attracting higher foot traffic.

The short- and medium-term outlook continues to be dominated by retailers' ability to respond to a greater share of sales going through online platforms. As this structural change takes place it is likely near-term vacancy rates will be higher than long-term historic averages. In the medium-term though, as retailers adopt, these rates could ease.

Demand was good over the quarter, with positive net absorption. There was a limited amount of new construction with Downtown Gallery in the CBD the only new addition. This retail podium to an office tower has a commitment rate of about 85% and is focused on being a lifestyle, wellness and technology destination for downtown workers.

Reflecting the overall challenging retail market, Q2 rents continued to moderately decline. Landlords are reportedly looking to secure renewals ahead of expiry in order to avoid vacancy in a leasing market they continue to expect to be competitive.

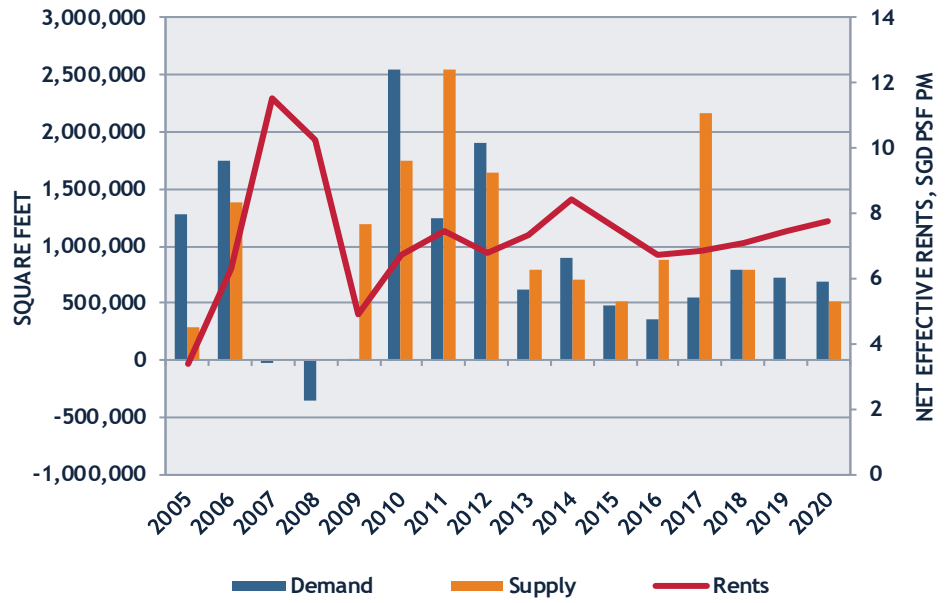
The pick up in residential sales volume continues, and sentiment is improving. That said overall pricing remains weak. Pricing has steadily fallen since the end of 2013, and the, albeit mild, decrease of 0.1% marks the fifteenth consecutive quarterly decline. The Q2 result is also the slowest rate of decline since pricing peaked. Expectations are the large majority of the price correction is now over. Land sales also indicate developers are looking for the market to start to recover. Recent suburban sites have gone to auction and with strong bidding transacted at record prices per square foot.

Singapore investment volumes (excluding land sales) were up 5% on a 12-month rolling basis in the second quarter. Although not included in this increase, the largest single transaction was the CBD Central Boulevard land sale, \$2.06 billion.

The largest income-producing sale was a prime suburban shopping center, Jurong Point, located in the west of the country. It sold in a very competitive bidding process for approximately \$1.59 billion, \$2,415 per square foot, 4.2% yield to Singaporean institutional investor NTUC Income (an insurance society).

Also of note was the sale of a 50% interest in One George Street, a grade A CBD office building. CapitaCommerical Trust, a listed REIT, sold the interest to FWD Group, the insurance business of Pacific Century Group, a Hong Kong investment group. The sale values the full asset at \$846 million, \$1,890 per square foot with 3.2% yield.

SINGAPORE CBD DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

Seoul

KEY REAL ESTATE INDICATORS

	VACANCY RATE	RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (Overall)	11.2%	↓	↑	↑	↔
Office (CBD)	14.4%	↑	↑	↔	↔
Office (Yeouido)	16.1%	↑	↔	↔	↔
Office (Gangnam)	4.8%	↓	↑	↑	↔

Source: JLL

Note: For the vacancy rate, rents and cap rates the arrows reflect the trend for the current quarter compared with the comparable quarter one year earlier. For absorption and completions the arrows reflect the 12-months through to Q2 2017 trend compared with the 12 months through to end Q2 2016. For vacancy rates, a down arrow indicates declining vacancy rates or an improvement in market fundamentals. For cap rates, a down arrow indicates lower cap rates.

Preliminary Q2 results indicate that the Korean economy grew about 0.6% quarter-on-quarter, slightly down from the 1.1% quarter-on-quarter growth in Q1. On a year-on-year basis, growth was 2.7% in Q2. A breakdown of GDP by component showed investment growth had a sharp slowdown, while private consumption and government spending were both higher.

Looking forward, growth is forecast to continue to hold up well. Solid global growth and a pick up in world trade are both consistent with South Korean exports doing well.

In addition, government spending is also likely to provide a boost to growth. At the end of July, parliament passed a supplementary budget, the equivalent of about 0.7% of GDP. The stimulus includes plans to create new jobs, largely in the public sector, as well as on increased welfare spending. Given the likely delays in implementation, the government has estimated that the budget will boost growth only slightly this year, with the remaining benefits to be felt in 2018. Offsetting this is an expected drag on private consumption from high levels of household debt. There is also a loss of tourist receipts as Chinese tourist arrivals have pulled back sharply in response to Korea’s decision to install the US anti-missile defense system (THAAD).

There have been no new office completions this year in the major submarkets of Seoul. Demand continues to be positive, with net absorption posting a third straight quarter of gains. This is a recovery from the previous year when demand contracted.

Net demand in the CBD would have been even stronger this quarter had it not been for a couple of tenant departures. These tenants have opted to leave grade A space for corporate owned, lower grade space. Similarly, in Yeouido tenants left grade A space for grade B stock. As a result, the overall vacancy rate increased 30 basis points to 11.2%. This is still below where it started the year, 11.8%.

While there were no completions in core districts during the quarter and very little due through to the end of the year, there is supply due next year. In Yeouido the grade A KTUC Building is on track for a Q1 2018 completion. It has been reported KTUC will owner-occupy 20% of the project with the balance of the space entering the leasing market.

In the CBD, Centropolis (403,000 square feet) is expected to complete in June 2018. In Gangnam, Gangnam N Tower (240,000 square feet) is also scheduled to enter the market next year. The building represents the first grade A building to be completed in the west end of Teheran-ro since 2011. Fundamentals are favourable in Gangnam. Parnas Tower, which was

Foreign F&B brands continued to expand during the quarter with landlords introducing well-known operators as part of a placemaking strategy for new outlets and shopping malls.

completed in Q3 2016, saw a sharp decline in vacancy over the quarter. The building reached almost 98% occupancy following the arrival of several new tenants.

Overall, net effective office rents were down slightly over the quarter, falling 1.5%. Gangnam rents were the strongest, essentially flat at 0.1% quarter-on-quarter, reflecting the districts better demand supply balance and low vacancy rate. CBD rents were down a little more than 2% quarter-on-quarter while Yeouido rents were down about 3.8% quarter-on-quarter.

In the CBD, quarterly rent declines were in five buildings, with the largest in Signature Tower, which has a pending vacancy of about 50% of GFA. As a result, the landlord increased incentives to five months per year of lease. Pending vacancies in Gran Seoul and lingering vacancy in several other buildings saw landlords raise incentives to attract occupiers. Buildings with improving or high occupancy continue to be able to gradually increase face rents and or reduce incentives.

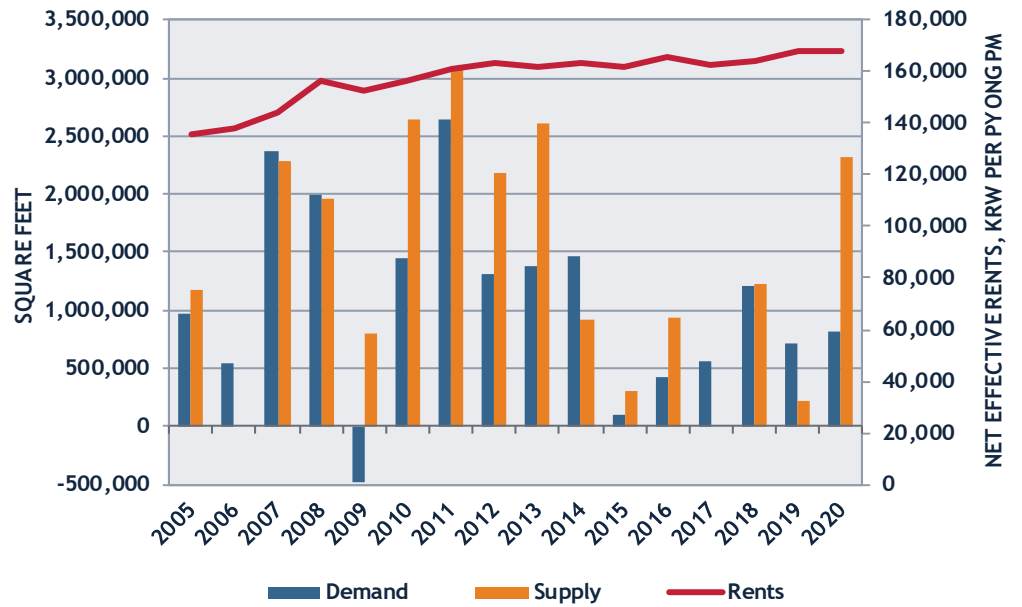
In Yeouido, a couple of buildings with the largest vacancies in the district, Three IFC and Hanwha 63 Building, reduced effective rents by about 4.5% and 5.5% during the quarter. There were also an additional five buildings that dropped their rents.

Foreign F&B brands continued to expand during the quarter with landlords introducing well-known operators as part of a placemaking strategy for new outlets and shopping malls. Three major new retail developments were completed in the quarter, two shopping centers and one department store. Upon opening, all three reported strong initial footfall. Retail rents rose during the quarter and were up on an annual basis as well.

On a twelve-month rolling basis, transaction volumes in Seoul were down slightly, 7%. This adjustment comes after a series of quarters when annual growth was very strong, averaging 30% over the Q2 2016 to Q1 2017. Year-to-date, cross border activity eased slightly and foreigners became net sellers after being net buyers 2013 to 2016. Domestic institutional investors were more active over the first half of the year and become net buyers after being sellers last year. The largest transaction during the quarter was the sale of the redeveloped KEB Hana Bank HQ in the CBD for \$803 million, \$998 per square foot. The asset was sold by Hana Group, a domestic financial institution, to a local investor, Booyoung Group.

Signature Tower was also transacted at \$648 million, \$602 per square foot. The National Pension Service is understood to have been the principle capital behind this IGIS Asset Management purchase from Singapore's Ascendas-Singbridge. It was reported that the deal included a rental guarantee to cover a significant amount of pending vacancy with a 5.5% yield.

SEOUL DEMAND, SUPPLY AND RENTAL GROWTH OUTLOOK



Source: JLL

Shanghai

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	12.4%	↑	↔	↑	↑	↔
Office (CBD - Puxi)	13.3%	↑	↔	↑	↑	↔
Office (CBD - Pudong)	11.3%	↑	↔	↑	↑	↔

Source: JLL

Note: For the vacancy rate, rents and cap rates the arrows reflect the trend for the current quarter compared with the comparable quarter one year earlier. For absorption and completions the arrows reflect the 12-months through to Q2 2017 trend compared with the 12 months through to end Q2 2016. For vacancy rates, a down arrow indicates declining vacancy rates or an improvement in market fundamentals. For cap rates, a down arrow indicates lower cap rates.

Shanghai's GDP grew 6.9% year-on-year in the first half of the year, a similar pace of expansion as with the national economy. This growth rate was better than expected according to the city statistics bureau. Secondary industry growth was 6.6%, aided by strong growth (11.2%) in six major industries (electronic information products, automobile manufacturing, petrochemical engineering, fine steel manufacturing, biological medicine manufacturing and equipment manufacturing), which are a key focus of the city's leadership. Service sector growth was 7% in the first half, which, in the context of a focus by the government to cool the property sector, is a robust result.

Demand for office space in the CBD continued to be good with net absorption of about 700,000 square feet. In addition there was another 1.7 million square feet of net take up in decentralized locations, a pick up on the first quarters 1.1 million square feet.

In Pudong's CBD, domestic financial companies continued to upgrade to new completions. Leasing activity during the first half of the year was 68% higher than the five-year average. Expectations are for activity to remain robust in the second half as companies continue to take advantage of ample supply to upgrade or expand. New projects with easy access to the metro system and better amenities will likely outperform but landlords will likely have to be lenient on rents. The vacancy rate in Pudong CBD fell from 13.1% in Q1 to 11.3% by the end of June. It spent most of 2015 and 2016 less than 10%.

In Puxi, domestic financial services companies continued to be the primary source of leasing demand. One example was the Bank of Hangzhou leasing a whole bloc in the Bund Finance Center by the Huangpu River.

Telecom, Media and Technology (TMT) firms were also active and is an industry that is rising. Examples include video game companies, such as Electronic Arts, and domestic e-commerce companies. The submarket continues to feel a certain pressure from competitive decentralized locations but support remains from financial services, professional services and the retail sector. Whereas there were no new completions during the quarter in Pudong CBD, and only two in Puxi (vacancy rose just over one percentage point to 13.3%), in the decentralized market there were ten projects that completed during the quarter. Vacancy rose from 22.5% in Q1 to 25.7% in Q2. Rents were broadly unchanged over the quarter with only minor shifts up and down of less than one percentage point.

Nationwide, retail sales growth was strong over the first six months of the year. From January to June, sales rose 10.4%. After growing 9.5% on a year-on-year basis in January and February, sales growth rose to be between 10% and 11% since March. In Shanghai, the local statistics

Co-working operators are utilizing large space in malls that have proved challenging to traditional retailers.

bureau reported improving retail sales growth. From January to June city-level retail sales rose 8.1% year-on-year, compared to 7.6% in the same period a year earlier.

The CNY appreciation and stricter customs control on international shipping have led to indications of a possible revival of the domestic luxury spending. Many high-end retailers, such as Hugo Boss, Burberry etc., have reported an improvement in domestic performance. F&B continues to be a major driver of leasing demand, particularly mass-market chains. As mentioned in previous reports, co-working operators are utilizing large space in malls that have proved challenging to traditional retailers. On top of luxury, F&B and alternative sources of demand like co-working, brands in the 'healthy lifestyle' category have also been active. In general, retailer sentiment improved over the first half of the year and is expected to continue to be strong over the coming six months.

2017 and 2018 will represent a peak of the supply cycle, with most of the construction in decentralized locations. In the city center, two high-profile projects opened during the quarter. HKRI Tai Koo opened in the West Nanjing Road submarket. Its opening occupancy was only 75% but several affordable luxury brands are set to open soon and are anticipated to drive foot traffic. Also in Puxi but further west and close to the Inner Ring Road Raffles City – Changning opened during the quarter. Raffles City is a mall brand of Singapore listed CapitaLand. This is the second Raffles City in Shanghai and it had an opening occupancy of over 90%.

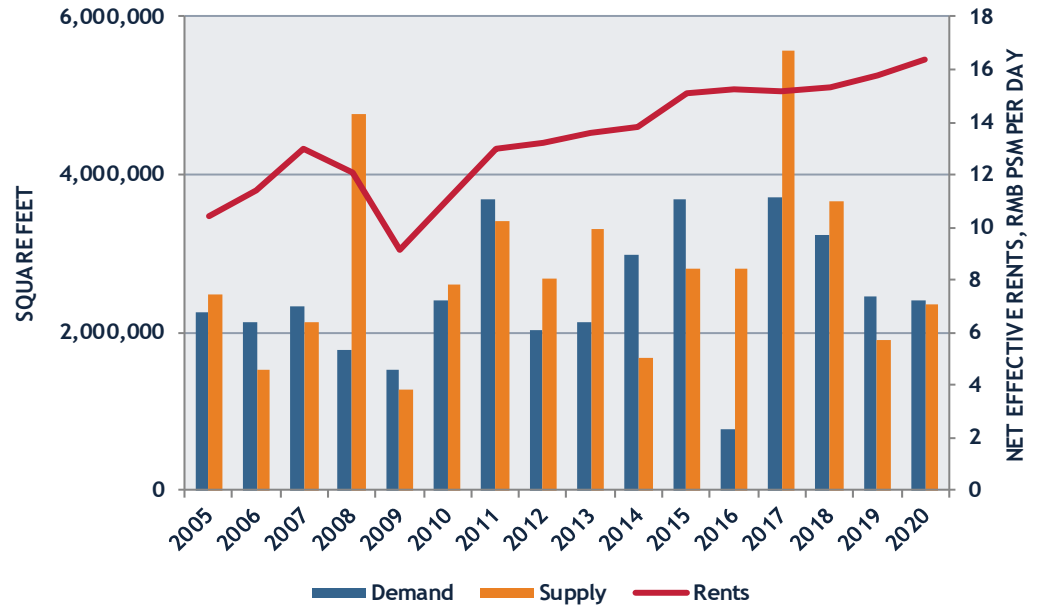
Retail rents were up modestly over the quarter. Mall operational performance is being rewarded in the current environment. In the prime market, mature properties that have established themselves as regional or city-wide destinations continue to enjoy relatively strong rental growth, lifting the sectors overall performance. This includes 'one-stop' community malls with diversified tenant mixes and large catchments.

Small-scale properties with accessibility issues, undifferentiated tenant mix and inexperienced operators are underperforming by comparison. Overall, despite the supply surge, rents will likely grow 4% to 5% per annum over the next few years.

On an annual rolling basis, transaction volumes in Shanghai have held up well, slipping only 2%. Activity in Shanghai has been very strong now for several years. Sales in the 12-months to end June 2017 are about 50% more than where they were just two years earlier. However, during the second quarter, volumes were the lowest they have been in several years, at least since 2013. This may be a result of a very strong start to the year with Q1 volumes being stronger than any previous first quarter since 2014. On-the-ground investment sentiment remains very strong and with a degree of capital controls in place, investment capital is focusing on domestic opportunities, especially in highly favorable tier I markets like Shanghai.

The largest non-development site transaction during the quarter was H88 Yue Hong Plaza, an office building, which sold for \$280 million, \$465 per square foot, estimated yield of high 4.8% to 5.0%. CLSA sold the property to local investor Everbright group.

SHANGHAI CBD DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

Sydney

KEY REAL ESTATE INDICATORS

	VACANCY RATE	RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Sydney CBD (prime)	8.1%	↓	↑	↓	↓

Source: JLL

Note: For the vacancy rate, rents and cap rates the arrows reflect the trend for the current quarter compared with the comparable quarter one year earlier. For absorption and completions the arrows reflect the 12-months through to Q2 2017 trend compared with the 12 months through to end Q2 2016. For vacancy rates, a down arrow indicates declining vacancy rates or an improvement in market fundamentals. For cap rates, a down arrow indicates lower cap rates.

Recent data from Australia are supporting the view that growth will remain steady in the short-term. The trade balance closed out the financial year to June 2017 with a \$0.9 billion surplus, confirming the view net trade will be a driver of growth this year.

In contrast, domestic demand continues to be mild. It is being held back by a moderation in residential construction activity and a continuing decline in mining sector investment. Countering this, non-mining sector investment is recovering as capacity constraints begin to appear in some sectors. Capacity utilization shifted above 80% over 2016 and continues to be high in 2017. This sustained momentum, coupled with recent business surveys, which have been positive, suggest a possible upside risk to non-mining investment.

After a strong finish in 2016 consumer spending momentum has been broadly maintained. Expectations are for consumption growth to be between 2% and 3% over the next two years, probably in the lower end of that range. Employment growth has been strong but may slow after a strong start to the year. Jobs in the labor intensive construction industry is likely to slow as residential housing activity declines. In addition, private income growth has underperformed, creating a drag on the consumption sector.

GDP growth for the full year is forecast to be about 2.5%, holding at this level in 2018 (2.4%). CPI inflation is forecast to remain in the bottom half of the RBA's 2% to 3% target range, suggesting no monetary tightening in the near term. The official cash rate is currently 1.5%, a historic low and half the 3% it fell to during the 2008 Global Financial Crisis.

Demand for CBD office space picked up over the quarter, rising to about 376,000 square feet. Professional service firms, dominated take up, followed by government. Gross leasing volume are well above historic averages, led by Barangaroo. There is a persistent demand at the top end of the market with strong net absorption due largely to tenants moving into the Barangaroo precinct. Premium vacancy is now the lowest it has been since the end of 2012 (8.1%).

Demand for secondary space (two thirds of secondary space is grade B, 25% is grade C) remains strong with the vacancy rate continuing to be well below the ten-year average, and as of June, it was 5.9%, compared to the long-term average of 8%. Net demand was negative but the result was heavily impacted by withdrawals.

A better indicator of the strength in the secondary market is the 2% quarter-on-quarter increase in net face rents, the steady reduction in incentives and the more than 4% quarter-on-quarter increase in effective rents. These quarterly increases build on previous escalations. On an annual basis, face rents are 15% higher while effective rents (after deducting incentives) are 40% higher.

Supply this quarter was dominated by withdrawals for the Sydney Metro line development. After increasing in 2016, total Sydney CBD office stock continued to fall this year. Six buildings totaling around 260,000 square feet were removed from the stocklist this quarter. Five of the six were withdrawn for the metro project. There is only one asset left to be withdrawn for the infrastructure development, 39 Martin Place that has an expected withdrawal date of Q4 2017. There was only one project completed this quarter, International House Sydney (74,000 square feet). The property is located in the Barangaroo district and is a low rise office building with small associated retail in the new mixed-used development by Lendlease.

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Investment sales in Sydney were down 9% on a 12-month rolling basis as activity pulled back slightly. Nationally, Australian investment sales were down a comparable 7%.

AEW is aware of a substantial number of assets in the sales market and full year volumes will likely continue to be strong if these complete during the second half of the year.

The combined, two 25% interests in MLC Center, Sydney CBD, that transacted during Q2 was the largest sale in the city. Dexus, a listed Australian REIT, along with a wholesale fund it controls, brought the 50% share from QIC, a Queensland state-owned investment manager. The transaction had a yield of about 4.5%.

20 Bridge Street, Stock Exchange Centre, sold to a private investor, believed to be a high net worth from Hong Kong. Investa Property Group, on behalf of Malaysia's second largest pension fund Kumpulan Wang Persaraan, sold the property for \$255 million, \$1,193 per square foot on a yield of about 4.5% (AUD 16,800 per square meter). The transaction was described in local press as setting a new record for a property of its size (approximately 214,000 square feet).

Lastly, Telstra Plaza North, a Pitt Street fronting office asset was bought by a joint venter between two Singapore based investors, ARA Asset Management and Straits Trading. The property sold for approximately \$203 million, \$648 per square foot on a yield of 6.3%. The seller was Propertylink Group, an Australian listed REIT.

For more information, please contact:

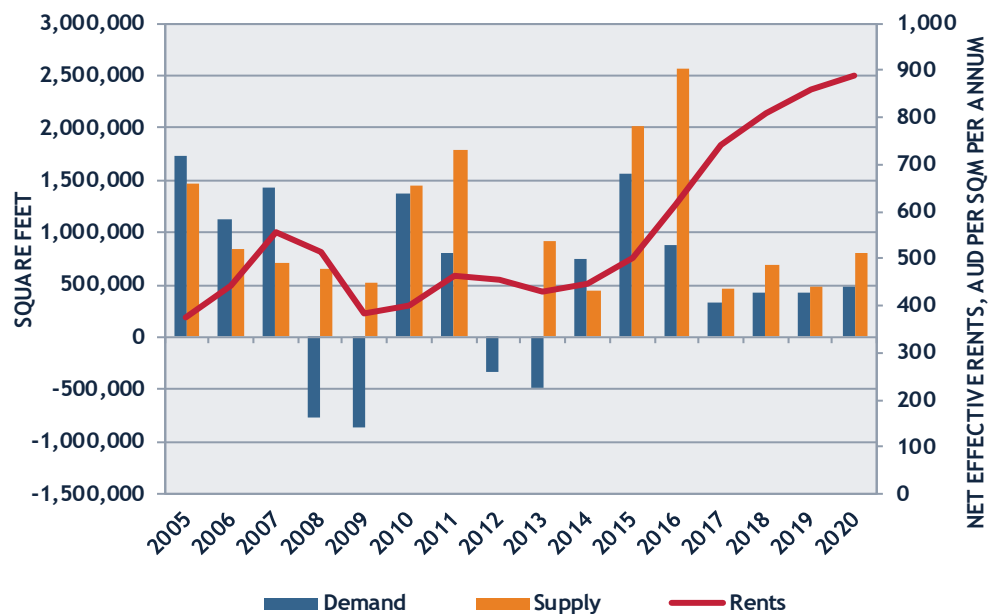


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SYDNEY CBD DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL