AEW RESEARCH

ASIA MARKET PERSPECTIVE

Q2 2016

AEW

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General Economic Overview

In their mid-year World Economic Outlook Update, the International Monetary Fund (IMF) downgraded 2016 world growth to 3.1% (from 3.2% in April's forecast) and 2017 to 3.4% (from 3.5%).

The IMF highlighted growth in the first quarter of 2016 which was in line with expectations, with better than expected Euro-area growth counterbalancing weaker U.S. growth, and stronger than expected Chinese growth. In fact the IMF stated growth was in line with April forecasts, and improvements in some large emerging markets were indicating a modest upward revision to global growth.

However, the vote by the U.K. to leave the European Union at the end of the quarter changed that view stating; "the Brexit vote implies a substantial increase in economic, political and institutional uncertainty...especially in the advanced European economies."

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In Asia, the short-term impact of Brexit is expected to be minimal. The regions gateway markets[1] are very lowly exposed to the negative consequences of Brexit. Transmission mechanisms of the Brexit fallout will primarily come via the financial markets and trade/exports. The financial market implications seem to have abated after a bout of initial volatility in reaction to the surprise factor of the result. Most regional equity markets are stronger now, when compared to prior to the vote. The USD exchange rate in many of the key gateway markets was slightly weaker over the second quarter. After a broadly flat April, most of the currencies appreciated over May, with the RMB being the exception. In June there was a stretch of local currency weakness against the USD. From the beginning to the end of the quarter the SGD was unchanged, however the RMB (3.2%), AUD (2.6%) and KRW (0.5%) were all weaker.

Since the Brexit referendum, local currencies have diverged. Both the AUD (2.3%) and KRW (4.1%) were stronger from the date of the vote to mid-August. RMB continued its weakening bias, down 0.9%, while the SGD also depreciated slightly, down 0.5%.

Following the Brexit result many forecasts predict significantly slower growth in the U.K., but not an outright recession and slightly less growth in the EU. On the face of it this could be a challenge to Asia's exporters. However, the economies of the region's gateway markets have very little direct export exposure to the U.K. The U.K. represents on average 1.5% of the respective economy's exports while the European Union is about 9.1% on average.

Beyond Brexit, world trade growth continues to be slightly below trend but recent high-frequency indicators suggest world merchandise trade may be stronger in Q2 than Q1. The export orders of leading trading economies rebounded above trend levels and continue to pick up, while air freight and container port data are showing signs of stabilizing.

The World Trade Organization forecast world merchandise growth of 2.8% in 2016, unchanged from 2015's growth rate. At these rates of growth, world trade will have grown at roughly the same rate as world GDP for five years (market exchange rates). Looking forward, world trade growth is expected to pick up in 2017 to 3.6%. Asia is expected to record the fastest export growth of any region this year at 3.4%. Next year's export growth is forecast to build on that, rising by 4%.

[1]For the purposes of this report, "key gateway markets" refer to Hong Kong, Singapore, Shanghai, Seoul, Taipei and Sydney

Export Exposure to U.K. and European Union, 2015 (%)

	EXPORT DESTINATION	U.K.	EUROPEAN UNION
EXPORT ORIGIN	Hong Kong	1.40	8.50
	Singapore	0.95	8.00
	Korea	1.40	8.80
	China	2.61	15.90
	Australia	1.48	4.40

Source: U.N. Comtrade, Oxford Economics

Most office demand is coming from domestic service companies across a range of sectors including finance, technology, and business services.

China reported steady GDP growth of 6.7% year-on-year for Q2. The private sector GDP indicators from Oxford Economics and Capital Economics corroborate the official stabilization estimates.

Some of this pickup in momentum is coming from the housing sector and the delayed impact of monetary easing. Housing market strength is following cuts to mortgage rates and the relaxation of purchase controls. Nationally, housing sales and starts are edging up and developers are making progress on reducing their inventories of unsold properties. Interest rates are at record lows and monetary easing has translated into credit growth. This has helped to support the consumer sector, including retail sales, which are holding up reasonably well. Strong real wage growth (per capita real disposable income rose 5.9% year-on-year in Q2) has also supported the consumer sector. The region's central banks remain highly accommodative as inflation pressure remains benign.

The Bank of Korea (1.25%) and Reserve Bank of Australia (1.5%) reduced their policy rates to record lows over recent months. Similarly, in their April meeting the Monetary Authority of Singapore (MAS) moved to a neutral policy stance, which is in effect a loosening of monetary conditions.

Governments in gateway markets have also been supportive of growth. The Korean government recently announced an additional supplementary budget aimed at supporting consumption. China seems to have front loaded their fiscal stimulus program to the first half of 2016. Additionally, Singapore announced a 7.3% increase in spending for the 2016-17 budget, compared to the previous year.

Real Estate Review

Across most of the region's key gateway markets, office supply in Q2 2016 was lower than the average over the past two years, but an increase from the very low base in Q1. Demand was subdued over the quarter as office leasing momentum across the region eased. Multinational corporations were generally cautious, as they have been for several years. Most office demand is coming from domestic service companies across a range of sectors including finance, technology, and business services. One of the more high profile and active sectors has been the expansion of demand from co-working operators. These firms tend to prefer medium-sized floor plates, in strategic locations (often opening multiple offices in a single market), in Grade B buildings and have become a source of new entrant demand in many markets.

In the retail sector leasing activity was led by Food and Beverage (F&B) retailers as consumers displayed a strong preference for eating out and 'retailainment' – the use of entertainment drawcards to drive foot traffic and spending (the origin of the term is often credited to George Ritzer's book, "Enchanting a Disenchanted World: Revolutionizing the Means of Consumption (1999)"). Other active sectors included sportswear and consumer electronics. In some markets there has been demand from mid-range, value-based fashion brands.

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Established gateway cities continue to be the focus of most transaction volume. The region's key gateway markets (Hong Kong, Singapore, Seoul, Shanghai and Sydney) accounted for five of the top seven most active markets during the first half of the year (the other two were Tokyo and Melbourne). Investors are attracted to these markets for their "…income security and capital growth…" (Real Capital Analytics, Q2 2016).

The investment volume of gateway markets (in USD terms) was 9% lower in the 12 months ending Q2 2016, compared to the previous 12 months (this comes on the back of a flat Q1,). Office activity was up (9%) for the quarter (same basis) while all other sector sales were down 20% to 30%.

In local currency terms (same basis), transaction volume was flat in Hong Kong, higher in Shanghai (13%), Singapore (23%) and Taipei (33%). Singapore volume was helped by the sale of a very large office asset (Asia Square, approximately USD 2.45 billion, USD 1,900 per square foot) during the second quarter. This asset accounted for approximately a third of all sales in Singapore during the second quarter.

Similarly, in Shanghai two sales accounted for approximately half of the second quarter's volume (East Ocean Centre – office in Puxi USD 378 million, USD 558 per square foot, Amenity Garden – hotel in Pudong USD 385 million, USD 792,500 per room).

Volumes were lower in Seoul (19%) and Sydney (26%). Assets are especially hard to secure in these highly competitive markets. In Seoul, first quarter transaction volume was particularly low but there was a strong recovery during the second quarter; office sales were the largest since the fourth quarter of 2014. In Sydney, office sales were down less than overall sales (16% compared to 26%), as investors struggled to secure assets at a price that met their expectations.

It seems possible that two key investment trends will play out over the balance of the year. The first trend is a slight risk aversion and slower decision-making from European and U.S. investors as a result of Brexit and the presidential election, respectively. However, compared to their respective domestic markets, the Asia Pacific region should look comparatively more stable and remain attractive to those global investors.

This feeds into the second key trend, which is that investment volumes are still likely to remain fairly robust as there continues to be a significant amount of capital still looking to be deployed into the global market. Already there are several sales pending that should complete during the third quarter.

In this low-yielding macro environment, real estate yields continue to be highly attractive. In July, Citi Research estimated that a third of all world government bonds were negative yielding. In the same month, Bloomberg reported that nearly USD 10 trillion worth of sovereign debt had negative yields. Some sovereign debt curves are negative for very long durations, as Switzerland is negative out to 30-years and Japan's yield curve is negative to beyond ten-years.

The average spread between local sovereign 10-year bonds and property yields was 285 basis points in July. This is about 35 basis points higher than in May, as Brexit has pushed bond yields even lower, making real estate-based income even more attractive.

Moreover, in the middle of August, the market was pricing in a less than 50% probability that the U.S. Federal Funds Rate would increase in the second half of 2016. With a low-for-longer outlook and flattening yield curve, real estate will continue to attract capital.

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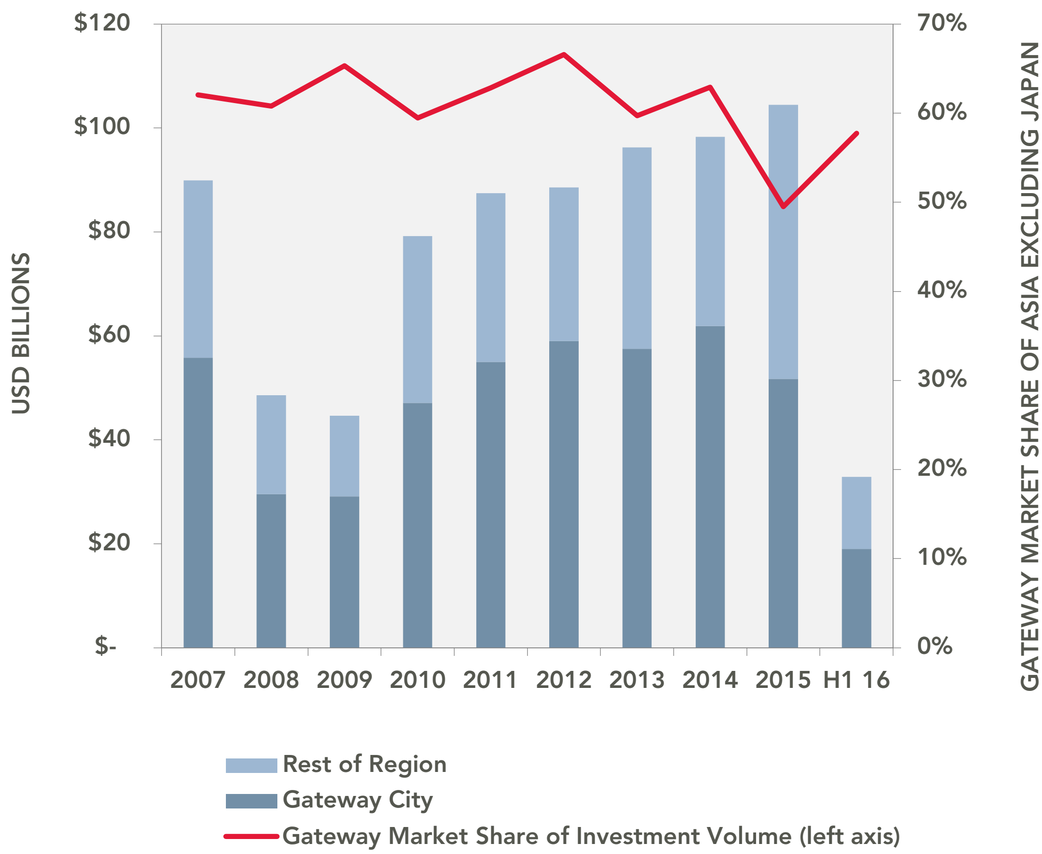
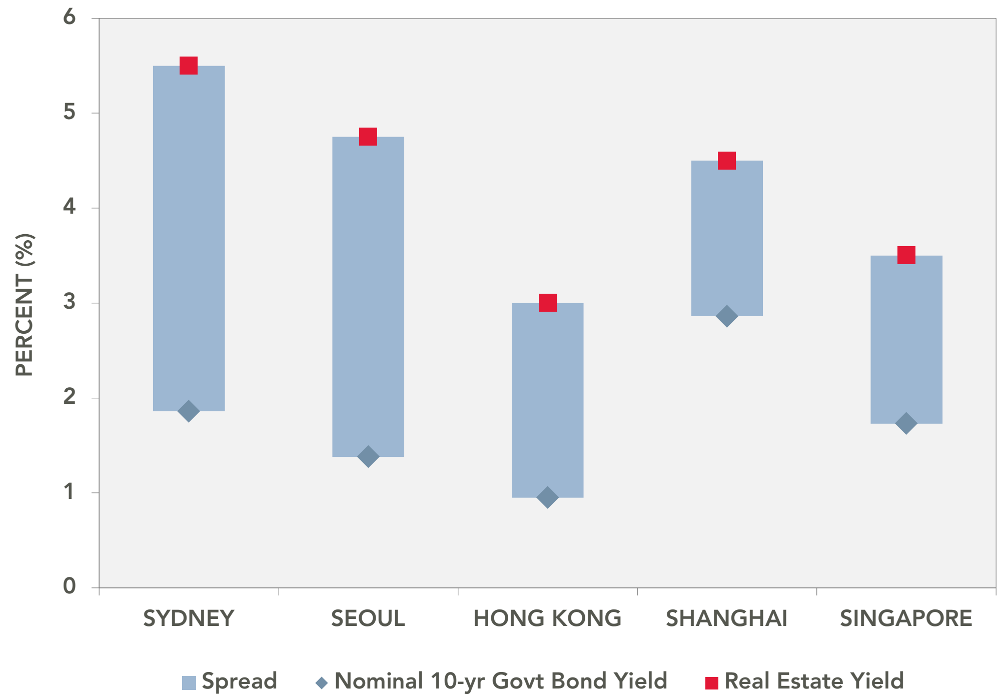
GATEWAY TRANSACTION VOLUME



Source: RCA

GRADE A OFFICE YIELD SPREAD OVER REAL BOND YIELDS



Source: Oxford Economics, JLL, AEW

Note: Office yields are net effective rent (net rent less incentives) over capital value

Hong Kong

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	1.4%	↓	↑	↓	↔	↔
Retail (Shopping Centre)	1.3%	↓	↔	↑	↑	↔
Residential	3.7%[A]	↔[A]	↔	↓[A]	↓[A]	↔

[A]As at December 2015, 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 2016 trend compared with the 12 months through to end Q2 2015. 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.

The labor market is broadly stable with unemployment staying low.

The latest monthly data in Hong Kong have been mixed. Business activity, as measured by the PMI survey, improved in July, rising to 47.2, up from 45.4 in June (a reading above 50 indicates economic expansion). Retail sales continued to fall in June but tourist arrivals fell at a slower rate in June than in May and April. The near-term outlook for private investment and consumption remains subdued as increased external headwinds from lower global growth suggest more of the same.

Q2 GDP growth was 0.1% quarter-on-quarter, an improvement on the first quarter contraction of 0.5% quarter-on-quarter. On an annualized basis, GDP was up 1.7% in the second quarter. External demand is not particularly supportive currently, with service exports creating a drag through lower Chinese tourist spending. The policy response has been supportive, with a loosening of fiscal policy and increased government spending which rose 3.4% year-on-year in Q2. This is helping to offset the housing market correction and aforementioned weak export sector. The quarterly result is likely to raise full-year 2016 economic growth projections, from about 0.7% to 1.0%.

On the positive side, the labor market is broadly stable with unemployment staying low at 3.4%. Inflation eased further during June, marking the fifth monthly decline in the annual CPI inflation rate. This is due for the most part to lower food and rental costs.

The residential property market is showing some signs of stabilizing after dropping 10% from its September 2016 peak, with both the Centa-City Leading Index and Hong Kong and Rating Valuation Department Index showing signs of price stabilization over most of the second quarter. This will aid domestic sentiment.

Overall office rents were up 1.3% during the quarter, building on the 1% gain in the first quarter. The submarket with the strongest rental gains was Central, up 2.3% quarter-on-quarter while Kowloon East was the only submarket where rents declined, down 1.1% quarter-on-quarter.

The variation in performance at the submarket level is due to the respective vacancy rates. In Central, the vacancy rate is currently 1.4%, and has been under 2% since June 2015. Meanwhile in Kowloon East, the vacancy rate has been higher. In Q1 2016 it was 5.2%, down 100 basis points over the previous 12 months. During the second quarter, demand in Kowloon East was negative. At the same time new supply was completed which were the first additions to the market for four quarters. This raised the vacancy rate to 7.3%, a level it has not reached for about 18 months.

Over the past several quarters, new office supply across Hong Kong has been low, averaging around 500,000 square feet per quarter. However, the majority of this supply has been outside the traditional five submarkets (Central, Causeway Bay/Wan Chai, Hong Kong East, Tsim Sha Tsu, and Kowloon East). Looking forward, supply will be concentrated in the Kowloon area. For the rest of the year, the only new project expected to be completed is a large development (Goldin Financial Global Center, 600,000 sq. ft.) in Kowloon East. This trend of new supply being concentrated in Kowloon East will continue, with the submarket representing about 70% of new construction in 2017.

Forecasts are for rents to start a cyclical correction during 2017 and last through 2018. Declines will likely be strongest in the submarkets where new supply is due to be completed over this time frame, namely Kowloon East and Hong Kong East. However, at this stage, it seems the very low vacancy rates will only cushion the other submarkets and rental declines in these districts should also be expected.

Investment sentiment for quality office space in Hong Kong continues to be strong. Office properties in Central continued to be sought after with rising rental rates and a tight vacancy environment. The low holding costs and positive sentiment are helping to hold capital values firm across the market. Mainland Chinese corporates will remain active and in search of en-bloc investment opportunities which should continue to pad transaction volumes over the near-term.

The largest sale in recent months was the July transaction of One HarbourGate East Tower for USD 580 million or USD 2,155 per square foot. The buyer was a mainland Chinese firm, Cheung Kei Group. The unit price, in local terms HKD 16,071 per square foot, is about 8% higher than what China Life Insurance paid for the West Tower in November 2015.

As reported earlier, retail sales contracted during the quarter. Hong Kong's June headline retail sales came in lower than expected, falling 8.9% year-on-year. Overall, retail sales volume fell by 10.5% year-on-year in H2 2016, an improvement over the 12.5% decline in Q1 2015 versus Q1 2015. The category's with the largest contribution to the contraction in goods sales continues to be jewelry, watches, clocks, and valuable gifts (a proxy for luxury sales - down 20.4% year-on-year in June) and increasingly consumer durable goods (down 26.5% year-on-year for June). Interestingly, food, alcoholic drinks, and tobacco (a proxy for F&B sales) has stabilized with year-on-year growth of 2.9% June.

Seasonally-adjusted June tourist arrivals were up modestly, with overall tourism inflows rising 0.6% month-on-month in June (all tourism statistics sourced from JP Morgan). On an annual basis, the picture continues to show a decline in arrivals. June tourism inflows fell 1.7% year-on-year (vs -6.4% in May), with mainland tourist inflows falling 3.8% (vs. -8.3% in May).

High street retail rents were down during the quarter, reflecting increasingly difficult operating conditions. Average Hong Kong prime high street shop rents are adjusting to the new operating environment, down 4% quarter-on-quarter and now down 24% year-on-year (30% peak to trough).

However, some high-street shops in Causeway Bay, where average rents are down 37% peak to trough, are reportedly being offered for lease at rents that are up to 78% lower than the previous tenancy (Colliers, July 2016). This trend of large discounts to previously achieved rents will likely continue into the early part of 2017.

Demand for this space is emanating from mass market retail brands such as fast fashion, activewear, cosmetics, and overseas F&B operators. These retailers are creating backfill demand for the previous tenant base of luxury retailers and jewelry retailers who are reducing their store count.

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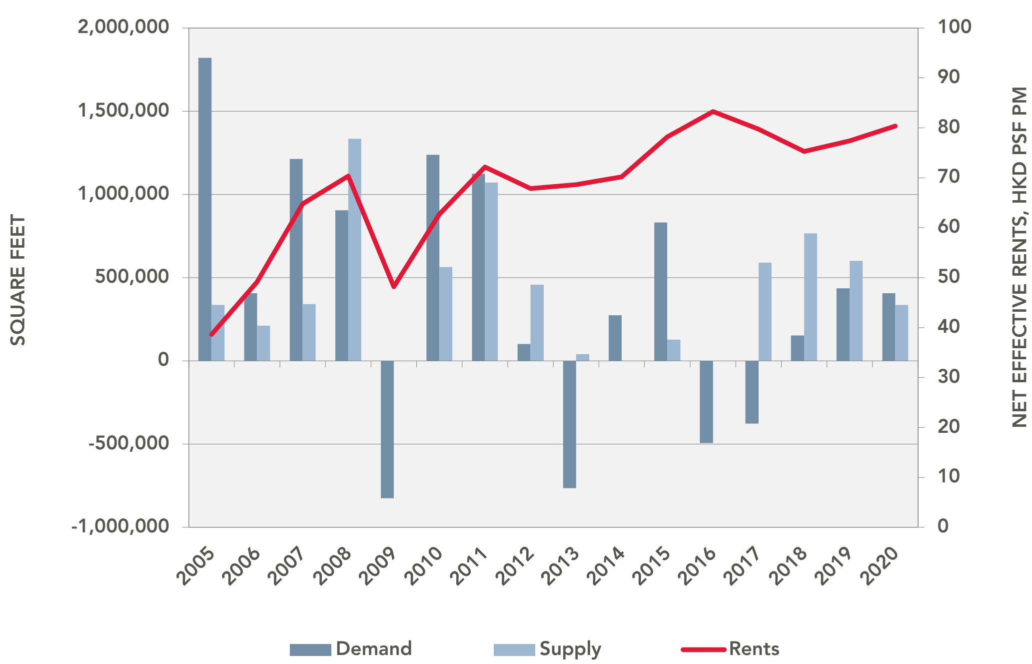
Capital values will likely fall further than rents over the full year of 2016, causing market spot yields to rise. At this stage, it seems likely that 2017 will present an interesting entry opportunity to this market.

The recent Link REIT portfolio sale suggests that demand for suburban malls continues to be strong. The total price of the portfolio was a 33% premium to appraised value. The sale suggests robust demand for neighborhood shopping centers with interested parties coming from listed companies as well as local and mainland Chinese investors. All properties were eventually sold to local investors at initial yields ranging from 2.2% to 4.7%.

HONG KONG ISLAND OFFICE DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

Singapore's economy continued to grow at a steady pace over the first half of the year. GDP growth was 2.1% year-on-year in the second quarter, the same pace of expansion as over the first quarter. Growth was primarily driven by a recovery in the service sector.

Singapore

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	4.8%	↓	↓	↓	↓	↔
Retail (Shopping Centre)	3.3%	↓	↓	↓	↓	↔
Residential	8.9%	↑	↓	↑	↓	↔

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 2016 trend compared with the 12 months through to end Q2 2015. 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 continued to grow at a steady pace over the first half of the year. GDP growth was 2.1% year-on-year in the second quarter, the same pace of expansion as over the first quarter. Growth was primarily driven by a recovery in the service sector (comprising about two thirds of the economy) with activity rising 0.5% quarter-on-quarter following a sharp contraction in the previous quarter (-4.8%). Manufacturing grew about 0.3% for the quarter while construction grew about 0.6%. In August the Government provided guidance on growth which is estimated to be between 1% and 2% for the year, bringing it in-line with private sector projections.

The headline consumer price index continues to fall, down 0.9% year-on-year in June 2016, led by housing and transport. Both private housing costs and transport costs, the latter led by the decline in road licensing costs, have been embedded for some time now. However the MAS Core Inflation Measure (which excludes the costs of accommodation and private road transport) remains positive, albeit low, and helps to explain why the MAS moved to a neutral policy setting in April.

The retail sales environment is benign in Singapore with the sales indicator trending down. The overall retail sales index (excluding motor vehicle sales) was down 3.7% year-on-year in June 2016. The greatest weakness in sales growth is coming from the telecommunication, apparatus and computers category which has contracted at a double-digit rate year-on-year for the past nine months. The decline in F&B sales continued in June 2016 with the category falling 5.3% year-on-year, albeit the pace of decline seems to be easing with the index back at end-2015 levels.

Preliminary estimates show that the seasonally-adjusted overall unemployment rate rose from 1.9% in March 2016 to 2.1% in June 2016, and total employment grew at a slower pace in the second quarter (up 5,500 compared to 13,000 in the first quarter). This reflects the subdued economic conditions, restructuring of the economy and slowing local labor force growth.

Singapore's CBD office rents have been correcting for some time now. The last quarterly decline was 3.3%, a slightly slower rate of contraction compared to the first quarter's 4.8%.

The vacancy rates across the submarkets of the CBD have been largely low and stable over the first half of the year. The current vacancy rate is 4.8% in the CBD. There were no new completions during the quarter and net absorption was a pretty strong 57,300 square feet, much higher than the first quarter net absorption of only 9,800 square feet.

Because of the expectation of about 2.7 million square feet of new supply to be completed by the end of this year, the projection is for the vacancy rate to increase to about 12%. There has been moderate preleasing activity in Guoco Tower (885,000 square feet) and Marina One (1.88 million square feet) with about 20% to 30% of the space committed or under Letter of Intent.

Rents are forecast to decline 16% this year, continuing the pace of decline seen during the first half of the year when rents fell about 8%. The 2017 outlook is for a more balanced market. There is very little supply with only one project, 5 Shenton Way (285,000 square feet), expecting completion. At this stage demand is forecast to be about half a million square feet, helping to lower the vacancy rate to 11%. Rents should start to stabilize during the year - especially during the second half - but rents will likely be down for the full year, by around 5%.

In the largest sale of an office asset, Qatar Investment Authority brought Asia Square Tower 1 from Blackrock (approximately USD 2.45 billion; or, USD 1,900 per square foot). The sale was long awaited and provided evidence of where pricing is for the best quality asset in the local market, helping to benchmark future transactions. The reported yield for the sale was 3.2%.

Shopping center landlords have been focused on tenant retention.

Also transacted was a 60% share of CapitaGreen for approximately USD 700 million or USD 997 per square foot). Additionally, an Indonesian tycoon bought a downtown Grade A asset, namely, Straits Trading Building for USD 416 million or USD2,622 per square foot.

As reported earlier, consumption and consumer spending is being challenged at the moment. While incomes are continuing to grow, job security is lower now than a year ago and falling house prices coupled with low overall economic growth combine to reduce discretionary spending. In addition, spending on high-end or luxury goods where comparable lower cost alternatives are available is also declining.

Growing tourist arrivals (year-to-date as of May tourist arrivals are up 13%) are helping to offset some of the aforementioned domestic weakness. In addition, there is a growing trend of overseas spending through online sales and outbound tourism as well as retailers dealing with labor constraints that impede operational efficiency. In this environment, retailers are concentrating on profitable outlets while closing loss-making locations.

Rents in prime shopping centers continue to adjust to the challenging operating conditions retailers find themselves in. Orchard Road, the main tourist shopping belt, saw prime shopping center rents contract 2.8% quarter-on-quarter. This brought the year-on-year decline to 7.2%. Prime suburban rents have also been correcting, down 2.5% quarter-on-quarter and 9% year-on-year.

As a result of weak rents, shopping center landlords have been focused on tenant retention. They are now more receptive to tenant offers to shore up occupancy during this difficult time. These include short-term leases at attractive renewal rates, usually in the form of pop-up stores that can draw in foot traffic. In contrast, well-managed malls with strong brands in either Orchard Road or in suburban locations (where access to public transport is also important) have been able to hold rents relatively stable.

In July 2016 there was a forward sale of a retail podium by a local developer to an offshore buyer (Mohammed Saiful Alam, who controls Bangladeshi conglomerate S Alam Group) for approximately USD 100 million or USD 3,680 per square foot). Again, this was another example of an offshore, private, non-institutional buyer paying above market norm.

SINGAPORE CBD OFFICE DEMAND, SUPPLY AND RENTAL OUTLOOK

Source: JLL

Seoul

Korea is anticipated to achieve economic growth of about 2.8% per annum over the coming four years, supported in large part by domestic demand growth.

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (Overall)	11.7%	↑	↑	↓	↓	↓
Office (CBD)	11.2%	↑	↑	↑	↓	↓
Office (Yeouido)	15.3%	↑	↑	↓	↔	↓
Office (Gangnam)	10.1%	↑	↑	↓	↔	↓

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 2016 trend compared with the 12 months through to end Q2 2015. 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.

Second quarter GDP growth was 0.7% quarter-on-quarter (3.2% year-on-year) and an improvement on first quarter growth of 0.5% quarter-on-quarter (2.8% year-on-year). Private consumption rebounded during the quarter, rising 0.9% quarter-on-quarter. Fixed investment rose a very strong 2.6% quarter-on-quarter, driven by an expansion in both construction and facility investment. After being a drag on first quarter growth, exports improved, increasing 0.9% quarter-on-quarter. However, with imports also growing strongly (due to demand for crude oil and automobiles), net trade ended up being a slight drag on headline growth (about 0.4 percentage points).

Year-on-year GDP growth averaged close to 3% in the first half of 2016. Risks to the outlook are now balanced. Korea is anticipated to achieve economic growth of about 2.8% per annum over the coming four years, supported in large part by domestic demand growth. Much of this domestic growth is emanating from solid private consumption as well as active government spending.

Policy makers have been consistently proactive in supporting economic activity over recent years. Most recently, the government announced an economic stimulus package of about USD 9.6 billion (0.6% of GDP). The plan is to support sectors undergoing corporate restructuring, principally shipbuilding, and to ensure limited follow on effects on the local labor markets. Separate to this program, the government announced an additional USD 14 billion of spending to increase investments and foster domestic demand by encouraging state-run companies to make large-scale investments, among other measures.

In addition to fiscal stimulus, monetary policy has been highly supportive. The Bank of Korea policy rate is currently 1.25%, having been adjusted down from 2% at the start of 2015. The general consensus is for at least one more policy rate cut this year. It is likely, with CPI inflation low and under control, that the Bank will keep their easing bias and loose monetary policy settings for a while.

There is very little supply anticipated to be completed over the coming five years in the Seoul office market. In 2016 only two Grade A properties will be completed. The Daishin Securities building (5.7 million square feet) in the eastern part of the Central Business District ("CBD") is scheduled to be completed in October 2016. Daishin, the owner of the building, intends on occupying half the building and WeWork is reported to have signed a memorandum of understanding (or "MoU") for the balance of the space, making the building fully-occupied.

Looking ahead, as the supply demand balance improves and vacancy rates continue to decline, landlords will be in a better position to renegotiate renewals and new lease contracts at more favorable rates and terms.

Parnasse Tower (1.1 million square feet) in the eastern side of the Gangnam Business District ("GBD") is expected to be completed in July 2016. It is understood that there have been several occupiers who have either signed or are negotiating for space in this building. Asking rents are reportedly very high and at the upper end of the prime rental range (KRW 133,000 to 140,000 per pyung with three to four months rent free).

Overall net absorption was negative over the quarter, down about 250,000 square feet. However the negative result was concentrated in the GBD where Samsung C&T completed their six-month long relocation from several Gangnam buildings. Excluding Samsung's departure, demand was positive with the Yeouido Business District ("YBD") and the CBD both recording positive net absorption of about 76,000 square feet and 40,000 square feet for the quarter, respectively.

In the CBD, demand was supported by expansion and upgrading activity by SK affiliates. This helped to offset a loss of occupied space from Samsung relocating several departments to the GBD. The net result of this and other take up activity was a 30 basis point decline in the CBD vacancy rate to 11.2%.

In the YBD leasing demand was fairly robust; causing the vacancy rate to contract to 15.3%, down 135 basis points over the quarter. The prime FKI tower was completed in 2013 and is now about 99% occupied after the leasing activity during the quarter. IFC signed several leases over the quarter helping to improve Three IFC's occupancy rate to 32% (One IFC is 97% occupied while Two IFC is 95% occupied).

Overall rents grew on an year-on-year basis to the end of June. Grade A rents were up 3.1% in Q2 while Grade B rents were up 4.3%. In terms of submarkets GBD had the strongest rental growth across both grades, while rental growth in CBD and YBD have been broadly flat.

The rental outlook is for steady face rental growth of about 1% to 2% per annum (in-line with the historic average of about 2.5% per annum over the past five years). Looking ahead, as the supply demand balance improves and vacancy rates continue to decline, landlords will be in a better position to renegotiate renewals and new lease contracts at more favorable rates and terms. Accordingly, within the next few years incentives should reduce, driving net effective rental growth that should be stronger than face rental growth. For example, a one-month reduction in incentive from three-to-two months over two years, could increase face rental growth of 2% per annum to about 7.5% per annum in effective terms.

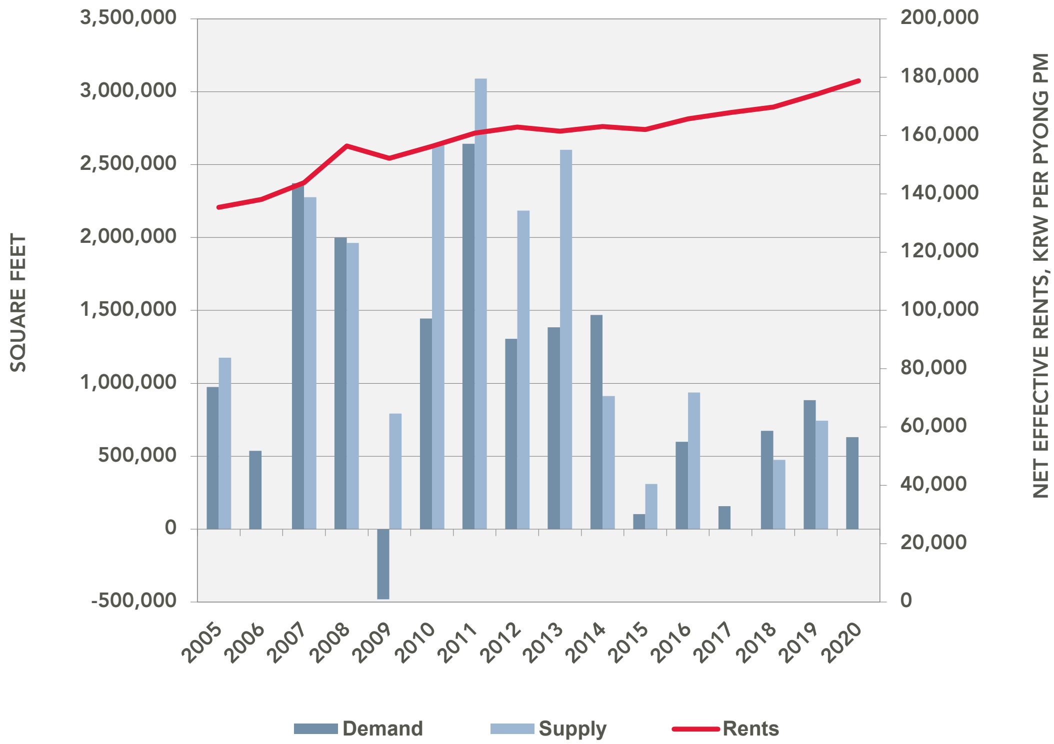
The 10-year government bond yield (risk-free) is currently 1.4%, down 69 basis points year-to-date as of August 16th. During the second quarter, the overall Grade A office yield firmed 10 basis points to 4.6%. As a result, the spread between the 10-year bond and property yields widened increasing from 258 basis points at the beginning of the year to about 320 currently. Moreover, the sovereign yield curve flattened during the year, with the five-year yield down 57 basis points to 1.25% as of August 2016, lowering the cost of debt financing which is often benchmarked against this rate.

With lower debt financing costs and increased spread over the risk-free plus sustained investor demand, pricing has been firming. It seems likely office yields could fall further, perhaps by about 50 basis points over the near-term.

There were several large office transactions during the quarter. The largest was the purchase of Lim Kwan Buildings (a portfolio of two neighboring assets) for about USD 265 million or USD 383 per square foot) by a domestic investor, NH Life Insurance, who exercised their right of first refusal. M&G Real Estate disposed Nara Building in the GBD for about USD 181 million (USD 562 per square foot). A collection of local institutional investors purchased the asset via a Koramco Asset Management Company. Over the quarter, Samsung continued to dispose of non-core real estate, with Samsung Fire and Marine selling 50% of Samsung Fire and Marine Building in the GBD to KB Real Estate Trust for approximately USD 94 million (USD 500 per square foot).

There were several large office transactions during the quarter.

SEOUL OFFICE DEMAND, SUPPLY AND RENTAL GROWTH OUTLOOK



Source: JLL

Shanghai

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	5.0%	↑	↑	↓	↑	↔
Office (CBD - Puxi)	3.9%	↑	↑	↓	↓	↔
Office (CBD - Pudong)	4.5%	↑	↑	↑	↑	↔

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 2016 trend compared with the 12 months through to end Q2 2015. 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.

Co-working operators are taking up a number of spaces around Shanghai.

Shanghai's GDP grew 6.7% year-on-year over the first half of the year, driven by the fast developing services and high value added sectors. Shanghai's tertiary industry, which includes advanced manufacturing and internet-related businesses grew 11.6% over the first half of 2016 compared to the same period a year earlier, outperforming the national average of 7.5%.

The tertiary industry, or service sector, is a very important part of Shanghai's economy. Value-added for the tertiary industry accounted for a highly significant 71% of the city's overall GDP, much higher than the national level of 54%. Reforms in the free trade zone and supply-side reforms are contributing to Shanghai's development and improving economic structure.

Investment in fixed assets rose 7.9% year-on-year in the January-June period and the disposable income of urban residents rose 8.9% in the same period. Consumer price inflation was up 3.1% driven by both higher food prices and service costs. Retail sales rose 7.7%, faster than the 5.9% growth in the first half of last year.

Domestic financial firms and multinational (MNCs) retailers (such as fast fashion and affordable luxury brands) continue to be active in the CBD. In particular, these retailers are upgrading and expanding their office requirements in Puxi. There is also good demand from domestic financial services firms, however newly introduced regulation on peer-to-peer (P2P) firms has started to impact the number of these new start-ups in the market searching for space.

Co-working operators are taking up a number of spaces around Shanghai, focusing on decentralized or off-core locations, CBD Grade B or C buildings and retail or creative spaces. For example, the upper floors of an old department store on West Nanjing Road was leased to Fountown, a co-worker space operator. Also, a non-performing furniture store in a low quality retail space in Zhabei district was converted to 270,000 square feet of co-working space for Feimalu.

Overall full-year CBD demand forecasts are projecting a net take up of about 3.2 million square feet in 2016. Of this, about 1.3 million square feet is in Puxi, with the balance in Pudong. That said, net absorption during the quarter was negative (54,000 square feet), but first half of the year net demand was still positive (185,000 square feet) due to a strong Q1.

Much of this forecast net absorption is coming from the pre-leased space in about 5.5 million square feet of new supply to be completed this year (2.9 million square feet in Puxi and 2.6 million square feet in Pudong). The new supply is expected to partially satisfy the under-supplied nature of the CBD in recent quarters. Puxi has now had three quarters of no supply and a vacancy rate under 4% since September 2015. In Pudong it is 6.3%, the highest it has been since Q1 2013. By the end of the year the Puxi vacancy rate is projected to be 9.1% while the Pudong vacancy rate is likely to be 7.9%.

The low vacancy base is contributing to the unusual situation where both vacancy rates and rents are expected to rise. CBD rents are forecast to be up 3% in Puxi and 6% in Pudong this year. This dynamic is projected to continue for most of 2017.

CBD projects are in high demand but there are a limited number of assets available for sale.

Higher rents and the widening rental gap between CBD and decentralized locations together with low vacancy in the CBD and limited new supply is pushing more tenants, domestic and foreign alike, to consider more affordable options in other locations. Rental performance continues to diverge across decentralized submarkets. Districts with close proximity to the CBD and with better public transport access are outperforming.

There was strong interest for Shanghai office assets. Domestic capital is benefiting from looser regulations and greater access to financing and is seeking stabilized office assets. Domestic insurers are typically under invested in the property sector and will likely become more active in the future. In June, Huaxia Life Insurance closed two deals by buying SCE Plaza (approximately USD 220 million or USD 426 per square foot) and Poly West Bank (approximately USD 182 million or USD 875 per square foot). CBD projects are in high demand, but there are a limited number of assets available for sale, lowering the overall transaction volume. In RMB terms office transaction volume was down 62% for the first six months of the year compared to the same period a year earlier.

As a result of this difficulty in securing CBD assets, purchasers are starting to look a little further afield in to decentralized office and business park locations, but are still focusing on high-quality properties with strong tenant covenants. There are a number of deals under negotiation at the moment, suggesting activity in the second half of the year could be stronger than the first.

As reported earlier, retail sales growth accelerated in the first half of 2016, up 7.7%, when compared to the same period in 2015 (5.9%). *The Shanghai Daily* recently reported on a PwC report that forecasted continued, sustained strength in the Chinese retail and consumer sector. The report projected compounded annual growth of 7.5% in the value of the retail and consumer products sector, from 2016 to 2020. It quoted a PwC representative as saying "the purchasing power of millennial shoppers is increasing [and] there is a shifting demand for new products that promote life experiences and healthy lifestyles".

This transition is visibly underway in Shanghai where local shoppers are clearly more discerning. Consumers are moving away from traditional retail outlets, such as department stores, and are spending more time in shopping malls which combine shopping, dining and entertainment experiences, often appealing to the whole family.

The demand transition from luxury retailers to affordable luxury retailers continues. Often, affordable luxury brands will take the space vacated by a luxury brand. There is also expansion demand from F&B operators, notably mid-range family restaurants. In addition to affordable luxury and F&B, there is also strong demand from children and leisure brands, particularly in suburban mature locations.

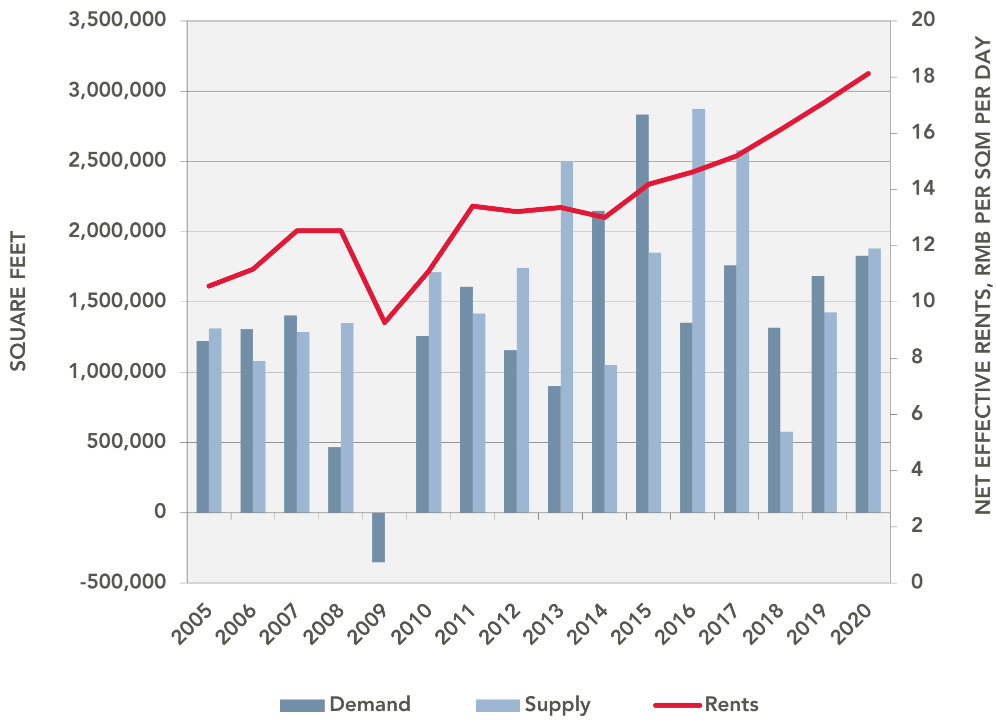
Shopping center vacancy rose during the quarter, from 8.5% to 9.6% as new projects opened with above-average vacancy. Net absorption was more subdued this quarter, down from slightly more than 320,000 square feet in Q1 to just 15,000 square feet in Q2. This is in part explained by several existing malls in traditionally key retail submarkets undergoing tenancy changes in which involve several tenants vacating spaces at shopping centers. Rents were slightly higher during the quarter, rising 1%, bringing year-on-year growth to 2.9%.

The demand transition from luxury retailers to affordable luxury retailers continues.

There were no en-bloc retail transactions during the second quarter in Shanghai. The fundamentals of the market remain the same: owners of core, stabilized assets are generally unwilling to compromise on pricing expectations and are under little pressure to offload buildings.

There is more activity and interest for stable properties outside of core locations where owners may be more willing to sell, and purchaser inquiry has risen in recent months. There are a number of institutional parties undergoing due diligence on high-quality mall portfolios, with several deals under negotiation. Activity should pick up in the second half of the year following a relatively quiet first half of the year. Prime shopping center market yields are about 4.7% currently with capital values flat for the quarter.

PUXI, SHANGHAI CBD DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

Taipei

Rents were mostly flat during the quarter as demand was mainly attributed to relocation.

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (overall)	9.8%	↓	↔	↓	↓	↔

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 2016 trend compared with the 12 months through to end Q2 2015. 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.

After three quarters of contraction, GDP started to expand again in Q2 2016, growing by 0.7% year-on-year. Advance estimates show that net trade was the main driver of the recovery, contributing 0.6 percentage points to overall GDP growth. The improved external backdrop has led to industrial output picking up after a period of weakness starting in early 2015. The Nikkei Manufacturing PMI edged up to 51 in July (above 50 is expansionary), suggesting that businesses are becoming less worried about the outlook for foreign demand than they were some months ago.

Domestic demand has been rather disappointing and has created a drag on recent growth. Private consumption growth slowed from 2.2% in Q1 to 1.1% in Q2, signaling that recent weak wage and employment growth have finally spilled over into spending. However, this might be a temporary however, as wage growth picked up in May and the stock market (wealth effect) has been strong over recent months. Full-year GDP growth is projected to be 0.9% in 2016, rising to a stronger 2% in 2017.

Subdued inflation has allowed the central bank to ease monetary policy. The bank has lowered its policy rate for four straight meetings, with the most recent decision being the reduction of the rate 12.5 basis points to 1.375%.

Office demand was very strong in the second quarter, with 128,500 square feet of Grade A net absorption across the main submarkets in Taipei. Activity was mostly coming from finance, high-tech, IT, and on-line gaming sectors. Cost-saving continues to be the primary concern of occupiers. With no new completions during the quarter for the third consecutive quarter, and strong demand, the vacancy rate fell about 80 basis points to 9.8% in Q2. This is the lowest it has been in a year.

Rents were mostly flat during the quarter as demand was mainly attributed to relocation. Landlords are willing to relax expectations and offer incentives to induce occupiers to their buildings. Rents in some buildings were higher, reflecting building-specific occupancy conditions, but market level incentives were higher on the quarter. Yields are unchanged at 3.2% for a well located, Grade A office building.

Sydney

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Sydney CBD	7.1%	↓	↑	↑	↑	↔

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 2016 trend compared with the 12 months through to end Q2 2015. 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.

The RBA lowered their policy rate to a record low of 1.5%.

Australia's GDP grew faster than anticipated in the first quarter, rising 1.1% quarter-on-quarter and 3.1% year-on-year. This is the strongest rate of quarterly growth since Q1 2012. The Australian economy remains very dependent on the external sector with strong growth in exports accounting for a large proportion of growth in Q1 2016. The transition of the economy away from the resources sector still has some way to go with private investment a drag on overall growth. Full-year growth is projected to be 2.9% for 2016. Support is coming from residential investment and household spending, both of which are being sustained by very loose monetary policy. An increase in export capacity and a lower Australian dollar will also boost exports.

CPI inflation rose 0.4% quarter-on-quarter in seasonally adjusted terms in Q2. This follows a fall of about 0.2% in Q1. Headline inflation is now running at only 1% year-on-year, the weakest price increase in 16 years. Inflation has now been below the Reserve Bank of Australia (RBA) inflation target of 2% to 3% for seven consecutive quarters. Projections are for inflation to be below this band for the full year, at about 1.5%.

Supporting this low inflation view, and as expected, the RBA lowered their policy rate to a record low of 1.5% at their August monetary policy meeting. Forecasts are for the policy rate to remain very low for the remainder of 2016 and probably for most of 2017. Another cut is not an unlikely possibility.

On July 2, Australia had a double dissolution election to elect all 226 members of Parliament. Because of the close nature of the vote it took nearly two weeks to conclude that Prime Minister Malcom Turnbull and the Liberal/National Coalition would return to government. The government's majority shrunk, losing 14 seats, but they did reach the threshold of a 76-seat majority (one-seat majority) in the House of Representatives. The Australian Senate took a little longer to confirm, but on August 4th the final Senate result was announced with the Coalition winning 30 seats. The Liberal/National Coalition will require at least nine additional votes to reach a Senate majority (76 seats). This new configuration of Parliament suggests a more difficult path to policy implementation than under the previous government.

There continues to be very strong demand for office space in Sydney's CBD. Second quarter net absorption was almost 400,000 square feet, the tenth consecutive quarter of positive take-up. This is more than three times the ten-year average for the market (116,000 square feet). Demand was driven by centralization and expansion activity as well as relocation activity as a result of office completions. The finance and professional services sectors accounted for over 80% of gross take for the quarter.

Rental growth momentum has been sustained for seven consecutive quarters and has led to a year-on-year growth of 12.2%.

Premium grade vacancy is high and remained unchanged over the quarter at 11.4%. With additional new completions due over 2016, the vacancy may end the year even higher. In comparison, demand for Grade A and B space is very strong and their respective vacancy rates are about half that of the premium market (grade A vacancy rate is 6.9% while the Grade B vacancy rate is 6.0%). The Grade-B leasing market is becoming increasingly competitive as a result of office withdrawals and tenant displacements. The vacancy rate has now declined for five consecutive quarters and has fallen six percentage points from its Q3 2013 peak.

The demand outlook has been revised up on the back of the strength of local market conditions. Year-to-date net absorption (743,000 square feet) is close to the previous forecast of full-year net absorption (753,000 square feet). Consequently the forecast has been raised to 1.3 million square feet.

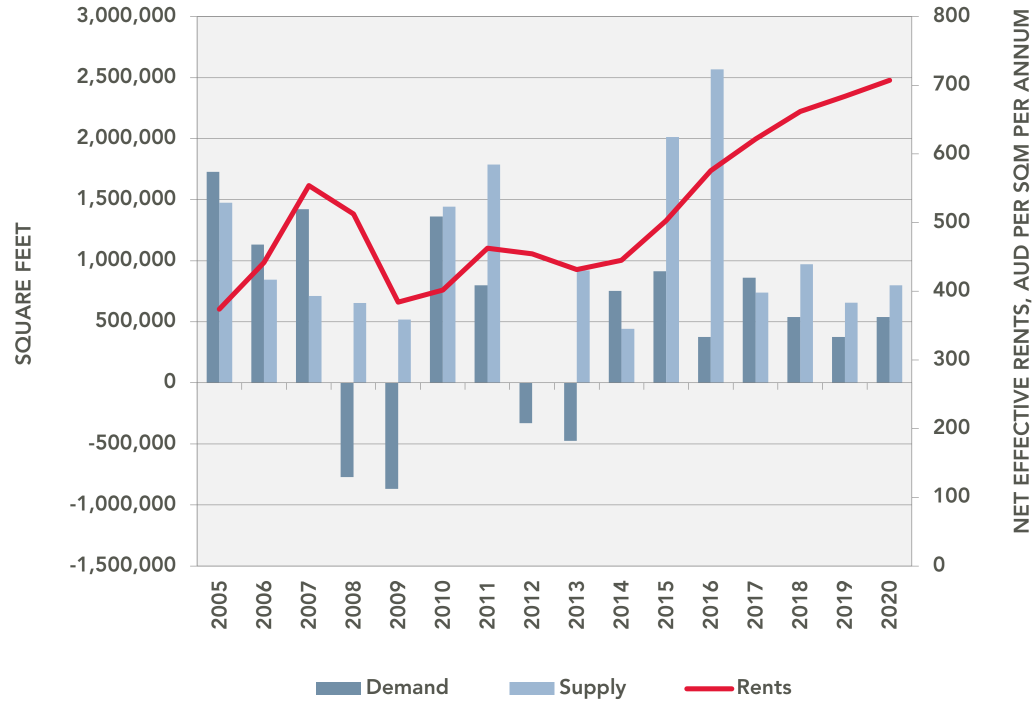
The Sydney CBD office market is at the forefront of the national office market rental recovery. Prime and gross effective rents in the CBD increased 2.1% quarter-on-quarter. Rental growth momentum has been sustained for seven consecutive quarters and has led to a year-on-year growth of 12.2% (well above the 20-year average annual growth rate of 3.9%). Prime leasing incentives have dropped from 31% (38 months rent free over a 10-year lease) to 28% (34 months rent free) over the past 12 months.

Conditions are even tighter in secondary quality space (Grade B and C). Rents are up 5.4% quarter-on-quarter and 17.7% year-on-year. Falling Grade B incentives are reflecting vacancy that is below the long-term average, robust occupier demand and stock withdrawals.

There continues to be a lot of investor demand for stock in Sydney's CBD. There were two major assets transacted in Q2 2016. 420 George Street sold via two separate transactions to Investa Commercial Property Fund for a combined AUD 592.5 million (approximately USD 453 million or USD 1,117 per square foot). Fortius Active Property Trust divested its 75% share in the asset at a 5.2% yield with the remaining 25% divested by Australian Prime Property Fund. Morgan Stanley brought One Shelly Street from Brookfield Office Properties for AUD 525 million (approximately USD 400 million or USD 1,124 per square feet).

The returns that can be generated from quality office assets in Sydney's CBD are expected to remain attractive to both local and offshore investors for some time to come. Valuations and yields are stabilizing even though there is a lot of investor interest and increased capital allocated to the commercial property market. However, it is becoming increasingly difficult for investors to obtain stock of institutional quality. Prime and secondary yields were unchanged over the quarter and are 5.5% and 6.1% respectively.

SYDNEY CBD OFFICE DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

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