

AEW RESEARCH

ASIA PACIFIC MARKET PERSPECTIVE

Q3 2016



AEW



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General Economic Overview

Global growth continues to track at the bottom end of most expectations and below long-term historic averages. In recent years, growth has been held back by a negative output gap, driven by the reinforcing loop of depressed trade, investment, productivity and wages. This output gap has lingered for some time now, with aggregate demand levels not strong enough to match existing capacity, and the world trade environment is a prime example of this. Excess capacity in the global economy has kept goods prices low for a sustained period of time, but demand has yet to significantly respond, mostly due to persistently cautious consumer sentiment.

There has also been a lack of business investment weighing on global growth. Immediately after the Global Financial Crisis, businesses were hesitant to invest and held excess cash. This led to a lack of business re-investment that continues to persist today, with many leading global firms holding significant amounts of cash and cash equivalents. This reduction in business investment growth, while in some ways preventing a wider output gap, has nonetheless contributed to reduced demand.

The OECD updated their September economic outlook for 2016 growth to 2.9%, a slight downgrade from the July update, but expect growth to rise to 3.2% in 2017. U.S. growth is anticipated to be 1.4%, a marked slowdown from the June view that is backstopped by weak investment and a prolonged inventory correction. Consumption and job growth in the U.S. have been strong, and the outlook is for demand growth to pick up in 2017, to about 2.1%, although this remains below historical standards.

In the euro area, weak domestic demand, including the stalling of the short-lived investment recovery, slowed second quarter growth. Additionally, while credit growth has improved overall, high non-performing loans in some euro area countries are holding back growth prospects. The full-year outlook is for growth of 1.5%, led by Germany with 1.8%. Growth projections for 2017 are for a similar rate of growth at 1.4% (again led by Germany with 1.5%).

The IMF recently characterized Asia's growth as 'strong' and anticipated full year growth of 5.4% across the region. Asian stock markets are robust and capital continues to flow into the region. Domestic policies have mostly supported growth with low interest rates and fiscal stimulus. Asia's exports are set to benefit from an anticipated recovery in global growth during 2017. Risks to the region's economic outlook continue to be external, with the uneven global recovery and sluggish world trade potentially undermining the region's growth outlook.

Gateway currencies had a volatile third quarter and subsequent October against the USD. On a month-to-month basis the AUD, CNY, SGD and KRW spent the quarter changing from appreciating to depreciating to appreciating again. They ended the quarter generally where they started, with the AUD slightly stronger, the KRW flat, and the CNY and SGD weaker. In October, USD strength prevailed and all currencies slipped on average 2.5%; ranging from 1.1% for the AUD and 4.5% for the KRW.

China's early third quarter GDP growth estimate was stable at 6.7% year-on-year. Growth was led by accelerated fiscal policy implementation, a rebound in investment via the property market and robust domestic demand. The rebalancing of China's economy continues with the services sector share of GDP now 50.4%, while manufacturing's share declined to less than 40%. On a production

Pricing and valuations remain strong across the region and AEW is noticing an increase in competition for a limited set of assets

basis, services (the tertiary sector) grew 7.6% year-on-year and contributed 60% of year-to-date overall growth. By the expenditure measure, consumption contributed 71% of year-to-date overall growth.

Of note, the GDP deflator (a broad measure of overall price movement across the economy) rose to 1% in the third quarter, from 0.6% in the second quarter. This was due to PPI year-on-year deflation turning around and becoming slightly positive during the quarter, the first growth in industrial prices in 54 months. Consequently, nominal GDP growth was 7.8% year-on-year. The full-year growth target of 6.5% seems very likely to be achieved now, and the coming question will be how policy makers intend to balance credit expansion and economic growth next year. Most private economists expect 2017 growth to be slightly less than 2016, but still above 6%.

More control on credit growth, while creating risks for the near-term growth outlook, does create more sustainable economic growth rates, albeit at a lower clip. While credit growth has been high, China does not seem to be on the cusp of a banking or financial crisis. Most credit is domestically funded, and the financial sector remains solidly liquid with loan-to-deposit ratios lower than 100%.

Real Estate Review

Occupiers are seeing value in a number of the gateway office markets, particularly in recently completed projects. Over the third quarter, office occupational demand picked up, recording the strongest quarterly increase of occupied stock this year. The completion of a number of office projects with strong pre-lease commitments was a main driver. Singapore, Shanghai, Seoul and Sydney all had projects completed during the quarter with strong occupier leasing commitments.

Across the region's gateway markets the average vacancy rate rose slightly as a result of the net increase in inventory introduced by these completions, but the increase in vacancy was not enough to dampen landlord's ability to raise rents. Annual rental growth continues to run at a steady pace of about 3.5%, a pace that has been sustained for several quarters.

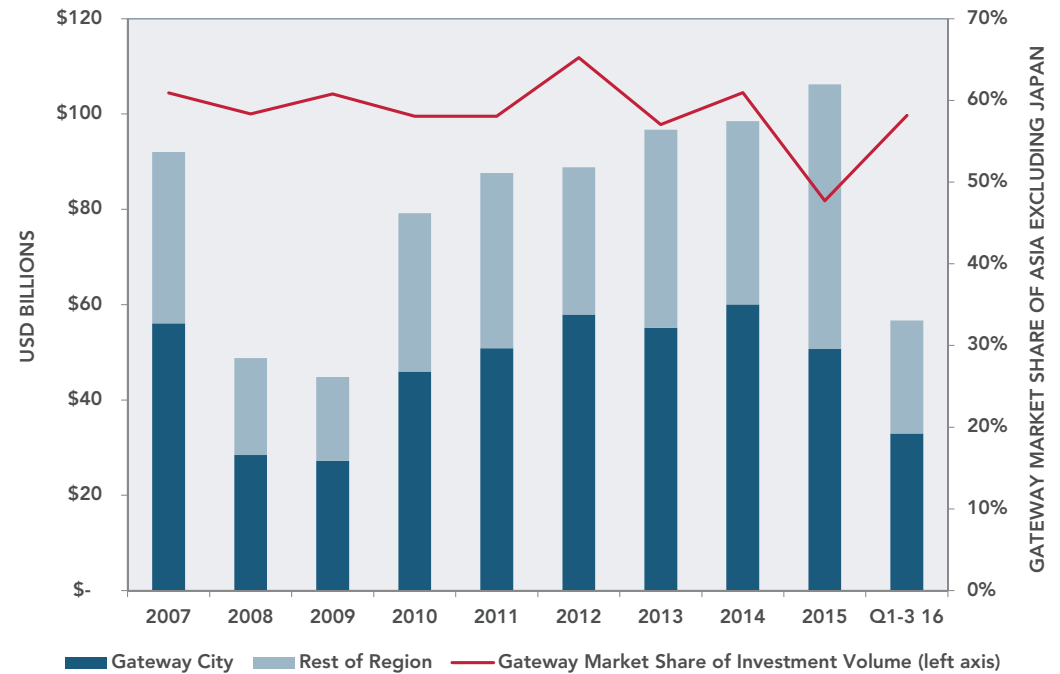
Pricing and valuations remain strong across almost all of the region's gateway markets. Reported capital value growth was 5% year-on-year during the third quarter, building on similar growth rates seen over the past several quarters. First-to-third quarter transaction volumes this year are tracking at the same pace as the same period in 2015. In the past 12-months the office sector has been very liquid, with transaction activity increasing 24% in USD terms. The retail sector did not experience that same activity, with a 3% decline in total transaction volume.

Broadly, AEW is noticing an increase in competition for a more limited set of assets. Purchasers are finding it more difficult to secure deals, especially if their cost of equity is higher than core investors. Debt funding continues to be relatively available and local banks are supportive of commercial property lending in most of the region's gateway markets. Borrowing costs have fallen after peaking at the beginning of the year as interest rates remain low and central banks maintain a clear easing bias. This balance could be thwarted by rising U.S. interest rate expectations, a strengthening USD and an increase in local bank wholesale funding costs.

With 10-year government bonds at their current low levels, the additional yield spread that real estate offers investors remains highly attractive and is generally seen as a primary source of fund flows into the sector. At the beginning of the year the spread was approximately 190 basis points,

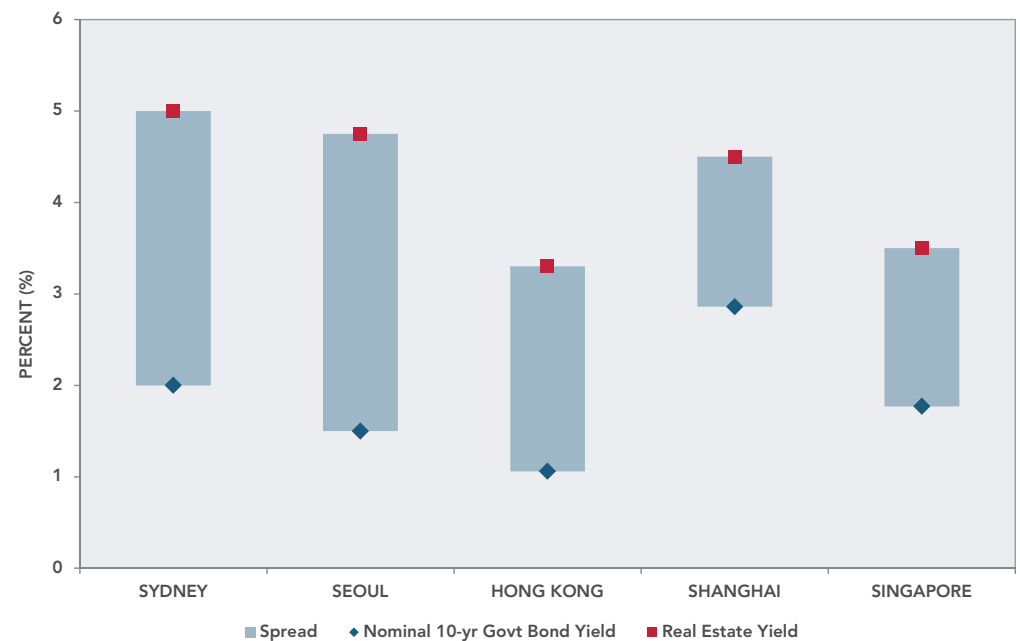
but government bond yields have decreased while real estate yields have remained broadly stable, increasing the spread to approximately 230 basis points by the end of the third quarter. Australia is a primary destination for much of this capital.

GATEWAY TRANSACTION VOLUME



Source: RCA

GATEWAY GRADE A OFFICE YIELD SPREAD OVER BOND YIELDS



Source: Bloomberg, JLL, AEW

Hong Kong

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	1.5%	↑	↑	↓	↔	↔
Retail (Shopping Centre)	1.7%	↔	↓	↓	↓	↔
Residential	3.7% ^A	↔ ^A	↓	↓ ^A	↓ ^A	↔

^AAs 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 Q3 2016 trend compared with the 12 months through to end Q3 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.

Hong Kong's economic activity for full-year 2016 is anticipated to grow by 1.4% and should pick up to 2% for 2017. In the short term, activity during the second half of the year is expected to be supported by stronger consumption growth. The labor market remains solid with low unemployment (currently at 3.4%), and steady overall employment levels. Nominal wages were up 3.8% year-on-year as of the end of June.

Goods imports outpaced export growth, rising 2.8% year-on-year in HKD terms in August, suggesting that, along with firmer commodity prices, domestic demand is picking up. The stabilizing property market also points to an improving background for domestic demand. Both home prices and sales volumes have picked up from their low points earlier this year.

The office sector remains favorable for landlords with rising rents and tight occupancy. Overall, Hong Kong office rents were up 1.2% quarter-on-quarter, a similar pace of growth as seen over the past year. On Hong Kong Island rents were up 1.5% quarter-on-quarter, while in Central rental growth was stronger at 2.2% over the same period. Again, both submarkets had rents rising at a pace similar to previous quarters.

A very tight occupancy market is supporting rent growth, and the vacancy rate has now been low for an extended period of time. In Central the vacancy rate is 1.5% and has been less than 2% since June 2015. On Hong Kong Island, vacancy is similarly low at 2%. There is some vacant space available in Kowloon East, where the vacancy rate is 7.2%, as supply delivered during the second quarter is being slowly absorbed, and with no new grade A completions across all submarkets during the third quarter.

The tight vacancy environment continued to restrict leasing activity with the total number of new lettings dropping by 17% quarter-on-quarter. There is also some decentralization from Central to other submarkets as the limited vacant space in Central has resulted in some tenants being forced to find space outside of the submarket.

Coupled with several whole floor lease expiries and ongoing relocation of tenants affected by the upcoming redevelopment of Warwick House and Cornwall House in Hong Kong East, the overall market recorded a net loss of 160,800 square feet of occupied space during the quarter; the second consecutive quarter of contraction. As mentioned Hong Kong East was the primary driver of this with a net loss of 114,600 square feet while Central lost only 25,600 square feet of occupied space.

The investment market has been highly active, especially in the office sector

Retail sales dropped 4.1% in value terms year-on-year in September. This represents a significant moderation in sales decline from the 10.1% seen in August. Retail sales in Hong Kong have now declined for 19 consecutive months. There are several reasons behind this dramatic shift. One is that August sales seem to have been restrained by the Rio Olympics. Additionally, the decline in visitor arrivals reduced from 9.4% year-on-year in August to 3% in September. Tourist spending is highly correlated with retail sales so a moderation in the fall of tourist arrivals suggests some support for the sector. Mainland China remains the overwhelming source of visitors despite persistent declines. In September mainland Chinese arrivals dropped 5% while almost every other origin increased.

Jewelry, watches and other luxury items, products that are usually popular with mainland Chinese visitors, led the declines in September, recording a 12.3% decline, compared with a 26.2% slump in August. Sales in supermarkets slipped 0.4%, while food, alcoholic drinks and tobacco fell 3.1%. But there were also some rebounds. Sales of clothes were up 1.8%, and medicines and cosmetics added 1.2%.

Consequently, retailer demand has been reasonably subdued for sometime now. In particular luxury retailers, which have seen significant revenue declines, have been focused on reducing store count and improving operational efficiency. For example, Chow Tai Fook recently released poor top line sales figures and closed stores in Tsimshatsui and Causeway Bay. Additionally, Prada expressed its intention to downsize or potentially give up its 3,000 square foot store at The Peninsula Hotel in Tsimshatsui.

At the same time, mid-range fashion retailers have expanded in the same districts. Mass retailers such as cosmetics and fashion retailers remain the main driver of leasing demand as they look to capitalize on more affordable rents and prime store locations that are becoming available. On top of this trend, F&B is also an area of robust demand, with novel catering experiences becoming increasingly more prominent.

After reaching a trough at the end of the first quarter, Hong Kong residential pricing has recovered 8.8%. Momentum has built during recent months with a 6.9% gain during the third quarter. As of September, home prices were less than 4% off their September 2015 peak. Developers started to sell into this market early, offloading projects they had retained during the correction.

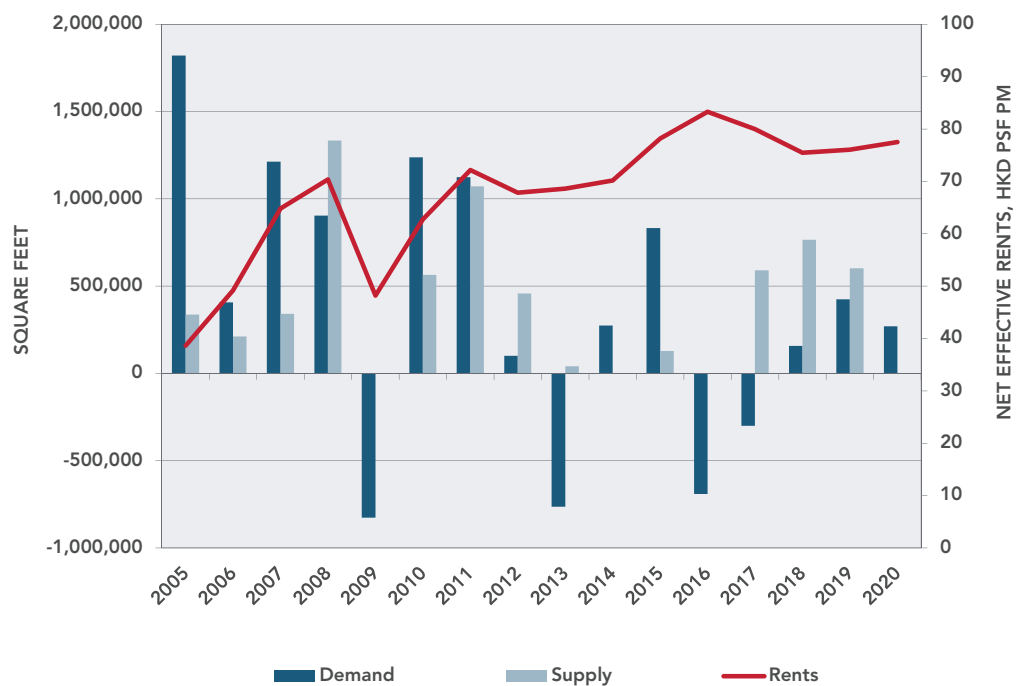
As a result of this recent surge in pricing the government increased the stamp duty for the second time in three years effective November 5th. The stamp duty on property transactions for non-first-time buyers is now 15% for individuals and corporate buyers, up from 8.5% previously. Foreign buyers now pay an effective 30% stamp duty. Bloomberg reported the chief executive of Centaline Property Agency Ltd., a local broker with large market share, as saying that he expects volumes to fall by as much as 60% to 70% in the subsequent three months as a result of rise in the stamp duty charges. He was also quoted as saying pricing could decline by 5% to 8% as well.

The investment market in Hong Kong has been highly active with local currency volumes up 16% on an annual rolling basis at the end of September. Activity was concentrated in the office sector where sales volumes were almost 100% higher.

The largest deal during the quarter was the Shenzhen-base Cheung Kei Group purchase of the East Tower of One HarbourGate in Kowloon East for USD 580 million (USD 2,155 per square foot). The buyer intends to use a part of the building as the company's headquarters in the city

and keep the rest of the building for investment purposes. The unit price was about 8% higher than the amount China Life Insurance paid for the West Tower in November 2015. Also sold was Henderson Land's Golden Centre in Sheung Wan for USD 563 million (USD 3,610 per square foot). This sale surpassed the previous acquisition of Infintus Plaza in the second quarter of 2010 to be the largest office transaction in the district on record.

HONG KONG ISLAND OFFICE DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

Singapore

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	7.2%	↑	↓	↓	↓	↔
Retail (Shopping Centre)	3.5%	↑	↓	↑	↓	↔
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 Q3 2016 trend compared with the 12 months through to end Q3 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.

Demand in the office sector rebounded after a number of subdued quarters; pre-leasing in new supply has been robust

The third quarter advance estimate of Singapore's economy reported annual GDP growth slowed to 0.6%, from 2% in the second quarter. On a quarterly basis the economy contracted 4.1%. The decline was concentrated in the manufacturing sector, reflecting sluggish external conditions. In line with the slump in trade flows, growth in the transport & storage sector was also modest. However, there were partial offsets from growing areas in the economy, including tourism-related activities and public infrastructure construction. The service sector was resilient, with a slight contraction of 0.1% on a year-on-year basis (compared to 1.2% in the preceding quarter).

Overall CPI declined 0.2% year-on-year in September compared to a decline of 0.3% year-on-year in August. The recovery from deflation towards inflation is mainly coming from smaller declines in private road transport costs and higher food inflation. The Monetary Authority of Singapore (MAS) Core Inflation estimate moderated to 0.9% in September from 1.0% in August, largely on account of lower service inflation.

In April 2016, MAS reduced the slope of the Singapore dollar nominal effective exchange rate (S\$NEER) policy band to zero percent. Effectively this changed their policy stance from a 'modest and gradual appreciation' of the currency, held in place since 2010, to a neutral policy setting. In the October monetary policy meeting, the MAS maintained its policy of zero appreciation of the S\$NEER. The monetary policy setting is a reflection of the near-term outlook., as GDP growth is expected to come in at the lower end of the 1% to 2% forecast range for 2016. Additionally, while there is some softness emerging in the labor market, wages continue to grow. First half 2016 wage growth was 4.1% year-on-year, more than the 3.5% recorded in 2015 and the 10-year average of 3.6%.

Demand in the office sector rebounded after a number of subdued quarters. Third quarter net absorption was almost 150,000 square feet, much more than the 57,000 square feet recorded in the second quarter. Most of this can be attributed to the completion of Guoco Tower (880,000 square feet). Recent reports suggest the grade A office tower was 80% let by October. Guoco reportedly offered competitive lease terms and rents. Tenants have been drawn to the property from the surrounding submarket, Shenton Way, as well as from locations outside the CBD, adding to the submarkets occupier base.

Marina One (1.9 million square feet) is the next major project to be completed, having been delayed from Q4 2016 to Q1 2017. AEW estimates, from local media reports and broker interviews, the tower is already about 40% committed. Demand for this new supply has been strong, but as the supply completes, AEW continues to expect the vacancy rate to increase

Office occupational demand continues to be diversified and transaction activity has been solid

at the expense of existing stock as tenants relocate to the new projects. The vacancy rate will likely increase to 12% or slightly more during 2017. As the market is expected to be fairly balanced over the coming 12-24 months, the vacancy rate is anticipated to be more than 10% for the next several years.

Occupational demand is coming from the business services, finance and insurance, and technology sectors. For several years, tenants have preferred to renew rather than relocate. The lack of capital expenditure budget from headquarters is part of the reason. Capital expenditure budget reports are becoming more available, albeit still tight. However, coupled with CBD rents being down 22% from their peak, occupiers are starting to see value in the sector again.

Further declines in rents are expected, but Q3 2016 looks likely to be an inflection point. Declines should become smaller from this point forward, and ultimately, rents will start to grow again, perhaps as soon as end-2017.

Retail sales (excluding motor vehicles) continued to adjust, contracting 6.5% year-on-year in August (2.1% month-on-month), and on an annual basis, all categories fell. F&B sales were down 8.7% year-on-year, with restaurant sales down 8.8%. Partially offsetting this fall, fast food outlets (1.1%) and other eating places (e.g. cafes etc.) (2.0%) were both higher year-on-year. Apart from F&B, spending continues to be focused on necessity trades, with the most robust sales trades being medical goods and convenience stores. In addition, shopping center rents continued to fall during the quarter. Prime Orchard Road rents were down 1.3% quarter-on-quarter and have slipped 7.7% year-on-year. Similarly prime suburban rents were down 0.3% quarter-on-quarter and decreased 8.7% year-on-year.

In the Orchard submarket, refurbishment of Orchard Central was completed for Uniqlo's first flagship store. Refurbishment was also completed at The Centrepont, but was met with slow take-up, likely due to the new retail supply in the Marina submarket. Developments such as DUO Galleria and The Heart in the Marina submarket have been delayed and will open in 1Q17 and 2Q17, respectively. Also in the Marina submarket, Funan DigitaLife Mall was closed for redevelopment to a new lifestyle concept.

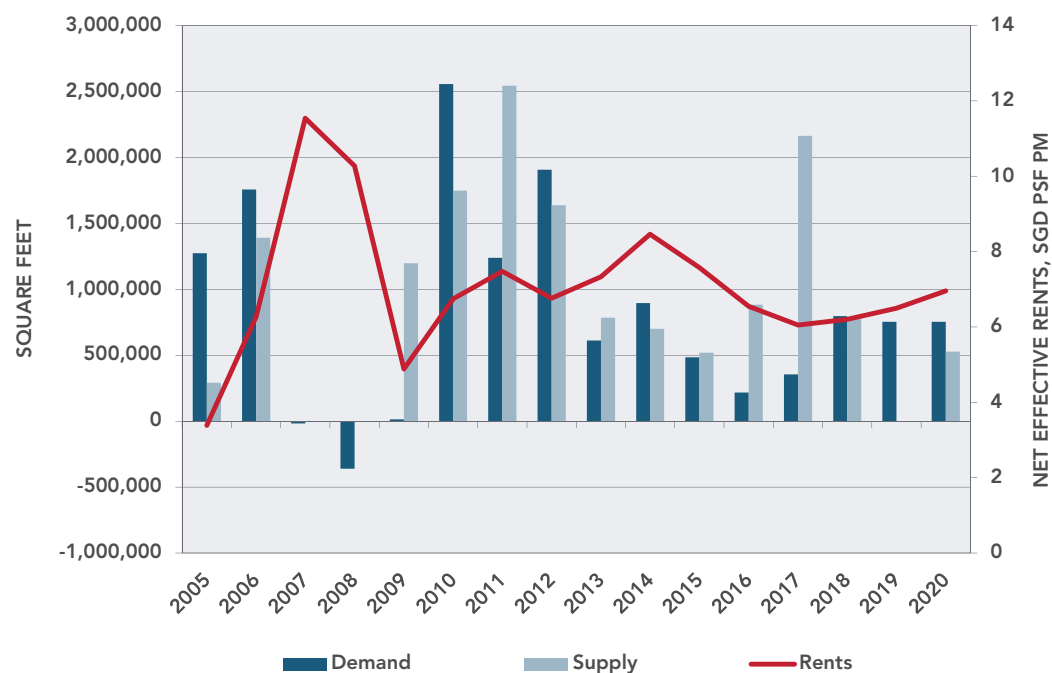
Compass One, a suburban mall in Sengkang, closed for refurbishment in Q4 2015 and reopened during the third quarter with 95% occupancy. The landlord redeveloped its interior and provided more F&B options. Its redevelopment highlights the need for shopping centres to continually fine-tune their tenant mix to remain attractive to an ever-demanding customer base.

Singapore's residential sector continues to see pricing declines. Prices fell 1.2% quarter-on-quarter during the third quarter and have now fallen for 12 consecutive quarters. The peak-to-now price decline increased to 9.4%. Primary pricing for high-end projects have reportedly been hit worse, with sales at the same project showing declines of up to 20-25% from their peak. However, over recent months sentiment may have shifted. Pricing for these projects appears to have stabilized as capital from foreign high net worth individuals and families looks to have targeted this sector.

During the quarter several large transactions were reported, including a partial 60% interest in 139 Cecil Street that was sold to a mainland Chinese buyer for approximately USD 55 million (USD 1,333 per square foot). The site has approved redevelopment permission, and the family who purchased the interest also owns the neighboring 137 Cecil Street. A local high net worth individual acquired The Verge, a well-known, mixed-use project in Singapore's Little India District.

The project comprises a retail mall and serviced apartments and was extensively redeveloped in 2009. The buyer paid approximately USD 139 million (USD 584 per square foot).

SINGAPORE CBD OFFICE DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

Seoul

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (Overall)	13.9%	↑	↑	↓	↓	↓
Office (CBD)	15.6%	↑	↑	↓	↓	↓
Office (Yeouido)	15.2%	↑	↑	↓	↔	↓
Office (Gangnam)	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 Q3 2016 trend compared with the 12 months through to end Q3 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 preliminary release of third quarter GDP growth was a seasonally adjusted 0.7% quarter-on-quarter. This was in line with the 0.8% growth posted during the second quarter. In year-on-year terms, the economy expanded 2.7% compared to 3.3% in the second quarter, due in part to a high base effect.

There are several headwinds that could impact GDP growth, leading to a challenging near-term outlook for Korea. Samsung's decision to stop production of its premium Note 7 smartphone has been estimated to reduce GDP growth by approximately 0.1 to 0.2 percentage points. In addition, new anti-graft laws could reduce spending in restaurants and gift shops. Ongoing corporate restructuring, which looks set to include aggressive cost cutting (especially in the shipbuilding and shipping sectors), will also be a drag on growth.

In light of these headwinds, fiscal and monetary policy are likely to remain highly supportive to encourage GDP growth. A supplementary budget that was part of a broader stimulus package worth 1.3% of GDP was approved in September and should provide some near-term relief to the economy. Monetary policy is highly accommodative with the Bank of Korea (BOK) cutting its policy rate to a new record low of 1.25% in June. Expectations are for the BOK to keep rates very low through to at least the end of 2017.

Full-year growth is forecast to be about 2.7%, due largely to a big contribution from the government sector. Next year's growth outlook is similar with 2.8% growth projected with improved domestic demand.

The restructuring activities of Samsung continued during the quarter, impacting the Seoul office market. Samsung Life relocated and downsized from the CBD to Gangnam, where they have Samsung corporate headquarters. In addition, Hanwha Galleria relocated from the CBD to Yeouido, leaving behind vacancy in its old building.

Helping to offset the impact of some of these moves, several occupiers took up space in the CBD. For example, occupancy in Tower 8 rose about 27 percentage points to 60% due to several lease commitments from a range of tenants. Other buildings also saw occupancy rates increase, namely Center 1, Gran Seoul and D Tower.

Despite these favorable examples, on an overall basis, there was a net loss of occupied stock in the CBD during the quarter, and the CBD vacancy rate rose to 15.6% as at the end of the

Several recent tenant moves have raised the office vacancy rate; despite this, landlords in well-located, good quality buildings continue to be able to lower incentives and raise rents

quarter. There is a wide variation of district vacancy rates within the CBD. They range from 5% in Myeongdong to more than 24% in several districts such as the North Fringe and Namdaemun.

Daishin Securities HQ is the only one grade A building to be completed in the CBD during the fourth quarter, and this will be the district's only grade A new supply through 2019. Daishin Securities HQ is fully-committed with Daishin Securities occupying half of the space and WeWork committing to the other half. With this limited supply outlook and a steady demand outlook, the vacancy rate could reduce to 13% by end 2016.

The GBD had the only supply during the quarter with the completion of Parnas Tower (616,000 square feet). Parnas represents the first grade A completion in the district since 2014 and achieved a commitment rate of 36% at the end of the quarter. Demand has come from a variety of industries including tech, gaming, and serviced offices, and many occupiers upgraded from grade B space. The GBD vacancy rate is now 11.3%, and with expectations of steady demand and no new supply for several years, the vacancy at the end of the year is projected to be 7%, with a further tightening to under 6% possible by the end of 2017.

The YBD vacancy rate is 15.2%, a level its been close to for several quarters. About two thirds of this vacancy is concentrated in Tower 3 of Seoul IFC. Excluding this space, which does not seem to be actively marketed at the moment, the district's vacancy rate is closer to 6%.

There was modest rental growth pressure during the quarter. Gangnam and Yeouido saw effective third quarter rental growth of about 1% and 2.6%, respectively. Gangnam's gain was due to reduction in average achieved incentives during the quarter. In Yeouido there was both face rental growth and a reduction in incentives.

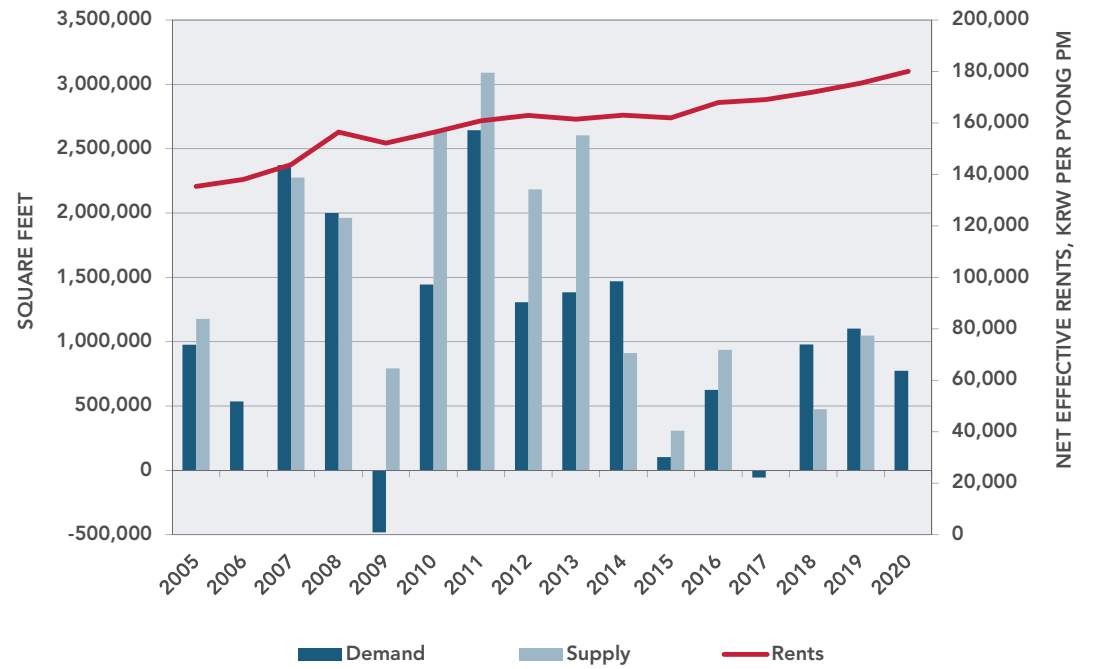
In the CBD, rents fell 1.5% during the quarter. While face rents increased, incentives were raised in a number of buildings. Landlords in buildings such as Signature Tower, Gran Seoul, and Samsung Fire Insurance all offered more incentives to counteract pending departures and to secure occupancy.

The investment market has been very active for most of the year. The sale of the mixed-use Seoul IFC to Brookfield Asset Management dominated the landscape at USD 1.5 billion (USD 542 per square foot). LG purchased Namsan STX Building from a Koramco fund for USD 266 million (USD 368 per square foot), and market reports suggest LG will relocate some affiliates into the property once the deal is completed.

Centre Point Gwanghwamun sold in September to a Koramco fund for a record local currency per unit price of KRW 27.2 million per pyung (1 pyung = 35.58 square feet). In USD terms it transacted at USD 274 million (USD 654 per square foot). The building has a seven year lease to local law firm, Kim and Chang, helping it attract core capital seeking long-term income.

Booyoung's acquisition of the former Samsung Life HQ Building in the CBD for USD 512 million (USD 547 per square foot) was the largest deal in terms of price. The building was fully-vacated by Samsung upon sale and Booyoung is expected to offer the property to the market for lease.

SEOUL OFFICE DEMAND, SUPPLY AND RENTAL GROWTH OUTLOOK



Source: JLL

Shanghai

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	7.1%	↑	↑	↓	↑	↔
Office (CBD - Puxi)	7.6%	↑	↑	↓	↓	↔
Office (CBD - Pudong)	6.5%	↑	↑	↑	↑	↔

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 Q3 2016 trend compared with the 12 months through to end Q3 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.

Office demand recovered during the quarter, led by the Puxi submarket; decentralised vacancy remains elevated at 15.8%

Shanghai's economic growth was 6.7% year-on-year in the third quarter, in line with the pace of growth the City saw over the first half of the year. The service sector accounts for 71% of total economic output and was the main driver of growth. The sector was up 10.3% in the first nine months, while manufacturing dipped 0.7% and agriculture was down 12%.

Retail sales were up 7.2% in the first nine months, a slight reduction in growth compared to the first six months of the year, and online sales were up 15.7% from a year ago. CPI inflation was 3.2% during the first three quarters, mostly driven by a rise in service and food prices. Disposable income rose strongly, up 8.8% to more than 40,000 yuan per year (USD 5,890) in the first nine months of 2016.

After a contraction in office demand during the second quarter, net absorption was 233,800 square feet in the third quarter. This brings the year-to-date expansion of occupied space to 419,000 square feet in the overall CBD (Puxi and Pudong). This represents a slowdown in activity when compared to the same period in 2015, during which some 2.5 million square feet of demand was recorded. Puxi accounted for all the growth in demand during the third quarter with net absorption of 258,000 square feet, while Pudong had a small contract of demand by about 24,000 square feet.

Three developments reached completion in the Puxi CBD. These were HKRI Centre One (1.03 million gross square feet), Raffles City Changning T2 (348,944 gross square feet), and Bund Finance Center N1/2/3 (312,260 gross square feet). The total NLA delivered was 1.15 million square feet. Supply exceeded demand during the quarter and the vacancy rate rose to 7.1% in the overall CBD (Puxi 7.6%, Pudong 6.5%).

In the decentralized market, fundamentals were stronger than in the CBD. Net demand was about 908,000 square feet, while supply was about 730,500 square feet, leading to a third quarter contraction in the vacancy rate of about 110 basis points. Nevertheless, the decentralized vacancy rate remains notably higher at 15.8%.

Additionally, after improving over the past several quarters, the forecast is for the decentralized vacancy rate to increase again by the end of the year. With a substantial amount of supply expected to be completed in the final months of the year (approximately 4.8 million square feet), the vacancy rate is anticipated to increase to 24%, and is anticipated to increase further to 28% by the end of 2017 as even more supply is delivered.

Overall CBD office rents were down slightly over the quarter, with a contraction of about 0.6% quarter-on-quarter. This was a result of the partially vacant supply entering the market during the quarter, creating some leasing competition among landlords.

The outlook for rents is slightly mixed. Rental growth experienced to date is expected to moderate as supply is delivered in the coming quarters. In the CBD there is some peripheral supply expected and the overall CBD vacancy rate could rise to 10% by years' end. As more supply is expected next year, the vacancy rate will likely be in the range of 10-12% for most of 2017, despite the favorable outlook for demand. Consequently, the rental outlook is subdued, with a modest full-year rise this year and a sub-2% gain expected in 2017.

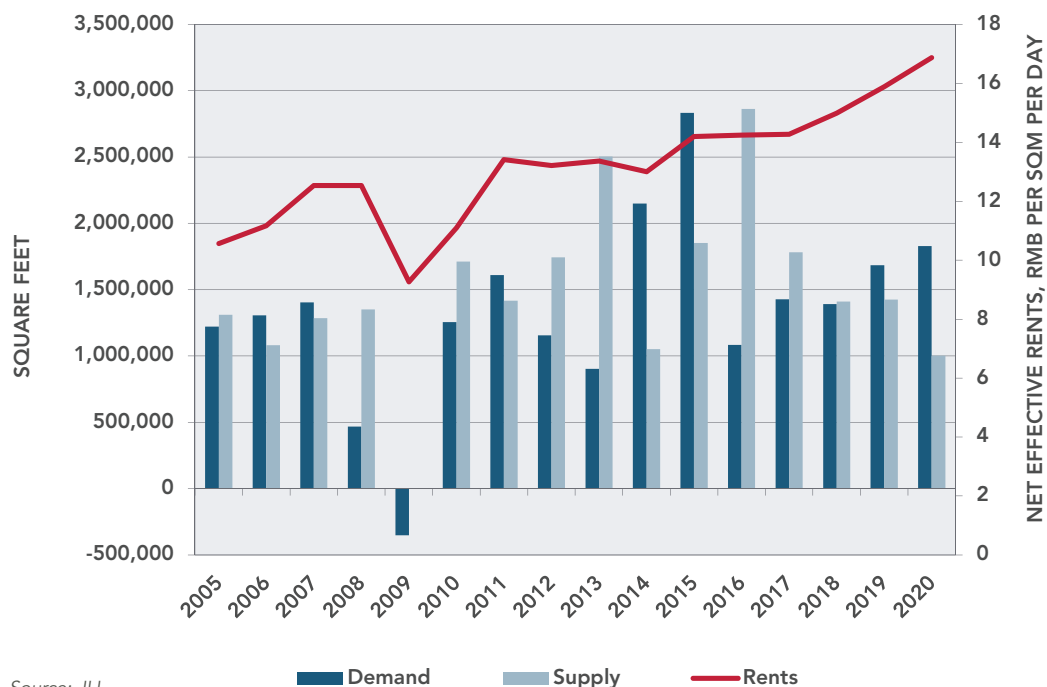
As mentioned the decentralized market is expected to see supply outstrip demand, pushing up vacancy to very high levels. Despite this, the forecast is for rental growth (on a like-for-like basis) this year of about 4% and stable rents next year.

As previously highlighted, retail sales growth was robust during the quarter, rising 7.2% in the first three quarters compared to the same period a year earlier. F&B demand remained robust, especially from Chinese regional cuisine restaurants that are targeting middle-income customers. Coffee and tea shops are also experiencing strong demand. Luxury retailers such as Dunhill continued to adjust store portfolios, while major fast fashion brands including Zara and Gap slowed their expansion.

Children's entertainment remained very active, including the new Snow World children playground in Chamtime Plaza. Fitness centers catering to consumers' increasing focus on health are increasing their presence in mature malls, as are restaurants selling juices and other health foods. This preference for healthy lifestyle-orientated products and services is a source of new demand. F&B, child-related retailers and service providers will remain the key demand drivers for the retail sector.

Tenants with a focus on Eating, Education and Entertainment (dubbed "the three 'E's" in the local market), are being sought after by shopping center landlords. They are seen as key foot traffic generators and landlords are increasingly willing to offer these brands lower rents plus fit-out allowance to attract them.

SHANGHAI CBD OFFICE DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

Sydney

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Sydney CBD	7.1%	↓	↑	↑	↑	↓
North Sydney	9.0%	↓	↑	↑	↑	↓

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 Q3 2016 trend compared with the 12 months through to end Q3 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 Sydney office market is in the midst of a significant recovery, with a withdrawal of stock driving rents higher

The Australian economy continues to transition away from a heavy reliance on growth from mining investment. Although mining capex is still about 45% higher than it was in 2010 when the mining investment boom started. Therefore, despite the sharp fall in mining investment over recent years, there is still some distance before the floor is reached. Non-mining investment has been comparatively more stable, albeit with restrained growth.

Second quarter economic growth (the latest available) grew 0.5% quarter-on-quarter bringing year-on-year growth to 3.3% as of June 2016. This is in line with the 20-year growth average of 3.2%. Private investment has been a drag on growth, but government spending was highly supportive during the quarter, although some of this was one-off public investment that is unlikely to be a source of sustained growth over the coming quarters.

Housing investment continued to increase, up 1.6% quarter-on-quarter and 8.3% year-on-year. The Reserve Bank of Australia (RBA) kept the cash rate constant at its September meeting, after cutting the rate at their August meeting by 25 basis points to a record low of 1.5%. Expectations are for one more cash rate cuts by the RBA before they hold the rate steady for an extended period of time.

Australia's labor market remains balanced. Over the past 12 months, 180,000 jobs were created, and the unemployment rate gradually trended down, reaching 5.6% as at August 2016. Wage growth remains relatively subdued at 2.1% year-on-year as of June, and domestic demand growth is anticipated to rise next year from the projected 1.6% in 2016 to 2.5%. Investment is expected to recover from a 2.8% contraction in 2016 to 2.1% growth in 2017, which should help blunt the impact of declining government consumption growth.

The Sydney office market is in the midst of a significant market recovery. Office rents in the CBD grew strongly during the quarter. Prime effective rents were up 5.5% quarter-on-quarter while secondary rents were up 13.3%. On a year-on-year basis, prime rents are now up almost 20% while secondary rents are 37% higher. This very strong rental growth is a result of several tailwinds.

Office stock is being withdrawn for residential conversion, refurbishment and infrastructure development. In the first three quarters of 2016, about 390,000 square feet of secondary space was taken out of the market which is in addition to the 835,000 square feet withdrawn in 2015. This withdrawal of space is helping to offset the completion of prime space.

New prime supply during the quarter included the high-rise component of International Towers, Sydney Tower 3 (470,000 square feet). The low-rise (380,000 square feet) was completed during the second quarter. Lend Lease has a major pre-lease in the high-rise component of the project representing approximately 55% of the space.

Also completed during the quarter was 161 Sussex Street (70,000 square feet). This is a mixed-use, multi-tower redevelopment with a partial grade A office component. While prime stock is increasing as supply is completed, secondary stock is contracting as buildings are withdrawn. The displacement of secondary occupiers in a low vacancy environment has led to a very landlord-friendly market over recent quarters.

The all-grade vacancy rate is 7.1%, slightly up over the quarter, but still below the long-term average (10-year average vacancy rate is 8.4%). The secondary vacancy rate is 6.6%. Tight occupancy conditions and increased enquiry from displaced tenants is becoming evident across secondary stock, and face rents are growing while incentives are reducing. During the quarter secondary incentives fell to 28 months on a 10-year lease, the first time they have been under 30 months since 2008.

More withdrawals are expected, and vacancy is expected to remain low. This will drive income growth from both face rental gains and declining incentives, and this trend is anticipated to continue into 2017. Further, the momentum forming is likely to be maintained for some time to come.

North Sydney fundamentals are similar to those occurring in the CBD. Effective rents have risen sharply as vacancy falls below the long-term average due in large part to withdrawals and tenant displacement activity. Prime effective rental growth was 2.2% quarter-on-quarter and 9.6% year-on-year. Secondary rents have been more sensitive to the occupational market, with quarterly growth of 4.4% and year-on-year growth of 15.2%.

The North Sydney vacancy rate fell to 8.6% during the quarter, due in large part to the 300 bps contraction in the secondary vacancy rate to 6.8%. Withdrawals totaled 400,000 square feet this year, effectively offsetting the completion of 177 Pacific Highway (420,000 square feet) during the quarter. The project was sold by the developer, Leighton Holdings to Singapore listed Suntec REIT with a head-lease by Leighton. Leighton subsequently sub-leased some of their space to Jacob's Engineering, Vodafone and Cisco Systems.

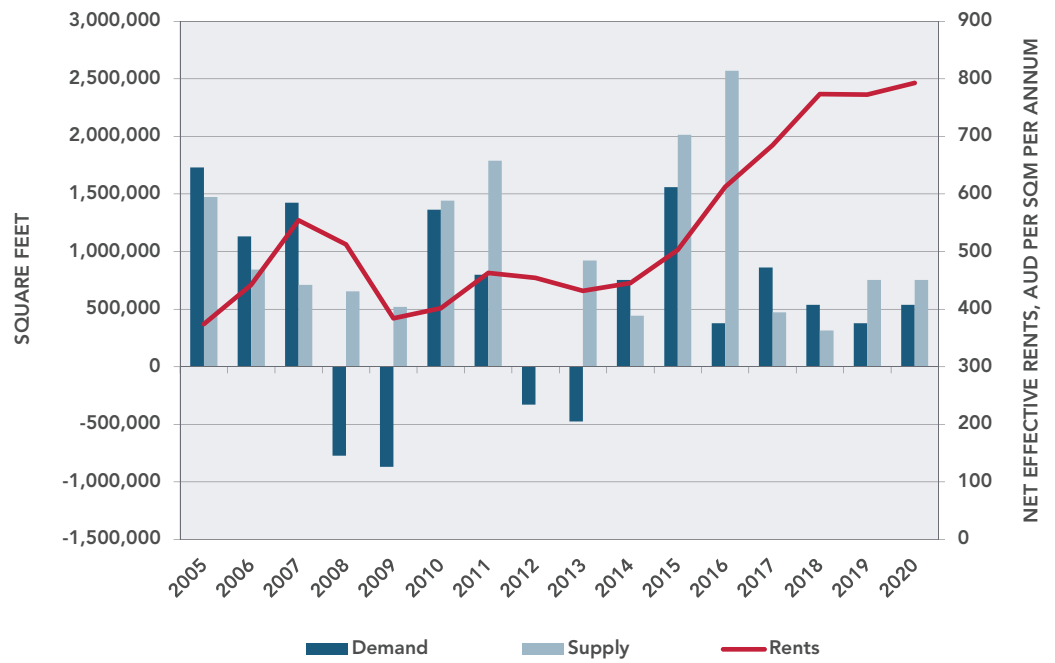
There is a wide variation in market yields reported in Sydney. In the CBD, the prime, best-in-class yield has now broken the 5% barrier and was 4.8% at the end of the quarter. The average prime yield is slightly higher at 5.3%, while the average secondary yield was 5.9%. In North Sydney the average prime yield is 6.1%, while the average secondary yield is 7.1%.

Bond yields were at a record low during the quarter. Ten-year bonds ended Q3 at 1.99%, down from 2.12% at the end of Q2. The long-term inflation-indexed bond yield fell marginally to close the quarter at 0.67%, implying a very low (1.32%) long-term inflation outlook. CPI inflation was 1% in Q2.

While the yield premium to real bond rates remains elevated, yield-seeking capital flows towards Australia, and Sydney as the gateway market, are expected to remain robust. As a result, assets with sustainable income returns are expected to attract greater interest from investors seeking superior risk-adjusted returns.

To this end, sales activity continues to be robust. On an AUD 12-month rolling basis, Sydney office sales were 3% higher at the end of the quarter. Kimberly-Clark House, 53 Alfred Street in North Sydney, closed in July at USD 96 million (USD 906 per square feet). The yield was reported to be around 5.1%. DMR House at 220 George Street in the CBD sold for approximately USD 81.4 million (USD 708 per square foot).

SYDNEY CBD DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL

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