AEW RESEARCH

ASIA PACIFIC MARKET PERSPECTIVE

Q4 2018

AEW

AEW

Prepared by AEW Research, March 2019

Growth in the Asia Pacific region remains strong compared to the U.S. and Euro area economies, supported by healthy domestic markets.

General Economic Overview

The global economy continues to expand in 2019 with risks skewed to the downside due to uncertainty regarding trade disputes and major geopolitical events. Global growth is believed to have peaked and is expected to slow mildly in 2019 and 2020, with forecasts now set at 3.5% and 3.6% respectively. However, the service sector looks more robust and consumer confidence across regions is generally higher than it was two to three years ago. The expansion in the United States (U.S.) is expected to continue but at a decelerating rate alongside the unwinding of the fiscal stimulus, and the Euro area growth is expected to moderate as well, with slowing growth rates expected for the major economies of Germany, Italy and France. Growth in the Asia Pacific region remains strong compared to the U.S. and Euro area economies, supported by healthy domestic markets.

China is expected to expand at a still-solid growth rate of 6.1% in 2019 ahead of other major economies. Most other Asian countries, which are reliant on trade and particularly sensitive to the fortunes of the Chinese economy, are expected to experience more measured growth in 2019 as demand from China slows. For key Asian gateway markets, average growth expectations for 2019 are 3.0%, and excluding China, growth is expected to be 2.3% per annum for the next two-year period (2019 and 2020). Growth across most developed Asian economies is expected to be domestically driven in 2019 with some governments (i.e. South Korea, Hong Kong) committing to wider fiscal stimulus.

The latest round of trade talks between the U.S. and China have reflected some progress towards a deal being reached but sentiment continues to fluctuate. At the China Economic Work Conference in December 2018, China's policymakers assured that the dual levers of fiscal and monetary policy will be implemented as appropriate to ensure stable aggregate demand. Already the Chinese government has shifted focus from deleveraging to supportive monetary policies. The rounds of easing in January 2019 reflected two cuts in the Reserve Requirement Ratio (RRR), while the central bank has effectively injected $83 billion of liquidity into the market through reverse repo operations. Alongside this, the Chinese government has also announced targeted actions to stabilize growth and renew business confidence.

Elsewhere in the Asia Pacific region, CPI growth is generally low and near the bottom end of target ranges. Recent meetings of the Bank of Korea (BoK) indicate that they are keeping fairly neutral settings after a 25 basis point hike in November 2018, while the Monetary Authority of Singapore (MAS) has adopted a slight appreciation stance since April 2018. The Reserve Bank of Australia (RBA) has kept the cash rate on hold after the first meeting of 2019 and will maintain a more balanced outlook on the possible direction of rates for the year.

With the exception of the Hong Kong dollar, Asian currencies generally depreciated against the USD in 2018, with the largest declines in the Australian Dollar and the Chinese Yuan. The trend began to slow in the second half of the year as the momentum in the USD slackened with the DXY up 1.8% from July to end December versus the 2.5% in the first half of the year.

MACROECONOMIC INDICATOR SUMMARY

COUNTRIES	GDP (Y-O-Y)		CPI (Y-O-Y)		INTERBANK RATE/ CASH RATE		USD EXCHANGE RATE	
Year	2019	2020	2019	2020	2019	2020	2019	2020
Australia	2.46	2.50	1.84	2.51	1.50	1.75	0.74	0.77
China	6.14	5.83	1.98	2.40	3.27	3.73	6.69	6.46
Hong Kong	1.56	2.27	1.79	1.77	3.00	3.00	7.82	7.76
Singapore	2.36	2.34	1.06	1.71	2.23	2.59	1.35	1.33
S. Korea	2.30	2.44	1.41	2.43	2.00	2.75	1,091	1,083

Source: Oxford Economics, as of 22 February 2019

Property Market

Transaction activity for income-producing assets in major Asian gateway markets surpassed 2017's volumes. Hong Kong and Seoul markets were the most active in 2018 with several megadeals or portfolio transactions taking place.

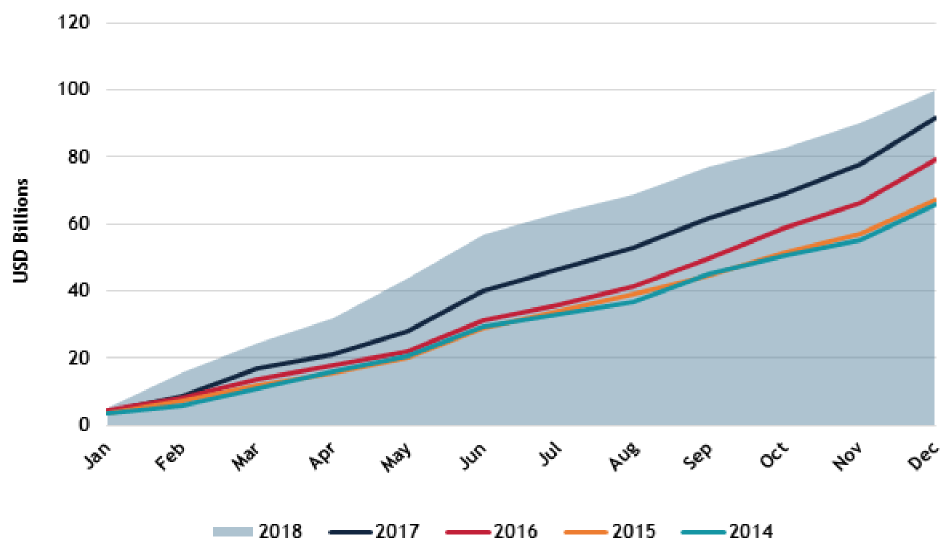
The office sector continues to see growth in multiple cities. Headwinds in retail are evident but select projects that are well-located and well-managed have shown the ability to outperform the market. The office sector in Singapore, Sydney and Melbourne continue to move through their rental cycles with positive reversions continuing into 2019 and beyond. In Shanghai Pudong CBD, limited supply in the next five years will support landlord-favorable conditions, while in Beijing pent-up demand in select submarkets continues to cause upward pressure on rents. In Seoul, the CBD office market is showing signs of stabilizing after large supply in 2018. Outside the office sector, interest in neighborhood retail in Hong Kong was strong in 2018 as discretionary retail spending showed resilience.

Despite a possible economic growth slowdown, office demand still exhibits strong fundamentals. Net take-up for major Asian gateway cities was 14.2 million square feet in 2018, about 1.7 times that of the previous year. Demand was driven by growing industries like technology, media and co-working, and in the Tier 1 Chinese markets, expansion in the finance industry was still relatively strong. Average vacancy rates fell from 7.9% at the start of the year to about 6.5% by the end of 2018. For 2019, demand is expected to track closely with supply across most markets. Contiguous space is exceptionally limited in Melbourne CBD, Sydney CBD and Beijing, but these markets will have a set of new completions from 2019 to 2020. This is not expected to disrupt rental cycles too much as pre-commitment rates are high in Melbourne and Sydney, while in Beijing a large proportion of the new space has been allocated for self-use.

Transaction activity for income-producing assets in the major Asian gateway markets surpassed 2017's USD volumes by 9%, coming in at $100 billion in 2018. Hong Kong and Seoul markets were the most active in 2018 with several megadeals or portfolio transactions taking place. In Hong Kong, the pace of activity slowed substantially in the second half of the year due to a combination of weakened sentiment from mainland China, poor stock market performance and rising interest rates. While financial conditions have stabilized since, weakness in the Hong Kong Central office market may result in transaction volumes dropping by 10% to 15% in 2019. Across target markets, cross–border activity remained strong in 2018, responsible for about 38% of activity, up from 30% in 2017. Notably, Shanghai, which had a soft start to the year, gained momentum with large inflows from foreign investors in Q4 and had 63% of activity attributed to cross-border capital for 2018.

The bond yield curve in most markets shifted higher over 2018, especially in Hong Kong and Singapore, reducing the spread to real estate yields. Capital continues to be attracted to the sector as many investors from outside Asia are under allocated and absolute yield continues to be attractive. Yields continue to firm in the office sector and have remained broadly unchanged or expanded in retail.

GATEWAY MARKET TRANSACTION VOLUME



Source: RCA, as of 8 February 2019
Note: Markets include Beijing, Hong Kong, Melbourne, Seoul, Shanghai, Singapore, Sydney

Hong Kong

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (Hong Kong Island)	1.7%	↓	↑	↑	↑	↓
Retail (Shopping Center)	3.7%	↑	↑	↑	↑	↔
Residential	3.7%[A]	↓	↑	↑	↓	↔

[A]As at December 2017, 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 Q4 2018 trend compared with the 12 months through to end Q4 2017. 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-supply fundamentals are shifting in the office market, but remain largely favorable in the decentralized markets of Hong Kong Island and Kowloon.

ECONOMY

The Hong Kong economy expanded by 3.1% year-on-year in 2018, despite the strained China-US relations weighing heavily on business sentiment. The Hang Seng Index ended the year at 25,846 points, down 13.6% in the 2018 and the Nikkei PMI reading remained below the 50 threshold reading in December 2018, suggesting continued weakness in manufacturing and business activity. Nonetheless, the domestic market was healthy in 2018, with labor markets tight and private consumption up 6.0% year-on-year. The growth outlook for 2019 is milder amid the China slowdown affecting re-export trade and softening domestic demand. Medium-term growth will be supported by expansionary fiscal policy highlighted in the Chief Executive's second policy address targeting the housing, healthcare, education and the technology industry.

PROPERTY MARKET - OFFICE

After a solid year, demand-supply fundamentals are shifting in the office market, but remain largely favorable in the decentralized markets of Hong Kong Island and Kowloon. Driving forces behind demand in 2018 were decentralization, co-working expansion and demand from mainland Chinese. While all sources of demand held up well during the first half of the year, there was a notable slowdown from mainland Chinese companies in the second half of 2018. This comes amid weakening sentiment in China and efforts by the mainland government to control capital outflows. It is estimated that mainland Chinese companies leased about 1.0 million square feet of space in 2018, the bulk of which is in Central, and this is likely to slow in 2019.

At the same time, decentralization is expected to continue as occupiers focus on managing costs amid the challenging business environment. In 2018, there were major relocations out of Central from firms in the finance and legal industries especially as high quality new buildings were added to stock in markets like Hong Kong East and Kowloon East. Hong Kong East in particular continues to attract more multinational corporations (MNCs) due to wide rental gaps versus Central and improved transportation connections (i.e. the Central Wanchai bypass which completed in January 2019).

Take-up in 2019 is expected to be relatively strong in decentralized markets where about 1.5 million square feet of new supply is completing in Kowloon East, of which 50% is already pre-committed. Rents in Central could decline by up to 5% in the next 12 months as demand softens, albeit from a high base, while rents in decentralized markets should continue to increase moderately in 2019.

PROPERTY MARKET - RETAIL

Overall retail sales in Hong Kong grew by 8.8% in 2018, the largest increase since 2013, but notably, from a low base. Growth was strong in the first five months of the year, but took a turn in the second half with setbacks in the property and stock market weighing on domestic sentiment. At the same time, through the completion of new transport links with the mainland, such as the Guangzhou–Shenzhen–Hong Kong Express Rail Link and the Hong Kong–Zhuhai–Macau Bridge, overnight visitors from China increased by 7.4% and day trippers were up 20.1% for the year. However, this uptick in visitor traffic did not translate to a measurable increase in retail sales - December retail sales growth was just 0.1% year-on-year, coming in below estimates.

Despite weaker retail sales in Q4, the recovery in the leasing market was sustained. Categories that saw the strongest expansion activity were mass market retailers in the personal care, pharmaceutical segment and food and beverage (F&B) groups. On the other hand, leasing among luxury retailers were focused on renewals and portfolio optimization. The recovery in both High Street and Shopping Centre rents continued into Q4 and rents were up by 1.5% to 1.6% for the year.

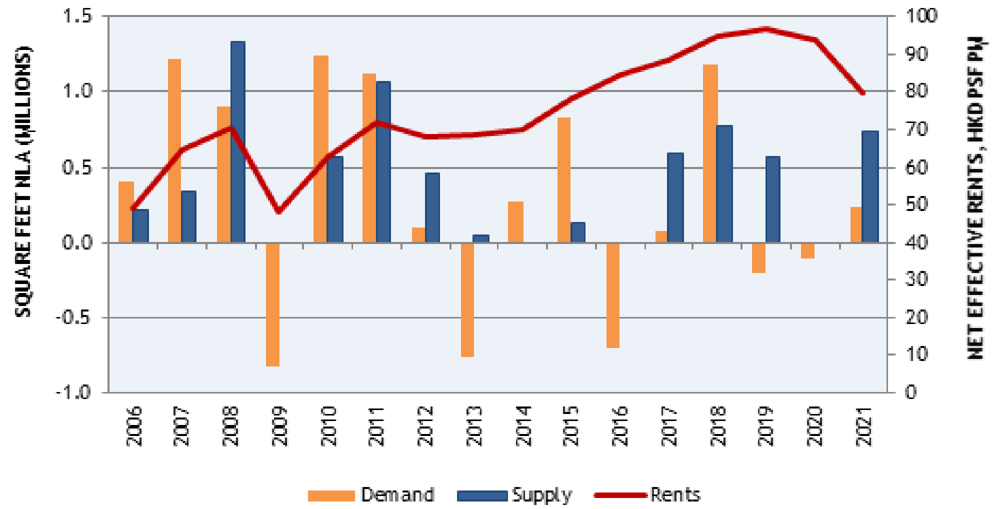
In the near-term, escalating trade tensions and lower economic growth may affect both local and Chinese consumer sentiment. With demand under pressure from both domestic and external fronts, the leasing market could soften in 2019 and slow the retail rental recovery.

PROPERTY MARKET - RESIDENTIAL

After a 28-month rally, the Hong Kong housing market began to correct in August 2018. Price indices from the Hong Kong Rating and Valuation Department reflect a decline of 9.2% in December from its July 2018 peak. In December, the trend softened slightly, with prices down 2.4% month-on-month compared to the 3.2% decline in the previous month. The smaller drop in December could be because of the slowing pace of interest rate increases and the increased turnover for both new and used flats. Some commentary pointed to the idea that the accumulated drop in the previous three months was already large enough to bring buyers back into the market.

Prices in the housing market have long been correlated with liquidity in the banking system - deposit ratios are high and are estimated to be 59 times the market value of new apartments sold last year. With the U.S. Federal Reserve Bank softening their tone of the pace of interest rate increases, as well as the stabilization of the stock market and the Yuan, the outlook for the residential market has turned more positive from the previous quarter. Expectations are now for the market to bottom as early as March 2019 and rise for the remainder of the year.

HONG KONG ISLAND DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL, as of December 2018

RECENT COMMERCIAL TRANSACTIONS

PROPERTY	LOCATION	DATE	SECTOR	PRICE (USDM)	UNIT PRICE (USD/PSF)	YIELD	BUYER
Link REIT Portfolio Sale	Various	Dec-18	Retail	$1,535	$1,653	2.5%-3.0%	Gaw, Blackstone constortium
Mapletree Bay Point	Kowloon	Nov-18	Office	$1,094	$1,925	n.a.	PAG Asia
FWD Financial Centre	Central	Oct-18	Office	$932.4	$4,350	n.a.	Henderson Land
Lever Tech Centre	Kowloon	Sep-18	Office	$159.3	$1,390	n.a.	Sun Zhi Lan
Nob Hill Square	Kowloon	Sep-18	Retail	$114.4	$1,246	3.7%	Winland HK

Source: RCA

Singapore

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (CBD)	7.2%	↓	↑	↑	↓	↔
Retail (Suburban)	2.6%	↓	↑	↓	↓	↔
Residential	6.4%	↓	↑	↑	↑	↔

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 Q4 2018 trend compared with the 12 months through to end Q4 2017. 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.

Rental forecasts across the 2019 to 2020 horizon have been lifted from the previous quarter - CBD rents are now expected to grow up to 15% over the next two year period.

ECONOMY

Singapore's economy grew by 3.3% in 2018, coming in at the upper band of the Ministry of Trade and Industry's (MTI) 2.5% to 3.5% official forecast. Growth in the fourth quarter lost some momentum as the service industry slowed, but strong output in the cyclical biomedical sector helped to pull up manufacturing growth in Q4.

With a challenging and uncertain outlook for global trade and policy for 2019, the government's growth outlook has been broadly set between 1.5% and 3.5%. The possible suspension of further tariff hikes would allow growth to settle in the upper range of that band. Singapore's manufacturing and export momentum is expected to moderate in 2019 and household consumption is also expected to ease from its strong base in 2018. Core inflation in 2018 was 1.7%, up from 1.5% in 2017. The MAS has been on a slight appreciation stance since April 2018 and is likely to continue that at a gradual pace in 2019 amidst the modest growth backdrop.

PROPERTY MARKET - OFFICE

Favorable fundamentals exist in the office sector, where over the 2019 to 2020 period, demand will exceed supply. Rental forecasts across this horizon have been lifted from the previous quarter as demand conditions have proven to be more robust. CBD rents are expected to grow up to 15% over the next two-year period, and leases reverting during this period will be in excess of 20%.

Overall take-up for 2018 was 1.8 million square feet, almost a two-fold increase from levels in 2017. As a result, the year ended with vacancy rates at 7.2%, down by 3.7 percentage-points from a year ago. Demand was noted to be relatively broad-based across financial and business services, technology and media as well as co-working groups. In Q4, Hong Kong-based group Campfire leased an entire building (16 floors or 85,000 square feet) at 139 Cecil Street, marking the largest co-working lease signed in the market to-date.

Recent completions such as Frasers Tower had its pre-commitment rate improve to 90% and 18 Robinson (completing in Q1 2019) has 50% of its space leased in advance. Upside potential for current rental forecasts is the withdrawal of ageing stock for redevelopment, which will put further pressure on vacancies and rents. The withdrawal and redevelopment of Chevron House (220,000 square feet) is confirmed and reflected in forecasts but outside of this, AEW understands redevelopment plans for 78 Shenton Way and Keppel Towers were recently submitted to authorities for approval and could materialize.

PROPERTY MARKET - RETAIL

Despite positive macro-economic conditions such as median income growth and tight labor market conditions, the brick and mortar retail industry continues to face headwinds from shifts in spending habits and consumer interests. Both mall owners and retailers have been focused on reinventing their retail space to ensure its relevance in today's competitive environment, but this has been met with varying degrees of success. Landlords have experimented with tenant-mixes, including more activity-based retailers and incorporating more elements of technology for seamless offline and online integration. As a result, new demand has naturally shifted to F&B groups and entertainment-related retailers such gyms, cooking studios, arcades and kid's play-zones.

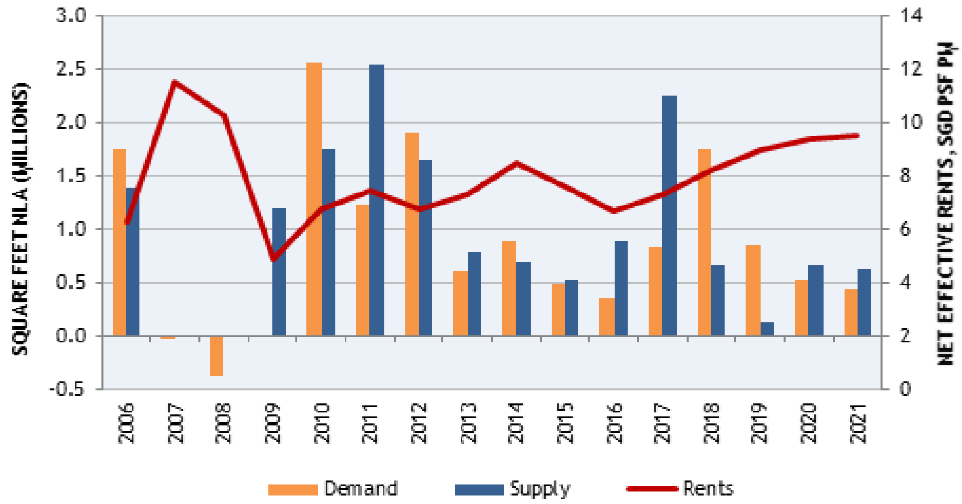
Despite better demand today, the changing tenant profile to include large-form activity-based retailers, which are usually more rent-sensitive, has generally kept the rental recovery mild. Limited supply of standalone malls in suburban areas from the second half of 2019 to 2023 could support a continued recovery in the sector.

PROPERTY MARKET - RESIDENTIAL

In 2018, the government announced two sets of measures linked to the residential market that has and should continue to impact buying sentiment and prices. The first announcement in July aimed at dampening speculative sales activity, by increasing stamp duties as well as tightening financing criteria. Following this, foreign buyers face a total stamp duty of 24% and loan-to-value levels capped at 45% for a second home purchase. While prices continued to hold up in the second half of the year, the effect on sales volumes was significant, with transaction volumes down 40% since end-June. The second measure announced in October was to increase the minimum average unit size of new private residential units to 85 square meters from the previous 70 square meters. This could have a more meaningful impact on prices in 2019, as larger unit sizes would make it difficult for developers to increase the per square foot price. Adding to these dynamics is also the large pipeline going forward, up 60% year-on-year to 40,000 units. These include several new launches from former bulk sale sites - where developers buy apartment blocks from individual owners and develop them to a higher density.

Despite the substantial supply and restrictive buying measures, a large demand pool exists locally. These include public housing upgraders as well as those who recently sold their apartments in the bulk sales program. It is estimated that about SGD$20 billion in collective sale payouts to displaced homeowners from deals over 2017 to 2018 have yet to be deployed back into the property market. The new launches from the former bulk sales sites will also have to factor in the higher land costs paid. Due to a combination of these factors, we expect prices to continue to hold firm or increase moderately in the near term.

SINGAPORE CBD DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL, as of December 2018

RECENT COMMERCIAL TRANSACTIONS

PROPERTY	LOCATION	DATE	SECTOR	PRICE (USDM)	UNIT PRICE (USD/PSF)	YIELD	BUYER
77 Robinson Road	CBD	Jan-19	Office	$520.6	$1,692	3.3%	Gaw Capital
Manulife Centre	CBD Fringe	Jan-19	Office	$415.4	$1,720	3.2%	Chelsfield-ARA JV
78 Shenton Way	CBD	Nov-18	Office	$491.9	$1,364	3.2%	PGIM Real Estate
Ocean Financial Centre (20% stake)	CBD	Nov-18	Office	$388.7	$2,214	3.2%	Allianz Real Estate
Capital Square (25% stake)	CBD	Nov-18	Office	$195.3	$2,021	3.2%	Kenedix

Source: RCA and JLL

Seoul

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Office (Overall)	12.8%	↑	↑	↑	↑	↓
Office (CBD)	17.3%	↑	↔	↓	↑	↓
Office (GBD)	7.5%	↑	↑	↑	↑	↓
Office (YBD)	12.5%	↓	↑	↑	↑	↓

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 Q4 2018 trend compared with the 12 months through to end Q4 2017. 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.

Landlord favorable conditions continue to exist in GBD. In YBD, leasing demand is picking up on the back of attractive incentives and better perception of the submarket. In the CBD, vacancy rates are in the midst of stabilizing after large supply in 2018.

ECONOMY

South Korea's economy grew by 1.0% quarter-on-quarter in Q4 2018, bringing growth for the full year to 2.7%, in line with expectations. The fiscal stimulus helped to mask the 2.2% decline in exports in Q4 as demand for semiconductors and petro-chemicals fell. While domestic consumption numbers were also weak, there have been nascent signs of improvement with a pick-up in employment in Q4 after some weakness seen earlier in 2018.

The US-China trade dispute and slowdown in both economies will continue to affect South Korea going forward, with export momentum expected to come under pressure. Growth for 2019 is expected to slow to 2.3%. The support from the fiscal stimulus, which will be frontloaded in the first half of the year is expected to be more visible in the second half of 2019.

Core inflation in December was 1.3% and is expected to remain suppressed in 2019 due to lower oil prices and the recent fuel tax cut. At the January 2019 meeting, the Bank of Korea ("BoK") left rates unchanged at 1.75% and reaffirmed its commitment to ensuring growth and maintaining accommodative monetary policy.

PROPERTY MARKET - OFFICE

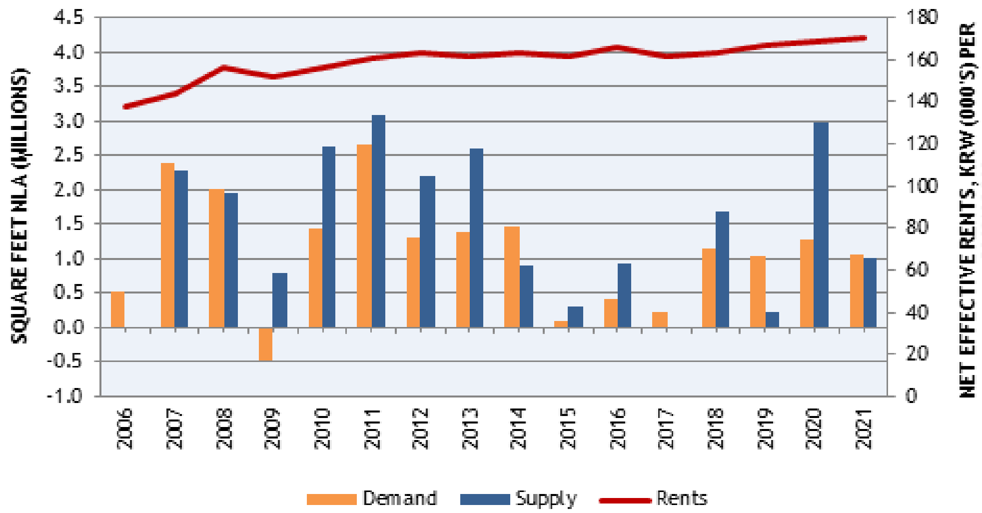
Demand dynamics are varied across Seoul's three-core office submarkets but a common theme reiterated in 2018 was the rapid growth in the co-working sector, estimated to have constituted about 30% of overall take-up in 2018. WeWork and Fast Five currently are the two largest operators but new entrants, such as Singapore-based JustCo and Lotte's Workflex, have entered the market in 2018 with aggressive expansion plans for the near- to medium-term. JustCo plans to branch out to eight different locations in the CBD and Gangnam Business District (GBD) in 2019, while Workflex has announced intentions for 50 locations across Seoul by 2030. Co-working is expected to continue to feature largely in the Seoul office market in 2019.

Landlord favorable conditions continue to exist in the GBD with 2018's new supply (Gangnam N Tower and Luceen Tower) observed to be leasing quickly. With no new supply for the next two-year period (2019 to 2020), vacancies are expected to fall to 2.9% by year-end 2019 and should remain tight in 2020. Incentives in the GBD are currently 1.8 months but are likely to decline further into 2020, providing support to effective rental increases going forward.

In Yeouido Business District (YBD), leasing demand is picking up on the back of attractive incentives and better perception of the submarket. Overall demand in 2018 was 752,000 square feet, more than two times the annual average of the past five-years (2013 to 2017). In H2 2018, the YBD saw a large portion of new leases signed from finance and asset management firms – these were concentrated in the IFC development where vacancy rates have fallen to 25% from 65% at the start of 2018. The next new completion in YBD is Parc One (2020), which would add another 2.1 million square feet and pose a leasing challenge to the market.

Meanwhile in the CBD, vacancy rates are in the midst of stabilizing after large supply in 2018. AEW understands that the bulk of new leases signed in the year was relocation demand, resulting in a series of moves among Grade A buildings. Grade A vacancy remained relatively high at 17.3%, but this is largely due to Centropolis, which completed in Q3 2018. Excluding Centropolis, which was still 100% vacant as of Q4 2018, Grade A vacancy in the CBD was 12.0%, down 1.5 percentage-points from the start of the year. On the other hand, a number of government entities have taken space at various Grade B buildings resulting in the decline of Grade B vacancy to 6.4% by year end. Rental forecasts for 2019-2020 were lowered slightly from last quarter. Incentives are expected to remain high at around 4.0 to 4.2 months while limited competitive supply in the near term will help support gross rental growth.

SEOUL DEMAND, SUPPLY AND RENTAL GROWTH OUTLOOK



Source: JLL, as of December 2018

RECENT COMMERCIAL TRANSACTIONS

PROPERTY	LOCATION	DATE	SECTOR	PRICE (USDM)	UNIT PRICE (USD/PSF)	YIELD	BUYER
State Tower Namsan	CBD	Jan-19	Office	$529.8	$737	4.3%	Mirae Asset
KG Tower	GBD	Dec-18	Office	$84.4	$615	n.a.	KORAMCO
Centropolis Towers	CBD	Oct-18	Office	$1,036.3	$717	n.a.	M&G Real Estate, KTCU and POCA JV
WeWork Building	YBD	Oct-18	Office	$187.4	$397	4.5%	IGIS
Seoul Square Building	CBD	Sep-18	Office	$894.2	$627	n.a.	NH Investment & Securities

Source: RCA

China

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Shanghai						
Office (CBD)	10.6%	↑	↑	↑	↓	↔
Office (CBD - Puxi)	9.4%	↓	↑	↑	↓	↔
Office (CBD - Pudong)	12.1%	↑	↑	↓	↑	↓
Beijing						
Office (CBD)	5.1%	↑	↑	↓	↓	↓
Office (East 2nd Ring Rd)	0.3%	↓	↑	↑	↔	↓

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 2018 trend compared with the 12 months through to end Q3 2017. 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-supply fundamentals in the Pudong CBD submarket are favorable, where no new completions up to 2023 will put upward pressure on rents.

In Beijing, landlords have benefited from the strong pent up demand in a low vacancy rate environment.

ECONOMY

China's 6.6% growth in 2018 was in line with targets for the year despite headwinds from trade tensions and the domestic market slowdown. The economy weakened visibly in the fourth quarter and in December the manufacturing PMI contracted for the first time in 19 months to below the expansionary 50 reading. However, in the domestic market, household consumption continues to hold up well with disposable income of urban households up 5.6% in Q4 2018. Growth forecasts for 2019 of 6.2% depict a year-on-year slowdown but still a significant level of expansion. The current forecast by the IMF incorporates US tariffs announced through to September and a further rise in tariffs to 25% on an additional $200 billion imports from China in March 2019.

Trade discussions continue to be underway leading up to the end of 90-day temporary "truce" on March 1, 2019. Amid heighted concerns on China's growth slowdown, the government has committed to policy measures to stabilize economic momentum. The PBOC's latest cuts in the RRR in January and injection of $83 billion via reverse repo operations confirm the government is on a path to monetary easing. Additional measures to boost the domestic economy include tax reductions, increased fiscal infrastructure spending, and easing of building restrictions in selected cities.

SHANGHAI PROPERTY MARKET – OFFICE

Shanghai's office market received 9.6 million square feet of new office completions in 2018. Demand generally kept pace with new supply, but because vacancies are still high across submarkets, landlords had little bargaining power and rents increased only marginally for the year. About 62% of demand in 2018 was in decentralized markets, led by technology and media companies. In Puxi CBD, demand sources continue to be varied across technology and media, business services and manufacturing, while in Pudong CBD, the bulk of demand still stems from the financial services firms. Rental forecasts for 2019 have been adjusted slightly downwards, given the cautious business sentiment going forward.

Demand-supply fundamentals in the Pudong CBD submarket are favorable, where no new completions in the next five-year (2019-2023) period will put upward pressure on rents. In 2018, the submarket received a large amount of new supply (2.4 million square feet) resulting in vacancy rates increasing 2.0 percentage-points from one year ago to 12.1%. Vacancies are generally concentrated in the newer completions in the Lujiazui precinct, where take-up has been slower than initially expected. AEW understands that domestic financial service companies have pulled back on their expansion plans, but foreign finance firms could emerge as a substantive portion of new demand 2019. At the same time, there have been reports of some occupiers relocating to the decentralized Pudong submarket where rents are at a 50% to 55% discount to CBD. These relocations have been mostly limited to manufacturing and trading firms. Despite these challenges, the market is expected to turn highly landlord-favorable after 2019 when excess supply gets absorbed and vacancies become limited. The supply shortage will become more pronounced in the longer term as there is currently no more commercial land supply in the Pudong CBD. Vacancy rates are expected to fall from their 12.1% peak at the end of 2018 to 3.4% by end 2023. Effective rent growth is expected to accelerate from 1.4% up to 5.8% per annum over the next five year (2019 to 2023) period.

BEIJING PROPERTY MARKET – OFFICE

Pent-up demand conditions persisted through the year and headline vacancy rates in Beijing fell by 2.2 percentage-points through the year to 4.9% by year-end. Across the core central office markets, net effective rents rose in the range of 2.2% to 7.7% for the full year.

Domestic finance, technology and media as well as the State Owned Enterprise (SOE)-backed firms remain the largest sources of demand in the Beijing office market. Leasing activity was strong in the first three quarters of the year but turned slightly soft in Q4 amid weakened economic sentiment. In Q4, more instances of tenants renewing leases at existing premises was observed. Meanwhile, the technology sector continued to display high levels of expansion due to strong policy support and surpassed the finance sector as the largest source of demand in the second half of 2018. In districts where the vacancy rates remained lower than 1.0% like East 2nd Ring Road and Finance Street, landlords were especially selective about signing on new tenants, rejecting occupiers with limited track record or with low credit quality.

New supply in Beijing's core office markets is expected to peak in 2019 with 4.6 million square feet coming online in the new CBD precinct, Guomao. Self-use and pre-commitments rates are healthy and AEW estimates that 76% of the leasable space is already committed. Beyond 2019, only three new completions are currently expected in the Guomao precinct, after which there will be no future supply till 2024.

Beijing's occupier base is largely domestic with an estimated 85% of stock occupied by local firms, making it more resilient to shocks in the global economy. Nevertheless, moving into 2019, landlords have slightly lowered their expectations for demand. CBD rents are now expected to remain stable in the next two-year term, with the rental outlook more positive in submarkets with limited new supply.

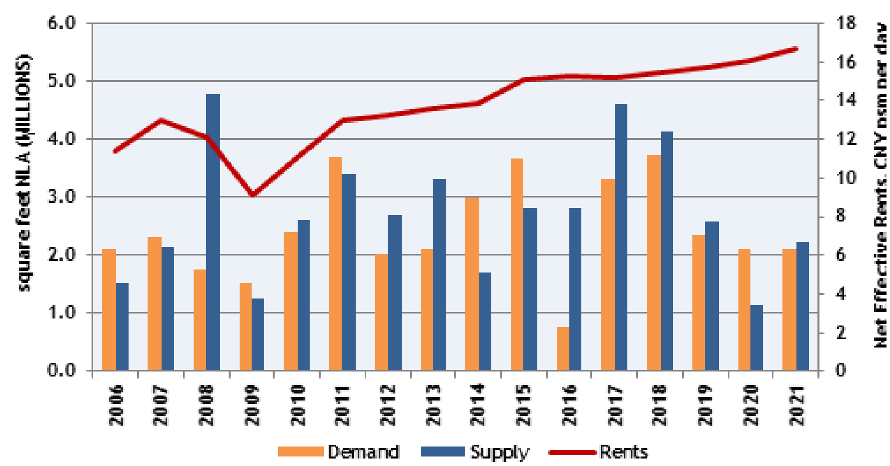
PROPERTY MARKET – BEIJING RETAIL

In 2018, retailers in Beijing had an active year, with expansion seen across almost all store categories. Net absorption across central areas in 2018 was 1.7 million square feet, slightly above the 1.5 million square feet of the new supply that year. Malls now have more dining and entertainment-type tenants to draw large crowds and increase footfall. JLL estimates that about 37% of all new store openings in 2018 were in the F&B space while another 7% were entertainment and lifestyle orientated. In 2018, there was also a significant amount of online to offline (O-2-O) demand, including supermarkets and fitness groups. Some of these brands such as the fitness app "Keep" have chosen central locations as an entry place into the offline market.

Going forward, retail supply will mostly be concentrated in the outer-lying districts and thus will not affect the centrally located sub-clusters such as Wangfujing and the CBD. In fact, future supply in the central retail areas are limited, with only three projects under construction and expected to complete in the 2020 to 2021 timeframe. Similar to the office market, construction delays are common which could result in these projects hitting the market a little later than currently anticipated. Furthermore, latest development restrictions by The Beijing Municipal Government will also limit any large scale retail development within the 4th Ring Road area. The policy adjustments are expected to significantly reduce the new commercial land supply in central areas and should have a positive effect on capital values and rental expectations for existing stock.

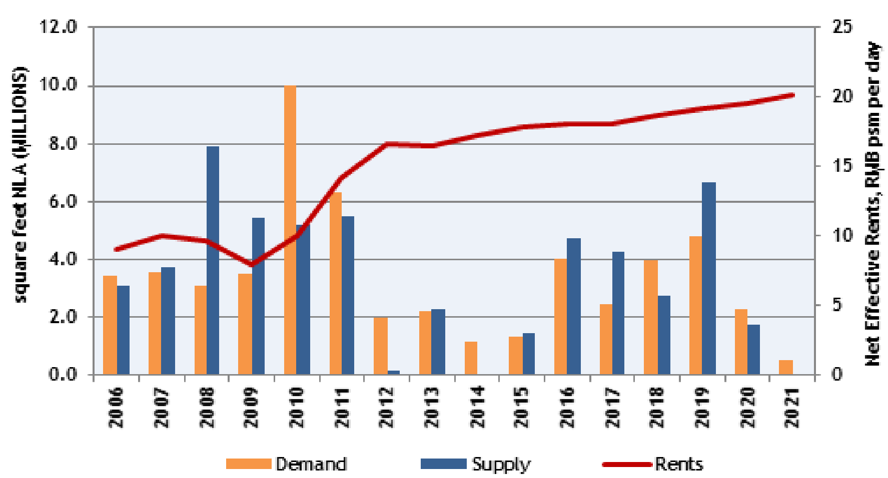
With demand still healthy and limited supply after 2018 in the central submarkets, vacancy rates are expected to remain low. Rents are expected to grow at around 1.0% to 1.5% in 2019 as retailers maintain cautious about expansions plans. The better managed malls with established landlords will continue to outperform their peers in terms of rental growth.

SHANGHAI CBD DEMAND, SUPPLY AND RENTAL GROWTH OUTLOOK



Source: JLL, as of December 2018

BEIJING OVERALL DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL, as of December 2018

RECENT COMMERCIAL TRANSACTIONS

PROPERTY	LOCATION	DATE	SECTOR	PRICE (USDM)	UNIT PRICE (USD/PSF)	YIELD	BUYER
Beijing Jingtong Roosevelt Plaza	Beijing	Jan-19	Retail	$372.4	$512	3.7%	LINK REIT
Star Harbour Intl Centre Portfolio	Shanghai	Dec-18	Office/ Retail	$1,839.6	$558/$530	n.a.	CapitaLand, GIC
Pacific Century Place Mixed-use Portfolio	Beijing	Dec-18	Office/ Retail	$1,327.5	$1,085/$735	3.9%	Yuanjing Mingde
Mapletree Shanghai Portfolio	Shanghai	Nov-18	Biz Park/ Retail	$1,184.3	$503/$486	n.a.	Blackstone
Shanghai Ocean Tower	Shanghai	Nov-18	Office	$426.3	$789	3.7-3.8%	Gaw Capital, QuadReal Property

Source: RCA

Market is expected to remain landlord favorable in Sydney's CBD with vacancy rates falling further over the next 12-month period.

Occupier profile in North Sydney is changing with larger firms and MNCs committing to space in upcoming projects. Effective rental growth is expected to gain pace in 2019.

Above-average demand conditions in Melbourne continue to exert pressure on rents.

Australia

KEY REAL ESTATE INDICATORS

	VACANCY RATE		RENTS	ABSORPTION	COMPLETIONS	CAP RATES
Sydney						
CBD	4.1%	↓	↑	↑	↓	↓
North Sydney	8.6%	↑	↑	↓	↔	↓
Pyrmont	6.4%	↑	↑	↑	↔	↓
MELBOURNE						
CBD	3.7%	↓	↑	↑	↑	↓

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 Q4 2018 trend compared with the 12 months through to end Q4 2017. 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.

ECONOMY

Australia expanded by 3.0% in 2018, with macro-economic indicators generally positive. Exports are on an upward trend supported by additional mining and LNG capacity, and investment is expected to pick up with confidence surveys generally in the expansionary territory. In contrast, the domestic market was weak, with household income and wage growth sluggish as well as the negative wealth effect from the falling housing market affecting consumer spending. A more pronounced economic slowdown in China is a further threat to the Australian economy in 2019, with growth expected to come in at 2.5% in 2019.

Month-to-month, CPI inflation readings in Australia have consistently come in below the RBA's target 2% to 3% range. In December, the core inflation reading was 1.8% year-on-year. At the most recent meeting on 6 February 2019, the RBA kept the cash rate on hold at 1.5% for the 30th consecutive month. With several dynamics to balance including falling housing prices and low inflation, the RBA is now adopting a more balanced view on the direction of rates going forward.

PROPERTY MARKET - SYDNEY CBD OFFICE

Since Q4 2014, face rents in the CBD have seen 17 quarters of consecutive growth, increasing by up to 60% in the secondary market while incentives have declined by 13 to 14 percentage-points over the same period. In Q4 2018, vacancy rates in the CBD fell to 4.1%, hitting a new low since 2000, keeping the office market tight.

New supply will be added from Q4 2019 onwards, which will provide some relief to the pent-up demand conditions. Pre-leasing for projects currently under construction such as 60 Martin Place (completing in Q4 2019), Wynyard Place (2020) and 275 George Street (2020) are expected to ramp-up in 2019. Vacancies are expected to drop further by the end of 2019 to 3.8%, a new 10-year historical low. Limited space availability will ensure that the market remains landlord favorable in 2019.

Incentives have reached a cyclical low and will likely start to increase going forward, especially as pre-leases for upcoming developments get confirmed. Generally, landlords of newer buildings offer larger incentives to entice potential tenants, which should have an effect on the wider market. As new supply adds some relief to the leasing market in 2020 and beyond, rental growth will slow. We expect net effective rents to grow in the range of 5% to 6% in 2019 before slowing in 2020.

PROPERTY MARKET - PYRMONT OFFICE

The submarket has seen limited supply since 2008 and double digit growth of small businesses in past years in the Pyrmont district has contributed to healthy office take-up. Gross leasing volume in 2018 was 195,000 square feet, about 1.8 times the volume in the previous year. The submarket has seen a 16% to 30% increase in face rents from 2015 to 2017 and in 2018 alone, face rents increased by another 3% to 4% across prime and secondary stock.

The submarket is located about three kilometers west of the Sydney CBD. On-going transport infrastructure improvements are underway to improve the connection to the CBD and other neighboring suburbs. In addition, after Google's purchase of a campus style office building in June 2018, interest in the market has increased from occupiers in the technology and media space. Google is expected to expand into their newly acquired premises in Pyrmont by 2020 and in addition to their current occupied space in a separate facility, would have a total footprint of about 480,000 square feet in the submarket.

In the near-term, only one project is expected to complete in Pyrmont by end 2019– 21 Harris (named the Workspace). French Public Relations company – Publicis, has committed to a 10-year lease in the building and the bulk of the remaining space is understood to have been taken up by an offshore co-working operator. Currently, only the smaller office and retail units are left. Once complete, 21 Harris, will inject more life into the area, with street level retail as well as additional facilities such as a gym and childcare center. The building has also recently been sold, setting new record in the submarket on a per square meter basis.

With minimal new supply in the near-term, and more activity being generated in the area due to transport developments and new amenities, we expect interest in the precinct to stay firm. Vacancy rates are expected to trend below the long-term average, providing further support to rental growth.

PROPERTY MARKET - NORTH SYDNEY OFFICE

Contiguous space options for lease remain limited, with about 720,000 square feet withdrawn since the start of 2016 to make way for residential and transport infrastructure. The completion of the Sydney Metro and Victoria Cross Station in 2024 will improve accessibility to North Sydney and firm-up its status as a secondary CBD.

Leasing markets in 2018 were active, but dominated by smaller occupiers. These were mostly technology and media firms from within the submarket or relocating from nearby commercial precincts. Notably, WeWork took their first position in the North Sydney market in Q4 2018, leasing 44,000 square feet at 50 Miller. Overall demand for the year however fell to -161,000 square feet, brought down by several tenants relocating out of the submarket. In Q4, the Ministry of Health vacated their premises at 73 Miller and will now split operations between Chatswood and St Leonard.

Demand is expected to pick up in the next 12-months, as the pending completion of new projects (100 Mount in 2019 and 1 Denison in 2020) will create some movement in the market. 100 Mount has a pre-commitment rate of 65%, but AEW understands that it is expected to be fully leased by the time of practical completion in Q2 2019.

As of end 2018, North Sydney still presents an attractive value proposition (35% discount to CBD rents). This differential could push more large CBD occupiers to split and relocate back office operations to the North Sydney market. Effective rental growth is expected to gain pace in 2019, rising by between 8% and 10%.

PROPERTY MARKET - MELBOURNE CBD OFFICE

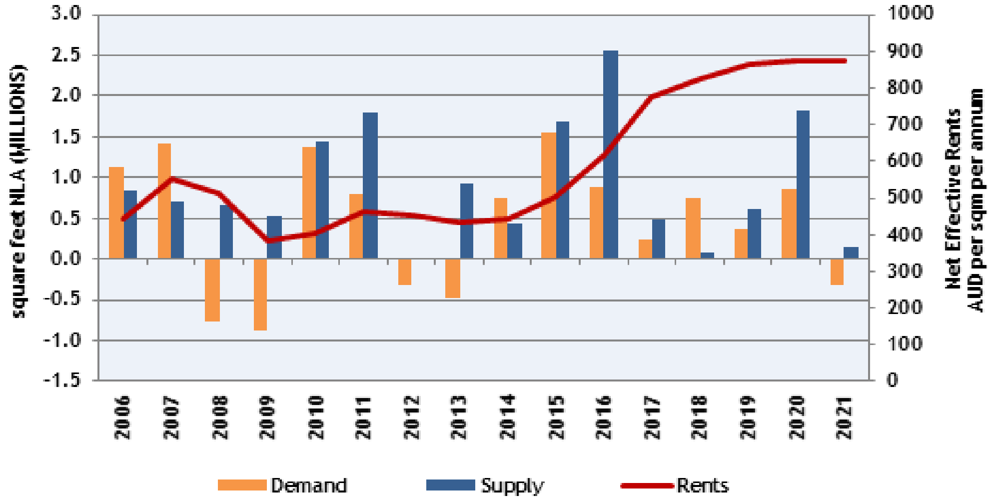
Above-average demand conditions in Melbourne continue to exert pressure on rents. The CBD has seen 19 consecutive quarters of positive take-up and in 2018, demand amounted to 1.8 million square feet, more than double the past 10-year (2008 to 2017) average. By end 2018, net effective rents were up 8.0% year-on-year and headline vacancy tightened further to 3.8%, the lowest level seen in the market since 1989.

The 8% net effective rental growth in 2018 was lower than initially expected due to a slight slowdown in leasing activity in the last quarter of the year. AEW understands that landlords were holding back on signing new leases due to the expectation of further rental increase in the following months. We expect some of the growth initially baked into 2018 numbers to come through in 2019.

In 2018, the market received close to 1.0 million square feet in new completions and as a result demand patterns for the year showed a flight to quality as occupiers moved into newly completed buildings. With the bulk of new leases taking place in prime grade stock in 2018, prime and secondary vacancy rates diverged slightly by the end of the year with prime grade at 3.0% and secondary grade at 5.2%. Nonetheless both still sit below their long term averages. A substantial portion of take-up for the year was characterized as business expansion. At the same time, co-working continues to play a central feature of demand in the Melbourne market. Melbourne's co-working penetration rate of 1.8% of total stock is currently higher than Sydney's and most facilities typically cater to corporates.

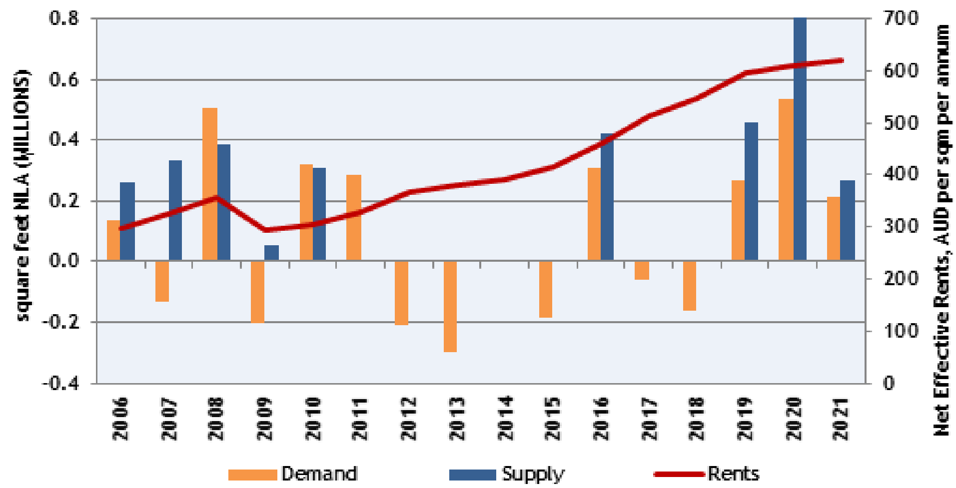
In 2019, another 1.8 million square feet of new completions are expected with close to 90% of this pre-committed in advance. Leasing markets are therefore expected to remain tight in the next year, with backfill leasing particularly active from education tenants and smaller businesses. Net effective rent growth for 2019 was increased from earlier forecasts and is now expected to continue to grow in the range of 8% to 9% year-on-year.

SYDNEY CBD DEMAND, SUPPLY AND RENTAL GROWTH OUTLOOK



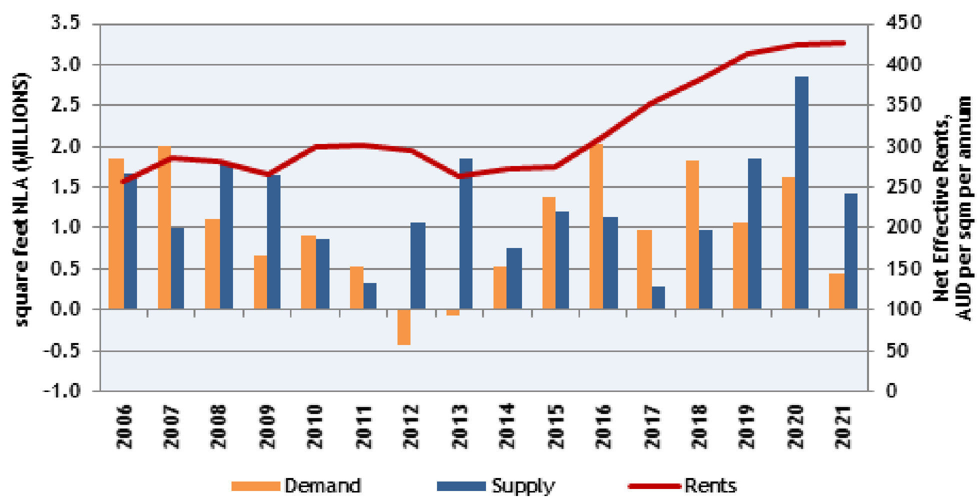
Source: JLL, as of December 2018

NORTH SYDNEY DEMAND, SUPPLY AND RENTAL GROWTH OUTLOOK



Source: JLL, as of December 2018

MELBOURNE CBD DEMAND, SUPPLY AND RENTAL OUTLOOK



Source: JLL, as of December 2018

RECENT COMMERCIAL TRANSACTIONS

PROPERTY	LOCATION	DATE	SECTOR	PRICE (USDM)	UNIT PRICE (USD/PSF)	YIELD	BUYER
King St Wharf Office Portfolio	Sydney CBD	Dec-18	Office	$581.5	$1,248-$1,307	4.5%	CharterHall REIT
595 Collins Street	Melbourne CBD	Dec-18	Office	$229.6	$669	5.4%	Foo Hang Jewellery
541 St Kilda	Rest of Melbourne	Dec-18	Office	$46.8	$528	5.0%	Marpop Development
60 Margaret Street (50%)	Sydney CBD	Nov-18	Office	$294.7	$1,182	n.a.	Blackstone
Coca-Cola Place	North Sydney	Sep-18	Office	$325.9	$1,062	n.a.	M&G Real Estate

Source: RCA

For more information, please contact:

GLYN NELSON

Director of Research, Asia Pacific

glyn.nelson@aew.com
+65.6303.9016

HANNA SAFDAR

Research Associate, Asia Pacific

www.aew.com/asia

AEW