

MARCH 2017

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AUSTRALIA —

AUSTRALIAN REAL ESTATE TRENDS

Standing **TALL**

AUSTRALIA TO SET WORLD RECORD FOR LONGEST
SPAN OF ECONOMIC GROWTH
PAGE 6

CBD OFFICE SECTOR CONSIDERED TO BE BEST
INVESTMENT OPPORTUNITY OVER NEXT 12 MONTHS
PAGE 15



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URBAN PROPERTY
AUSTRALIA —

FOREWORD

March 2017

Dear Readers,

When Urban Property Australia (UPA) and Situs RERC began to conduct research on the Australian commercial real estate market last year, a number of major global events had sent shock waves through the financial and capital markets. Since then, populist and protectionist sentiment have taken hold in Western nations, driven in part by rising concerns over an influx of refugees and immigrants and a string of high-profile terrorist attacks. Notably, the United Kingdom (UK) voted in June 2016 to leave the European Union (EU) and the United States (US) elected Donald Trump to the presidency.

In this time of uncertainty, there is increasingly greater scrutiny on investment decisions and strategies. In this inaugural issue of the *Australian Real Estate Trends* report, we provide data-driven insights into the opportunities for investment into the Australian commercial real estate market. Australia's soon-to-be record-breaking economic performance provides a solid foundation for investors who are seeking the respectable risk-adjusted returns that commercial real estate can offer.

On 1 April 2017, Australia will surpass the Netherlands for the longest-running economic expansion on record, with 104 consecutive quarters of growth without a recession. The ease of doing business in Australia – with its stable and transparent regulatory and legal system, strong ethical governance and high professional standards – has led to a significant rise in foreign capital inflows for the commercial and residential real estate markets. Australia's real estate yields, coupled with market fundamentals improving, has led to foreign investment appetite strengthening further.

Based on Situs RERC and UPA's market expertise and the results of an Australian investor survey, we found that foreign capital has been a primary driver of the Australian commercial real estate market. Situs RERC, UPA and the vast majority of survey respondents agreed that the impact of foreign capital on the Australian commercial real estate market over the last three years has been positive and that foreign capital invested into the Australian commercial real estate market will increase over the next three years. In addition, 88 percent of our survey respondents said that they believe the Australian economy would rise or remain stable in 2017.

We wish to extend our gratitude to those who completed our first quarter 2017 Australian Market Expectations survey. Your willingness to share your expert opinions on the Australian commercial real estate market has allowed us to share current trends with the industry as a whole. We thank you for your time and effort.

Sincerely,



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CONTACT US

Please contact Situs RERC or Urban Property Australia with questions about the research in this report at publications@rerc.com

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STANDING TALL IN AUSTRALIA

Australia is poised to break the world record for the longest streak of economic growth in history. On 1 April 2017, Australia will reach 104 quarters of economic growth without a recession, surpassing the previous record holder, the Netherlands.

This is a momentous achievement for Australia, which survived the Great Financial Crisis (GFC) better than most other global economies. In spite of the economic headwinds stemming from the GFC, the Australian economy offers an oasis of safety for investors amid global, geopolitical storms. In particular, Australian commercial real estate is seen as a safe haven for investment, as evidenced by foreign capital inflows into the Australian market.

Australia's strong economy, accessible market and stable government have made the country a highly desirable investment destination for real estate investment. Sustained business and consumer confidence, record low interest rates and the low Australian dollar have further boosted investor appetite for Australian property from offshore investors. Additionally, China's economic growth has contributed to a notable lift in Australia's coal and iron ore prices and spurred increased mining project construction and increased exports, especially for natural resources, in recent years.

However, there are some economic headwinds facing Australia, of which investors should take note. In addition to the lingering effects of the GFC, a potential decrease in Chinese economic growth would likely place some downward pressure on the Australian economy. While yields on most Australian commercial real estate sectors have fallen below previous benchmark lows, causing concern for some investors, the rental outlook of particular regions and sectors will help offset the benchmark low yields in the near term.

To gain further insight into Australian commercial real estate, Situs RERC and UPA conducted a survey of institutional and regional investors in the market. Our results indicated that investment conditions for most of the commercial property sectors surveyed rated above average in the first quarter of 2017. Central business district (CBD) office assets dominated survey responses as the best investment opportunity during 2017 for Melbourne, Sydney and Brisbane.

For Australia overall, respondents indicated that CBD office assets surpassed all other commercial property sectors as the best investment opportunity during 2017. Expectations of value and rent growth for all of Australia's major commercial property sectors were both positive, with the majority of respondents expecting growth between 0 percent and 10 percent throughout 2017.

By property type, respondents reported that the highest internal rates of return (IRR) for Australia overall were found in the industrial sector (9.23 percent) and the retail big box/bulky goods/large format sector (9.44 percent). High IRRs can also be found for the suburban office sector, with rates of 9.16 percent.

Sydney is already a top 10 destination for offshore capital, closely followed by Melbourne. Brisbane is also gaining investor interest. Total real estate investment in Australia is currently 17 percent above the 10-year average, while cross-border investment is 63 percent above the 10-year average. In 2017, Australia's economic growth is forecast to be 3.0 percent. Over the past year, growth has been even more pronounced in regions such as the Northern Territory (11.1 percent growth) and the Australian Capital Territory (7.2 percent growth). Within a global context, Australia is increasingly a major focus for international investors and is expected to continue a world-record pattern of growth for years to come.

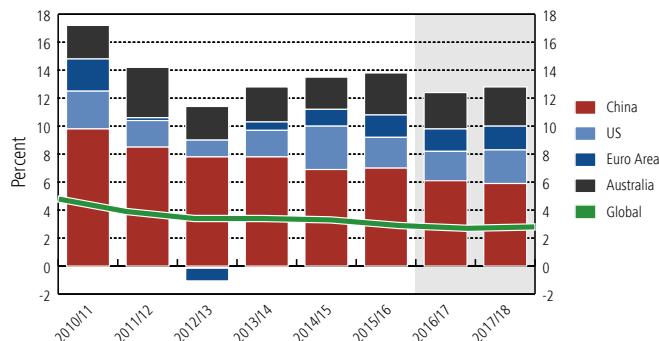


GLOBAL ECONOMIC OUTLOOK

While global events resulted in 2016 being a relatively subdued year for economic growth, economic activity is projected to pick up the pace in 2017 and 2018, especially in emerging and developing economies. However, there is a wide range of projected outcomes given the uncertainty surrounding the policy stances of the recently elected US president, Donald Trump, and the global ramifications of his actions.

Global economic growth is estimated to be 3.1 percent for 2016, according to the International Monetary Fund (IMF) (see Exhibit 1). This stable average growth rate, however, masks divergent developments in different country groups. There has been a stronger-than-expected pickup in growth in advanced economies, but growth prospects have marginally worsened for emerging markets and developing economies, where monetary policy has generally tightened. Near-term growth prospects were revised up for China, due to expected policy stimulus, but were revised down for a number of other large economies — most notably India, Brazil and Mexico. It has been nine months since the Brexit referendum. Initial panic in the financial and capital markets has been replaced by a wait-and-see attitude by the majority of investors. In January 2017, the UK Supreme Court determined that Parliament needed to approve Brexit before negotiations could begin. Article 50 is expected to be triggered on 29 March. Once formal negotiations begin, the UK has up to two years to withdraw from the EU.

Exhibit 1. World Annual GDP Growth



Note: Shaded area indicates forecast.

Sources: International Monetary Fund, Urban Property Australia, January 2017.

Currently, the global commercial real estate market has witnessed little fallout from the Brexit decision. The commercial real estate market is still considered to be the best asset class compared to other investment alternatives, both in the UK and abroad. Uncertainty still looms in the minds of investors, especially regarding upcoming European elections, which could introduce risk regarding the solvency of the EU.

In another shock to the global markets, Mr. Trump was elected president of the US. While the Trump administration is expected to bring tax cuts (both personal and business), an increase in infrastructure and military spending, and pro-business policies, investors are becoming anxious about what many consider the hastiness of Mr. Trump's decisions, especially in relation to free-trade agreements and controls on immigration and foreign work visas.

One of Mr. Trump's first actions as president was to withdraw from the Trans-Pacific-Partnership (TPP), a 12-nation trade agreement negotiated and endorsed by the Barack Obama administration. This move was widely considered to be a foreshadowing of future protectionist Trump administration policies and a rebuff to long-standing allies of the US, such as Japan and Australia, even though its passage by the US Congress was in doubt, regardless of who had been elected. Many US economists are concerned about the repercussions of this executive order as China will likely fill the economic void from the US's TPP dissolution.

Greater political uncertainty, tepid international trade and lower productivity marked a lacklustre 2016. Economic drag came from several quarters, including low commodity prices, the unexpected outcome of the referendum on Brexit, as well as regional political upheavals such as the impeachment of the presidents in Brazil and South Korea and the coup attempt in Turkey. However, the global economic growth outlook in 2017 is expected to be rosier, reflecting an increase in trades to and from emerging and developing countries, and an assumption of fiscal stimulus in major economies — particularly the US — and its effect on other countries.

Having proven resilient to global challenges last year, the European economic recovery is expected to continue this year and next. For the first time in almost a decade, the economies of all EU member states are expected to grow in 2017 and 2018. However, the outlook is surrounded by higher-than-usual uncertainty. The eurozone is projected to grow by 1.6 percent per annum over the next two years, and the UK economy is expected to grow by 1.5 percent in 2017, lower than the 2.0 percent growth achieved in 2016, according to IMF forecasts.

Eurostat shows that the EU experienced slower economic growth along with the rest of the world, with 2016 Gross Domestic Product (GDP) growth of 1.9 percent, down from 2.2 percent growth in 2015. With the Brexit negotiations en route, the data from the Organisation for Economic Cooperation and Development (OECD) show that the UK's GDP growth fell to 1.8 percent in 2016 from 2.2 percent in 2015. Now, all eyes have turned to the eurozone packed political

"Economic activity is projected to pick up the pace in 2017 and 2018, especially in emerging and developing economies."

calendar. The Netherlands went to the polls in March 2017 and will be followed later in the year by France in April and Germany in September. Developed eurozone economies such as Germany, France and Italy displayed modest economic conditions with 2016 GDP growth of 1.7 percent, 1.3 percent, and 0.9 percent, respectively. The eurozone was plagued by a number of obstacles, including high debt in certain economies, banking sector vulnerabilities and greater political uncertainties.

In the Americas, economic trends were mixed as the US GDP growth rate slowed from 2015 to 2016. Canada showed some strength, while Brazil continued to show weakness. GDP growth rates in the US, Canada and Brazil were 1.6 percent, 1.2 percent and -3.3 percent, respectively. The slow growth rate in the US was on the back of lacklustre business investment, historically low oil prices and the strength of the dollar, which made imports more attractive and expanded the trade deficit. The improvement in the Canadian economy came from increased household consumption and a drop in imports. Meanwhile, Brazil's economic rout deepened in a year marked by corruption and recession.

The US economy continues along the same sluggish growth path it has experienced in its recovery from the GFC. Moderate growth in the US is expected to continue, but with some strengthening later in the year if, as expected, the new presidential administration delivers fiscal stimulus. However, the size of any stimulus is likely to be more conservative than what the president advocated during the election. Trump's upcoming priorities are tax reform and deregulation. The IMF estimates that the US economy grew by 1.6 percent in 2016, and is predicted to build to 2.3- percent growth in 2017 and 2.5 percent in 2018.

Even though China's growth rate was a bit stronger than expected (supported by continued monetary stimulus), activity was weaker than expected in some Latin American countries such as Argentina and Brazil that are currently in a recession, and Turkey, which faced a sharp contraction in tourism revenues. Activity in Russia was slightly better than expected, in part reflecting firmer oil prices.

The Asia Pacific region experienced GDP growth of 2.2 percent in 2015 led by India and China, according to Asia-Pacific Economic Cooperation (APEC) data. According to the IMF, India and China GDP grew at 7.6 percent and 6.6 percent, respectively, in 2016. The yuan strengthened and China's economic growth figures were compelling. The Chinese government aims to deliver economic growth of around 6.5 percent in 2017. Likewise, India experienced favourable conditions even after the government's sudden move to cancel 500- and 1,000-rupee notes. Japan's growth stemmed from a weak yen that boosted exports and business investment, bringing the full-year growth for 2016 to 1 percent, due to rising business confidence in the country because of the Bank of Japan's accommodative monetary policy.

Having overtaken China as the world's fastest growing major economy, India is forecast to continue gathering momentum. Recently, India has benefited from low energy prices, and it is less exposed to the risk of global trade wars than most other major economies. According to the IMF, the Indian economy is projected to grow by 7.2 percent in 2017 and 7.7 percent in 2018. By 2030, India's working-age population is expected to rise by 125 million people – and account for more than half of the 233 million working-age population expected across Asia as a whole. India's economic growth is likely to result in greater demand for Australian resources to meet increasing infrastructure needs.



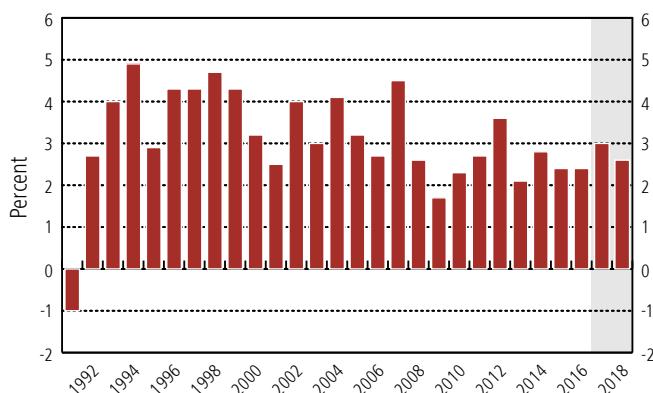
"The European economic recovery is expected to continue this year and next."

AUSTRALIAN ECONOMIC OUTLOOK

Australia is on the cusp of achieving an unprecedented event in modern world history. On 1 April 2017, Australia will surpass the previous Dutch-held record to lay claim to the title of the longest economic expansion on record, entering its 104th quarter of economic growth without recession.

Australia avoided a second consecutive quarter of negative economic growth – which would be by definition a recession – by rising 1.1 percent in fourth quarter 2016 to an annual rate of 2.4 percent (see Exhibit 2). Business investment rebounded 1.6 percent in the same quarter but was down 6 percent on a yearly basis. Household consumption rose 0.9 percent in the fourth quarter to be up 2.6 percent from a year ago. Dwelling investment also climbed 1.2 percent in the fourth quarter to reach 5.6 percent on a yearly basis.

Exhibit 2. Australian Annual GDP Growth



Note: Shaded area indicates forecast.

Sources: Australian Bureau of Statistics, Urban Property Australia, March 2017.

Prospects for 2017 are more encouraging with 3.0 percent growth expected. However, despite ongoing low interest rates and a significantly more competitive Australian dollar, economic growth is expected to slow in 2018, registering only 2.6 percent, with mining investment easing and household consumption constrained by weak labour income growth.

Australia's growth prospects are closely aligned with developments in China. Chinese direct investment has played a significant role in Australia's residential construction boom. However, the Chinese authorities' concerns with ongoing capital outflow are likely to weigh on offshore property investment activity. A slowdown in Chinese

foreign investment is likely to ease pressures on housing prices, particularly in 2018.

China's economic transition presents significant opportunities for Australia. Demand for Australian goods and services is expected to benefit from China's rising middle class in urban areas, which according to economists with ANZ Bank is expected to increase from about 528 million in 2014 to 854 million in 2030 to a total of 93 percent of the urban population. It is important to note, however, that continued reliance on monetary policy stimulus measures, rapid expansion of credit and slow progress in addressing corporate debt, especially in hardening the budget constraints of state-owned enterprises, raises the risk of a sharper slowdown or a disruptive adjustment.

Nonetheless, business conditions in Australia jumped for the second straight month in January 2017, hitting multi-year highs that are well above the long-run average. Business confidence also improved markedly in January 2017, spurred on by the financial market enthusiasm since late last year. The improvement in confidence levels is consistent with an anticipated rebound in economic activity, following the very weak second half of 2016. With that said, key industries like retail remain extremely weak, which suggests the outlook for consumption remains cloudy.



"On 1 April 2017, Australia will surpass the previous Dutch-held record to lay claim to the title of the longest economic expansion on record, entering its 104th quarter of economic growth without recession."

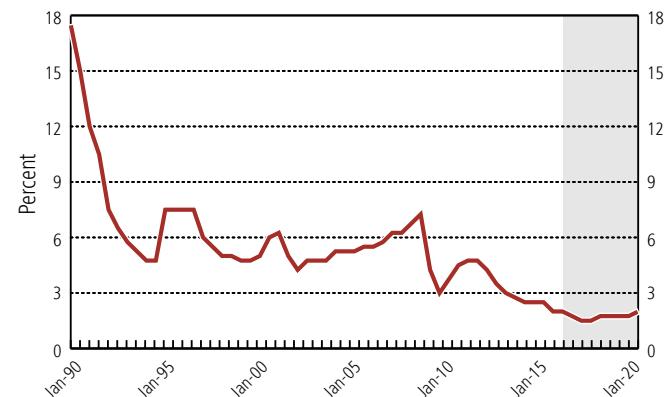
Modest growth in household spending, a contraction in residential construction activity and possibly a slowdown in services exports will restrain employment growth. While leading indicators of the labour market, such as job advertisements, point to strengthening employment growth over 2017, the unemployment rate will likely move back towards 6 percent in 2018.

Since the mining investment boom peaked four years ago, the Australian dollar has fallen significantly, supporting other exporters. Wage growth also fell, which aided Australia's international competitiveness while lower interest rates have cushioned job growth in other sectors.

While Australian interest rates, as of January 2017, are at record-low levels at 1.5 percent (see Exhibit 3), concerns about the economic outlook in 2018 and impending softening of the domestic economy indicates that the Reserve Bank of Australia (RBA) may remain hesitant to raise rates too early. The Australian dollar is forecast to depreciate through 2017 to a low of AUD/USD 0.70, in line with an anticipated strengthening in the US dollar and key commodity prices retracing.

Over the past year, economic growth has increased the most in the Northern Territory, up 11.1 percent, and the Australian Capital Territory is up 7.2 percent. Tasmania grew 2.4 percent. Among the Australian states, New South Wales (NSW) had the strongest state demand growth of the major states, up 4.1 percent, followed by Victoria (VIC), up 3.4 percent (see Exhibit 4). South Australia (SA) and Queensland (QLD) rose 2.1 percent and 1.8 percent, respectively. Although Western Australian (WA) demand was down 7.8 percent over the year, it rebounded 0.4 percent in fourth quarter indicating the worst might be over.

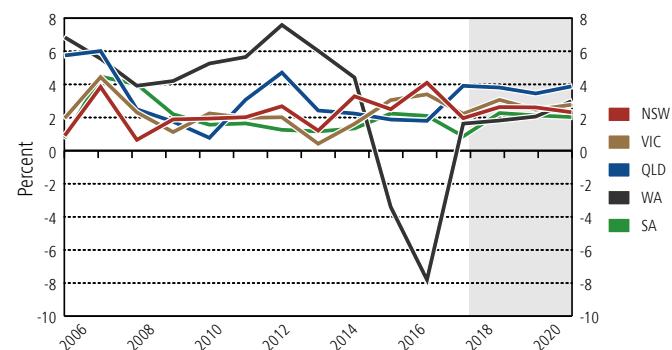
Exhibit 3. Australian Interest Rate



Note: Shaded area indicates forecast.

Sources: Reserve Bank of Australia, Urban Property Australia, March 2017.

Exhibit 4. State Economic Growth



Note: Shaded area indicates forecast.

Sources: Reserve Bank of Australia, Urban Property Australia, March 2017.



“Demand for Australian goods and services is expected to benefit from China's rising middle class, which according to some estimates is expected to increase from about 528 million in 2014 to 854 million in 2030 to a total of 93 percent of the urban population.”

GLOBAL INVESTMENT ACTIVITY

According to Real Capital Analytics (RCA), globally, transactions of commercial property totalled US\$1.3 trillion in 2016, down 4 percent from 2015; however, volumes remain above the 10-year average. The decline in transaction volume was not a reflection of easing investor appetite, as yields in major global cities moved well below their 10-year average levels. Transaction volumes were hindered by the uncertainty resulting from the Brexit referendum, the US presidential election campaign and vendors becoming increasingly reluctant to divest assets.

While global investment volumes for the past three years have surpassed the 10-year average, diverging trends are emerging. RCA's data reveals that in 2016 Germany (US\$60.2 billion) overtook the UK (US\$59.9 billion) as the top transaction market in Europe for the first time, while New York (US\$17.77 billion) overtook London (US\$17.71 billion) as the top overall destination for cross-border capital and

China became the largest market in Asia Pacific for income-producing assets.

While total global transaction volume fell in Europe and the Americas in 2016, commercial property investment levels rose in the Asia Pacific region. Asia Pacific investment totalled US\$584 billion in 2016, 15 percent higher than 2015 and the second highest level on record. Investment in Asia Pacific accounted for 45 percent of global investment volumes, its highest proportion since 2013.

According to RCA, China became the Asia Pacific region's largest investment market for all income-producing properties for the first time in 2016 with US\$36.6 billion in total transactions. While investment in Japan (US\$29.2 billion) and Australia (US\$23.5 billion) in 2016 followed China, investment volumes fell in both countries, leading to an overall fall in Asia Pacific investment from levels recorded in 2015.

"In 2016, investment in Asia Pacific accounted for 45 percent of global investment volumes, its highest proportion since 2013."



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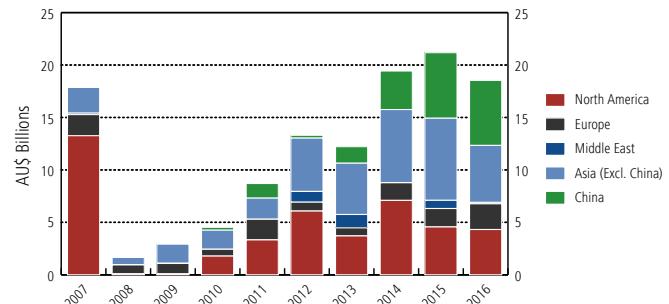
AUSTRALIAN INVESTMENT ACTIVITY

According to RCA, total real estate investment (domestic and off-shore) in Australia totalled US\$29.9 billion in 2016, 27 percent lower than 2015 levels; however, it is still 17 percent above the 10-year average. Overseas investors continued to drive Australian investment, purchasing 45 percent of transactions by value in 2016, followed by domestic institutions (26 percent) and private investors (25 percent).

Cross-border real estate investment into Australia in 2016 totalled AU\$18.5 billion from 300 properties (see Exhibit 5). Although off-shore investment did not surpass the record-high levels of 2015, cross-border investment into Australia in 2016 was still 63 percent above the 10-year average.

Representing a structural shift in the property markets, Asia-based investors accounted for 63 percent of all cross-border flows in 2016, up from 14 percent in 2007. Specifically, Chinese buyers dominated cross-border capital flow into Australia in 2016, spending more than AU\$6.2 billion, accounting for 34 percent of all cross-border investment over the year (see page 11 for an illustration of foreign capital flows).

Exhibit 5: Cross-border Investment into Australia by Origin-capital Region



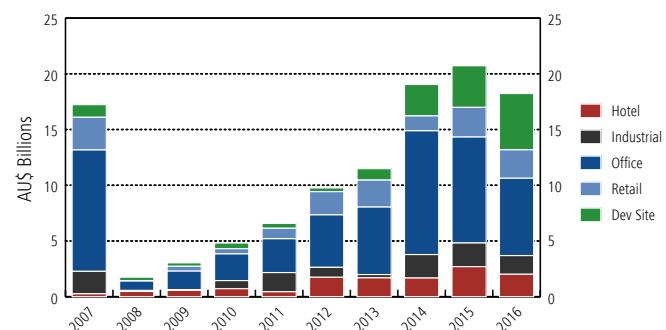
Sources: Real Capital Analytics, Situs RERC, Urban Property Australia, January 2017.

Capital from Greater China into the Australian property market has grown 293 percent in the last three years. This capital has largely focused on development opportunities across Australia; development sites accounted for 43 percent of all acquisitions. Overall, Chinese-based investors concentrated on Sydney and Melbourne with the two cities claiming 90 percent of all Chinese capital over the past three years.

Offshore investors spent AU\$6.9 billion on Australian office assets (see Exhibit 6), primarily in Sydney and Melbourne, capitalising on the increasing tenant demand and the associated rental outlook. As shown in Exhibit 7, development sites accounted for 27 percent of all cross-border purchases followed by retail assets (14 percent) and hotel properties (11 percent).

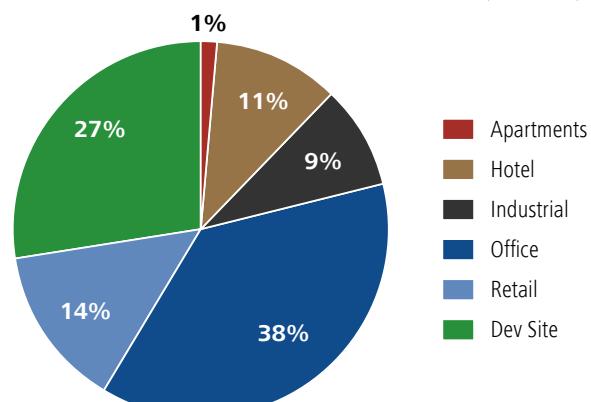
Aside from development sites and apartment purchases made by offshore investors, all other sectors recorded a fall in volume levels in 2016 compared to the preceding year; every sector, however, recorded, above-average transaction levels in 2016.

Exhibit 6: Cross-border Investment into Australia by Asset Type



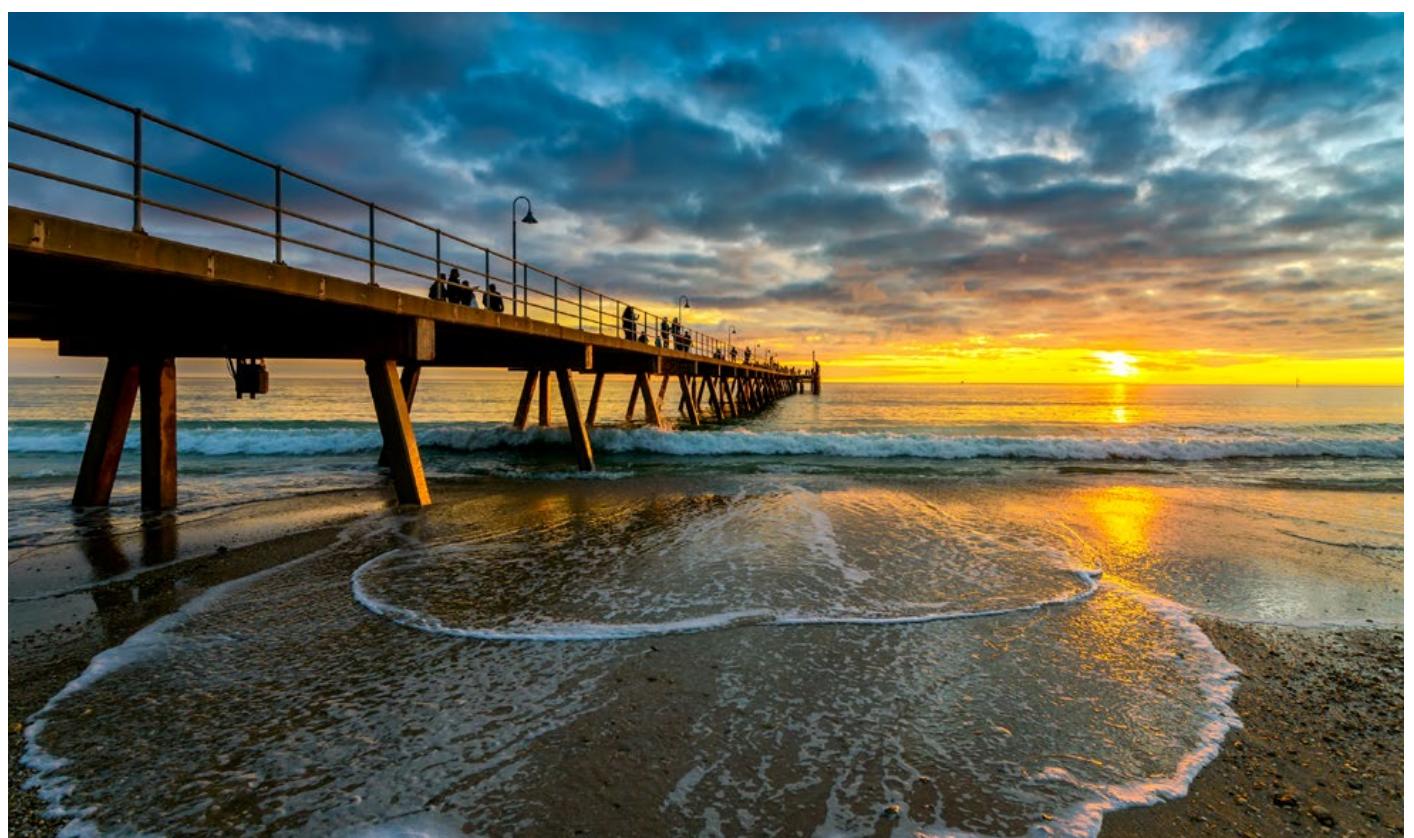
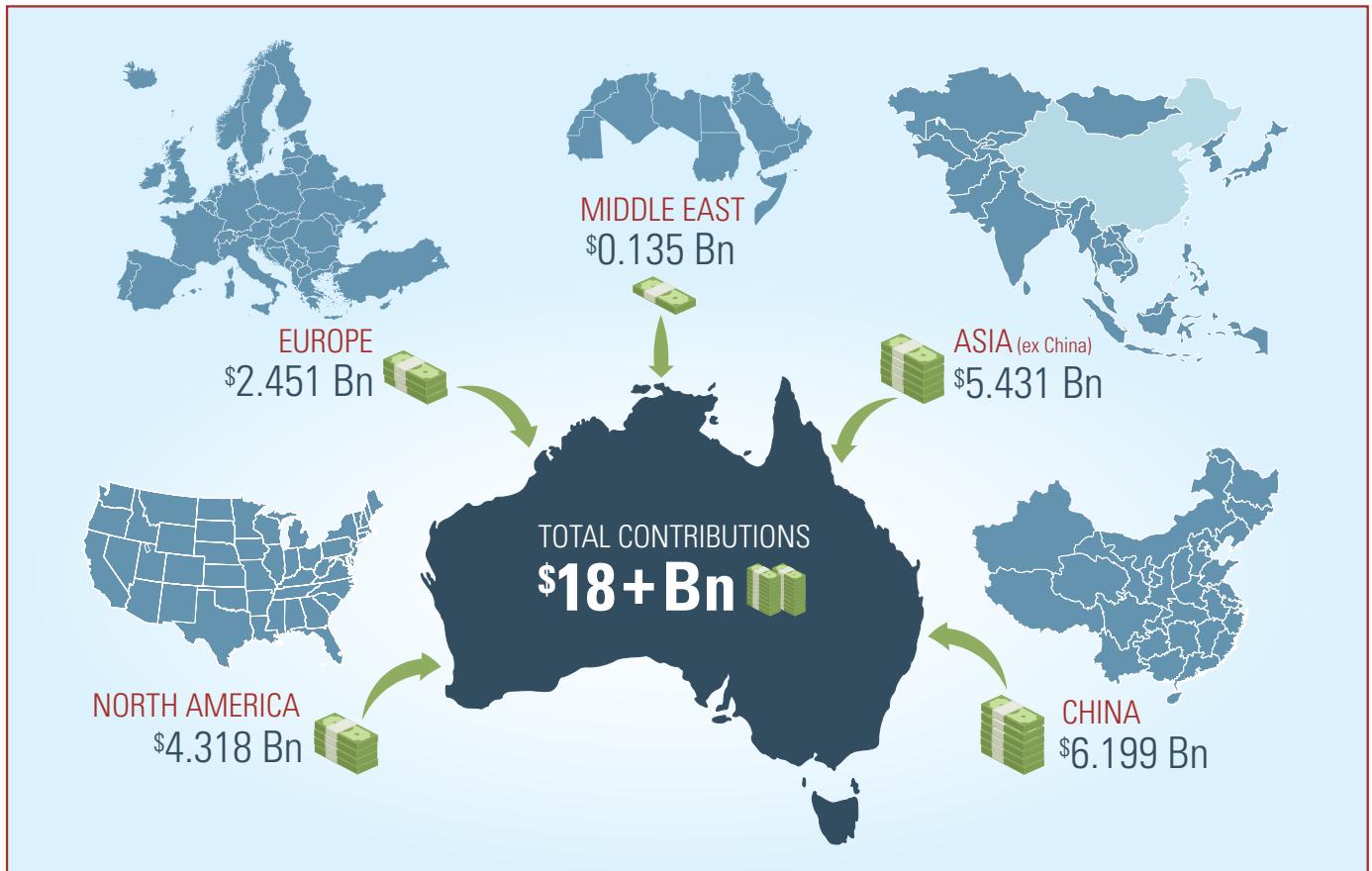
Sources: Real Capital Analytics, Situs RERC, Urban Property Australia, January 2017.

Exhibit 7: 2016 Australian Real Estate Investment by Asset Type



Sources: Real Capital Analytics, Situs RERC, Urban Property Australia, January 2017.



Exhibit 8. Foreign Capital Flows into Australia - 2016

North American investors remain active in the Australian property market (see Exhibit 9), accounting for 23 percent of all cross-border transactions in 2016. Highlights of North American acquisitions include JP Morgan's purchase of 28 Freshwater Place in Melbourne for AU\$286 million and Invesco's purchase of 77 King Street in Sydney for AU\$160 million.

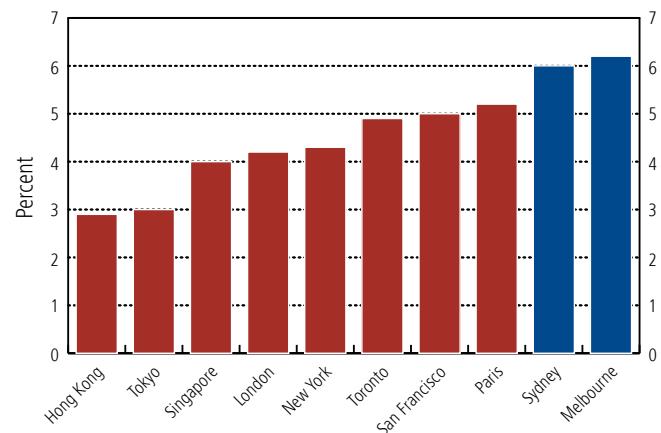
Looking forward, North American investment is forecast to gather momentum as demonstrated by Blackstone's recent announcement to launch a US\$5 billion fund targeting shopping centres and warehouses in Australia and Southeast Asia. This will be the second fund following the US\$5.08 billion Blackstone Real Estate Partners (BREP) Asia, which closed in 2014. The first fund targeted Japanese residential real estate, Australian office buildings and Chinese retail properties and delivered investors an internal rate of return of 17 percent per annum.

With offshore real estate investment into Australia previously peaking in 2007, cross-border investment increased tenfold from 2008 to 2015, with consecutive record highs set in 2014 and 2015. According to RCA, for the past three years, Sydney has been a top 10 global destination for offshore capital. Melbourne ranked number 10 for offshore capital

in 2014 and number 15 for offshore capital in 2016, while Brisbane continues to mature as a destination for foreign capital.

The growth in cross-border transaction activity has been a driving factor in pushing down Australian commercial real estate yields, including office, retail and industrial, over the past three years. In particular, the Australian office market still offers value compared to other global office markets, even though global real estate yields are below their 10-year averages in most global markets (see Exhibit 10).

Exhibit 10: Global Prime Office Yields



Source: Urban Property Australia, January 2017.

Exhibit 9: Top 10 Cross-border Investment Buyers into Australia in 2016

Rank	Investor	Region
1	Blackstone	North America
2	AXA Group	Europe
3	Zhengtang Group	Asia
4	Yunnan Metro	Asia
5	Invesco	North America
6	Sekisui House	Asia
7	JP Morgan	North America
8	Morgan Stanley	North America
9	Dahua Group	Asia
10	Shanghai Shenglong	Asia

Source: Real Capital Analytics, January 2017.



"North American investment into Australia is forecast to gather momentum as demonstrated by Blackstone's recent launch of a US\$5 billion fund targeting shopping centres and warehouses in Australia and Southeast Asia."

AUSTRALIAN-BASED CAPITAL FLOW

Once again, Australian investors are seeking opportunities in offshore regions after largely being absent from the overseas market since the GFC. Australian investors spent AU\$1.8 billion offshore in 2016 following AU\$5.9 billion spent on offshore real estate assets. Prominent Australian investors who have made recent major offshore acquisitions include AustralianSuper, QIC, Cromwell and Goodman Group. Australian offshore investment previously peaked at approximately AU\$12 billion in 2005. Given that the Australian real estate market is already highly institutionalised, and the weight of capital continues to grow, it is likely that Australian investors will once again explore offshore real estate opportunities.

In 1992, a universal compulsory superannuation scheme was introduced in Australia. All employers were required to contribute a percentage of an employee's salary into a superannuation plan. Initially capped at 3 percent, it has risen over the years and since 2002 has been set at 9 percent. Starting in July 2013, contributions were to be increased annually, reaching 12 percent of an individual's salary in 2020.

Australia's superannuation system has assets under management that are estimated to be worth US\$1.4 trillion, by some measures the fourth largest asset pool in the world, despite a population of only 23 million people.

Real estate has long been at the core of the investment options for the Australian superannuation industry, accounting for approximately 10 percent (US\$103 billion) of funds under management. The real estate allocation is split roughly 60 percent to direct investment and 40 percent into indirect investment vehicles such as REITs and unlisted funds. However, the domestic direct real estate market is relatively small, reflecting the size of the population and the domestic economy.

During the last cycle (1998 to 2006), Australian investors, many of them fuelled by super fund money, made significant commitments to overseas markets particularly in the US and UK/Europe. Although there are over 500 super funds (excluding self-managed super funds), many are small with no significant direct real estate exposure. In reality, only a handful of groups have the capabilities and the platform to invest overseas independently, including the Australian Future Fund, which manages the federal government's future pension liabilities. Joint ventures and dedicated investment mandates with specialist local managers are likely to be the preferred approach by the larger Australian super funds as they move offshore. Recent examples of

preferred investment partnerships include Australian Super providing a mandate to Henderson focusing on the UK retail sector, the Australian Government Employees Super Trust (AGEST) and Q Super providing capital to AEW for overseas opportunities.



"Australia's superannuation system has assets under management estimated to be worth US\$1.4 trillion, by some measures the fourth largest asset pool in the world."

INVESTOR SENTIMENT

As part of the inaugural first quarter 2017 Situs RERC/UPA Australian Market Expectations survey, respondents were asked to provide insight for commercial real estate across five of the Australian capital cities (Adelaide, Brisbane, Melbourne, Perth and Sydney) during 2017.

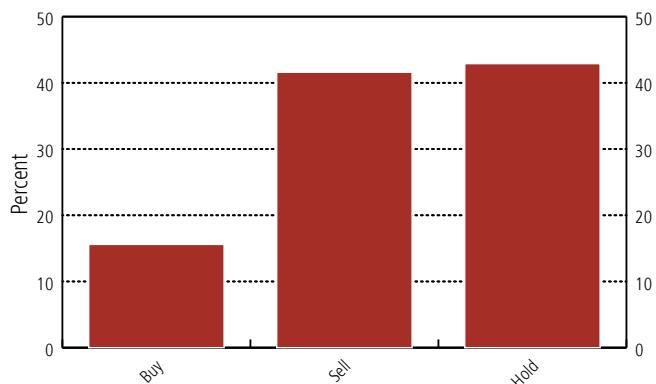
Respondents who contributed to the first quarter 2017 Situs RERC/UPA Australian Market Expectations survey consisted of fund managers, investment bankers, REIT analysts, superannuation fund managers, valuers/appraisers, financiers, private investors and real estate agents. The variety of respondents ensured that the analysis of the survey offers insight into investor sentiment and provides a useful tool to evaluate investment trends for the commercial real estate market.

Buy-Sell-Hold Recommendations

For Australia overall, first quarter 2017 survey respondents indicated that it will be a good time to either hold or sell commercial real estate next quarter, with approximately 40 percent of respondents recommending each strategy (see Exhibit 11). In comparison, buying commercial real estate was the least appealing investment option to respondents, accounting for only 16 percent of all responses.

Within **Melbourne**, approximately 50 percent of respondents said that the next quarter will be a good time to hold commercial real

Exhibit 11. Buy-Sell-Hold Recommendations



Note: Results are for Australia overall and include data from Adelaide, Brisbane, Melbourne, Perth and Sydney.

Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.

estate, the largest hold recommendation among the Australian capital cities surveyed. Selling commercial real estate in Melbourne was the second best investment recommendation, endorsed by 40 percent of respondents. In comparison, in **Sydney**, half of the respondents (approximately 50 percent) said it will be a good time to sell commercial real estate, followed by the recommendation to hold. Among all five capital cities surveyed, only **Brisbane** respondents reported that it will be a good time to buy commercial real estate next quarter.



Investment Conditions

For Australia overall, investment conditions for each of the individual property sectors surveyed, except the industrial sector, were considered above average in the first quarter of 2017. For the CBD office sector, the majority of respondents (35 percent) said that investment conditions were above average, and an additional 23 percent of respondents reported that investment conditions were excellent, as shown in Exhibit 12. The majority of respondents (44 percent) for the suburban office sector said that investment conditions were above average, while 30 percent of respondents considered conditions to be average during first quarter 2017. Nearly half of the industrial sector respondents (48 percent) reported that investment conditions were average, and approximately 32 percent of respondents said that conditions were above average. Investment conditions for the retail super and major regional shopping centre and retail big box/bulky goods/large format sectors were above average.

Among the five capital cities surveyed, the majority of respondents in **Melbourne** considered investment conditions for the CBD and suburban office sectors and the retail super and major regional shopping centre sector to be above average. However, industrial sector conditions in Melbourne were average, according to respondents. For **Sydney**, investment conditions for the CBD office and industrial sectors were excellent during first quarter 2017, while respondents reported that conditions for the suburban office sector were either above average or average. Investment conditions for the retail big box/bulky goods/large format sector in Sydney were considered above average by the majority of respondents. In **Adelaide**, respondents reported that investment conditions for the CBD and suburban office sectors were above average. In **Perth**, respondents considered investment conditions for the CBD office, suburban office and industrial sectors to be, in general, average. In **Brisbane**, the majority of property sectors were considered to have average investment conditions during the first quarter, with the exception of the suburban office sector, which was considered average or below average, according to respondents.

Investment Opportunities

For Australia overall, during the next 12 months, the CBD office sector towered over other property sectors, as 38 percent of respondents



Exhibit 12. Investment Conditions (by Asset Type)

	Poor	Below Average	Average	Above Average	Excellent
CBD Office	2%	13%	27%	35%	23%
Suburban Office	2%	11%	30%	44%	13%
Industrial	0%	7%	48%	32%	13%
Retail Super & Major Regional Shopping Centre	0%	8%	16%	72%	4%
Retail Big Box/Bulky Goods/Large Format	0%	12%	28%	60%	0%

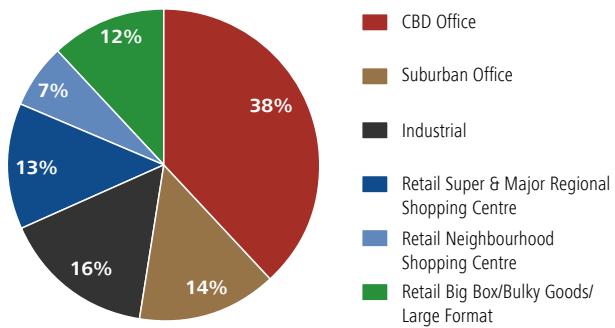
Note: Results are for Australia overall and include data from Adelaide, Brisbane, Melbourne, Perth and Sydney.

Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.

considered the CBD office sector to be the best investment opportunity during first quarter 2017 (see Exhibit 13). The industrial sector was considered the best investment opportunity by approximately 16 percent of respondents, while 15 percent of respondents said that the suburban office sector was the best investment opportunity. In comparison, the retail neighbourhood shopping centre sector was considered the best investment opportunity by only 7 percent of respondents.

Among the five capital cities, the CBD office sector dominated survey responses as the best investment opportunity during the first quarter of 2017 for **Melbourne**, **Sydney** and **Brisbane**. In contrast, within the **Perth** and **Adelaide** markets, responses were mixed in respect to best investment opportunity for 2017, with no clear distinction across the property sectors.

Exhibit 13. Best Investment Opportunity (By Asset Type)



Note: Results are for Australia overall and include data from Adelaide, Brisbane, Melbourne, Perth and Sydney.

Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.

Value and Rent Expectations

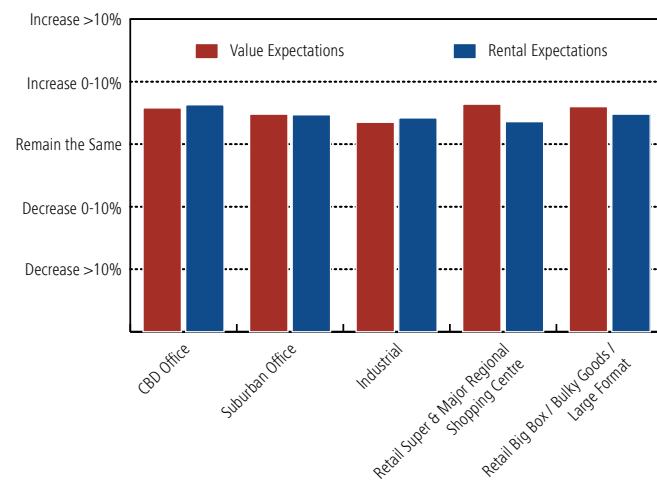
During first quarter 2017, Situs RERC/UPA's survey respondents were asked to share their expectations for net effective rent and value changes for the commercial real estate property sectors across five of Australia's capital cities over the next 12 months.

For Australia overall, expectations of value change for all of Australia's property sectors surveyed by Situs RERC/UPA were positive, with the majority of respondents expecting change between 0 percent and 10 percent throughout 2017. In terms of respondent expectations of value change, the retail super and major regional shopping centre sector only just eclipsed the retail big box/bulky goods/large format sector as the property sector in Australia judged to increase in value the most in 2017, as shown in Exhibit 14. Regarding effective net rent growth rates, respondents expect the CBD office, industrial and retail big box/bulky goods/large format sector rates to increase between 0 percent and 10 percent. However, rent growth rates

for the suburban office and retail super and major regional shopping centre sectors were expected to remain the same, according to the majority of respondents. Notably, 12 percent of respondents reported that they expect the CBD office sector rate to increase more than 10 percent over the next 12 months.

Among the five capital cities, in **Sydney**, the CBD office sector was expected to increase the most in terms of rent and value growth, whereas in **Perth**, rent and value levels for the CBD and suburban office sectors and the industrial sector were expected to remain the same or marginally decrease. In **Melbourne**, respondents expected to see the largest increases in rent and value growth throughout 2017 for CBD office and suburban office sectors, followed by the retail super and major regional shopping centre sector.

Exhibit 14. Net Effective Rent/Value Change Expectations (By Asset Type)



Note: Results are for Australia overall and include data from Adelaide, Brisbane, Melbourne, Perth and Sydney.

Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.

Foreign Capital Impact on the Australian Commercial Real Estate Market

Foreign investment has always been an important feature of Australia's economic growth and commercial real estate. In recent years, foreign investment has driven total Australian commercial real estate investment, with offshore groups having purchased 45 percent of all commercial transactions. Foreign investment totalled AU\$18.5 billion in the year 2016. As a result of the increased weight of money seeking investment in Australian commercial real estate, yields across most sectors have fallen to record-low levels.

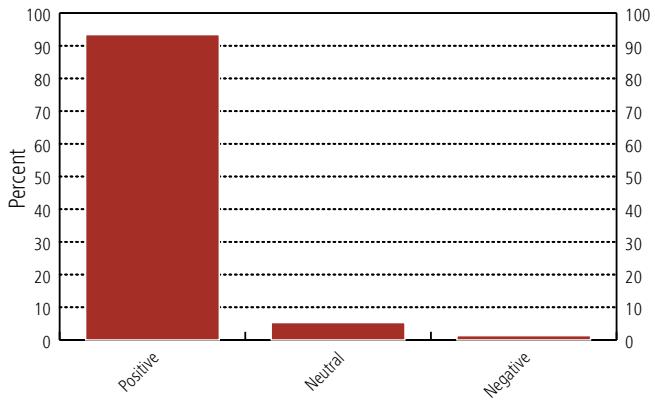
During first quarter 2017, the vast majority of survey respondents (93 percent) reported that the impact of foreign capital on Australian

"The CBD office sector towered over all other commercial property sectors as the best investment opportunity in Australia during 2017."

commercial real estate over the previous three years has been positive, with only 1 percent of respondents indicating that foreign capital has been negative for Australian commercial real estate, as shown in Exhibit 15.

Looking ahead at the next three years, the majority of respondents (79 percent) said that foreign capital invested into Australian commercial real estate will increase, as shown in Exhibit 16. It should be noted though, that Situs RERC/UPA's first quarter 2017 survey was conducted prior to recent regulatory changes in China, which may restrict funds movements into Australia. Chinese buyers dominated cross-border capital flow into Australia in 2016, spending more than AU\$6.2 billion, accounting for 34 percent of all cross-border investment over the year.

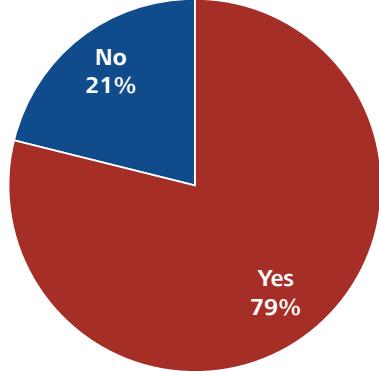
Exhibit 15. Foreign Capital Impact on Australian Commercial Real Estate



Note: Results are for Australia overall and include data from Adelaide, Brisbane, Melbourne, Perth and Sydney.

Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.

Exhibit 16. Foreign Capital Into Australian Commercial Real Estate Outlook



Note: Results are for Australia overall and include data from Adelaide, Brisbane, Melbourne, Perth and Sydney.

Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.



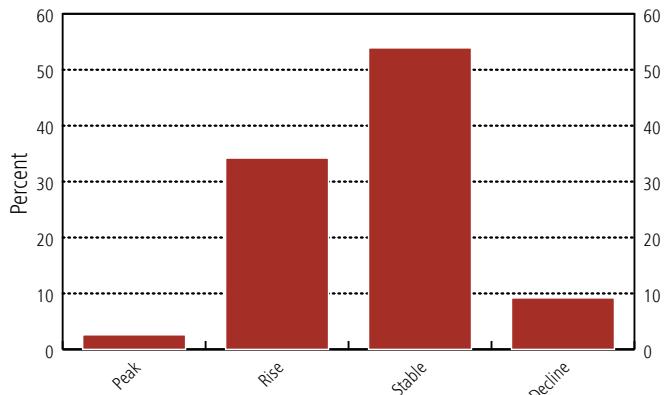
“93 percent of survey respondents believed that the impact of foreign capital on Australian commercial real estate over the previous three years has been positive.”

Australian Economy and Interest Rate Outlook

In terms of the performance of the Australian economy during the next 12 months, the majority of survey respondents (54 percent) indicated that the Australian economy will remain stable, while 34 percent of respondents predicted that the Australian economy will rise (see Exhibit 17). Only 9 percent of survey respondents indicated the Australian economy will decline in 2017.

With an interest rate of 1.5 percent as of December 2016, 83 percent of respondents indicated that the Australian interest rate will

Exhibit 17. Performance of Australian Economy in 2017



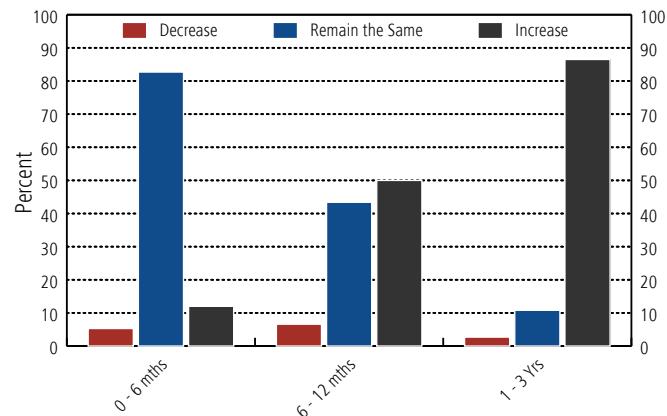
Note: Results are for Australia overall and include data from Adelaide, Brisbane, Melbourne, Perth and Sydney.

Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.

remain the same over the next six months, whereas respondents were divided about the movement of the interest rate six to twelve months from now (see Exhibit 18). While approximately half (50 percent) of survey respondents predicted that the Australian interest rate will increase during the second half of 2017, 43 percent of survey respondents indicated that interest rates will remain stable during the same period.

Beyond 2017, the majority of survey respondents (87 percent) predicted that the Australian interest rate will increase from 2018 through 2020.

Exhibit 18. Australian Interest Rate Expectations



Note: Results are for Australia overall and include data from Adelaide, Brisbane, Melbourne, Perth and Sydney.

Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.



“88 percent of survey respondents predicted that the Australian economy will rise or remain stable over the next 12 months.”

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SYDNEY

Sydney is the most populous city in Australia and Oceania. There are approximately 451,000 businesses based in Sydney, including 48 percent of the top 500 companies in Australia and two-thirds of the regional headquarters of multinational corporations. Global companies and investors are attracted to the city in part because its time zone spans the closing of business in North America and the opening of business in Europe.

Economy

NSW experienced a quarterly growth of 0.8 percent and annual growth of 4.1 percent in fourth quarter 2016, according to the Australian Bureau of Statistics. During 2016, NSW was the fastest growing state in Australia, experiencing growth at twice the national average. The key driver of the fourth-quarter result was a resurgent consumer, household consumption and housing investment. In 2015, employment levels surged in excess of 4 percent for the first time in 20 years; whereas in 2016, employment growth was negligible. However, prospects for more robust employment gains in 2017 are emerging across the state.

Sydney ranked fifth in the world in terms of cross-border investment, with total inflows of approximately US\$14.4 billion (see Exhibit 19). This puts Sydney in line with Shanghai and Berlin in terms of foreign capital inflows.

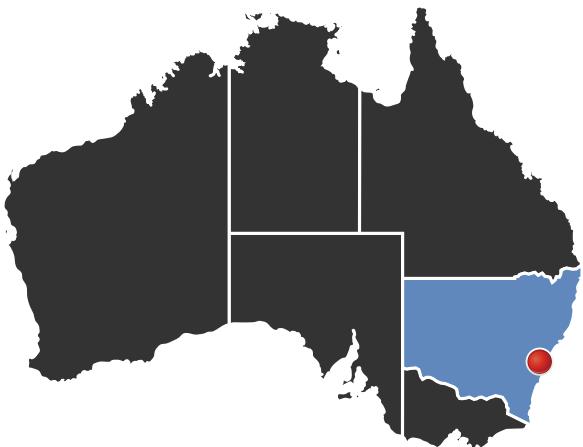
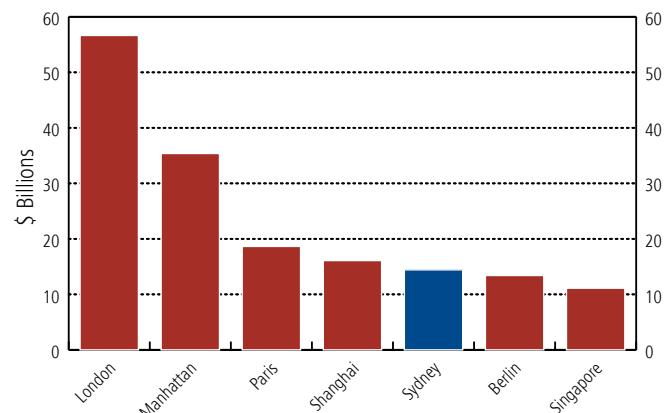


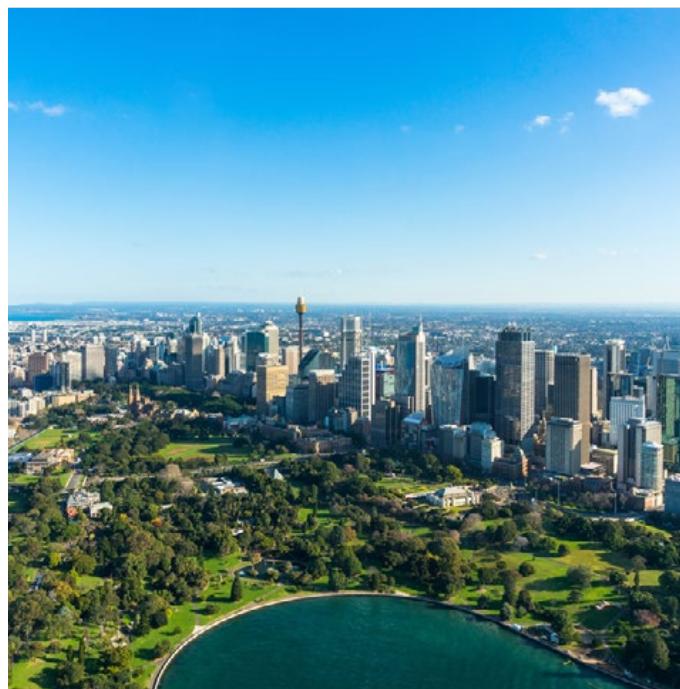
Exhibit 19. Real Estate Cross -border Investment



Sources: Real Capital Analytics, Urban Property Australia, January 2017.

Office Market

With the Sydney CBD office sector vacancy rate falling to an eight-year low and recording its strongest level of net effective rent growth in over 20 years, Sydney was the envy of many CBD office markets across the world. Although sales activity did not match the investment volume achieved in 2015, total sales still reached AU\$3.5 billion. Sales volume, however, was limited by the lack of core assets and portfolios offered to the market rather than lack of investor appetite. Domestic purchasers surpassed foreign investment, which had dominated the acquisitions in the previous five years. The Sydney CBD office sector is Australia's largest CBD office sector, comprising 5.1 million square metres, with the lowest total office sector vacancy rate (at 6.2 percent) of all of Australia's CBD office markets. The first quarter 2017 Situs RERC/UPA survey results reveal that respondents



“During 2016, NSW was the fastest growing state, experiencing growth at twice the national average.”

believe the average unlevered initial yield for prime Sydney CBD office assets is 5.50 percent with an average IRR of 8.75 percent (see Exhibit 20 for yield rates and IRRs by property type).

While the Sydney CBD office sector holds the lowest vacancy across Australia's major office markets, the lack of availability of high-quality office space created by the Sydney Metro development has led to tenants having to migrate into the non-CBD business areas of South Sydney, Parramatta, and North Sydney, amongst other locations. So chronic is the shortage of office space that B-grade gross annual rents in the Sydney CBD are now approximately AU\$1,000 per square metre, whereas A-grade stock in North Sydney commands AU\$825 per square metre. Sydney non-CBD office markets enjoyed a stellar year of investment activity in 2016 with the total investment value reaching AU\$4.2 billion (see Exhibit 21 for a breakdown of investment by asset type), which was the second strongest level of investment since 2008 and the first time in eight years that the volume of sales across the non-CBD markets surpassed the levels recorded in the CBD markets. Survey responses from the first quarter 2017 Situs RERC/UPA survey reveal that the average unlevered initial yield for prime Sydney suburban office assets is 6.19 percent with an average IRR of 9.38 percent.

Industrial Market

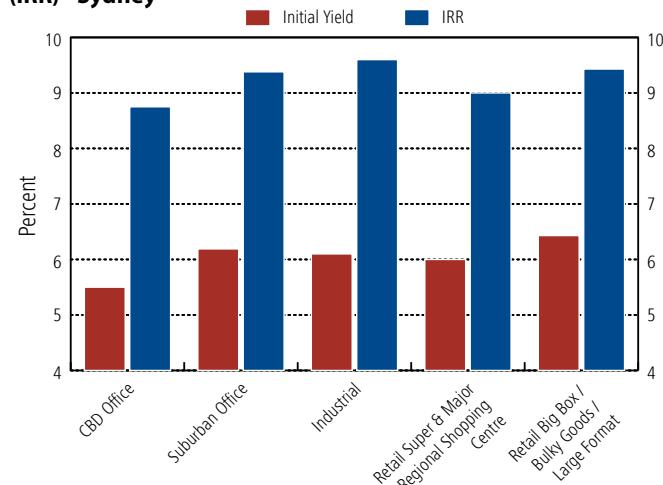
With the NSW economy growing at above-average levels, e-commerce, retailers and third-party logistic groups have driven demand for industrial space in Sydney. The increased demand for industrial space has pushed absorption of industrial space to above-average levels, with speculative development increasingly leased prior to completion. Boosted by the strong tenant demand, prime net face Sydney industrial rents grew at 10-year highs, increasing by 4 percent in 2016. Although investor demand remains strong, volumes moderated over 2016 with AU\$2 billion of Sydney industrial property transacted, which was 20 percent lower than the preceding year due to a lack of quality stock on the market rather than diminishing investor demand. According to the first quarter 2017 Situs RERC/UPA survey results, respondents reported that the average unlevered initial yield for prime Sydney industrial assets is 6.10 percent with an average IRR of 9.60 percent.

Retail Market

While NSW retail sales increased by 3.4 percent over 2016, sales were lower than the 2015 level when retail sales grew by 5.1 percent. Although a number of Australian retail brands have collapsed recently, international retailers continue to enter Australia, capitalising on the economic growth of the country. According to the Australian Bureau of Statistics, the vast majority of retail sectors recorded sales growth during 2016. NSW retail trade growth was led by takeaway food turnover, which grew by 15.0 percent over 2016, followed by clothing sales (7.6 percent) and supermarket sales (3.4 percent).

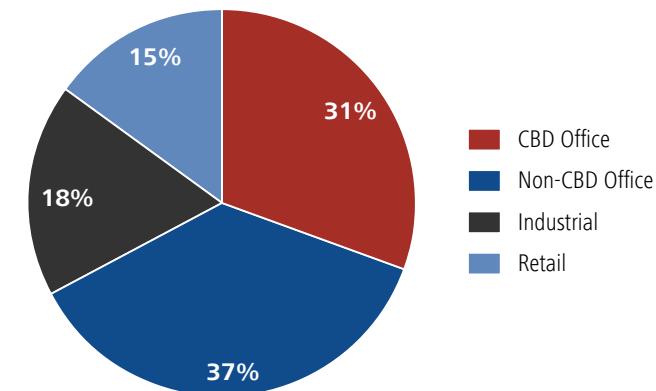
Retail sales declined in electronic goods retailing (-1.7 percent), department stores (-1.8 percent) and cafes and restaurants (-3.5 percent). On the back of increased infrastructure spending and the subsequent population influx, tenant demand and rental growth within shopping centres have been supported. With heightened global risks, investors are increasingly seeking retail assets, compressing Sydney retail asset yields to record lows. The first quarter 2017 Situs RERC/UPA survey results reveal that the average unlevered initial yield for Sydney retail super and major regional shopping centre assets is 6.00 percent with an average IRR of 9.00 percent. Despite strong investor interest, large-format retail sales in NSW transactions fell in 2016, with AU\$175 million recorded across the state, which was down from AU\$475 million transacted in the previous year. Survey responses from the first quarter 2017 Situs RERC/UPA survey reveal that the average unlevered initial yield for prime Sydney retail big box/bulky goods/large format retail assets is 6.43 percent with an average IRR of 9.43 percent.

Exhibit 20. Initial Yields (Unlevered) & Internal Rates of Return (IRR) - Sydney



Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.

Exhibit 21. 2016 Sydney Property Investment by Asset Type



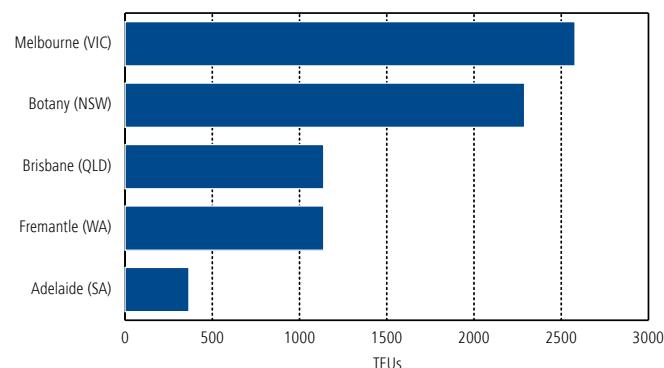
Source: Urban Property Australia, January 2017.

"With Sydney CBD office sector vacancy falling to an eight-year low, net effective rents grew by their strongest rate in over 20 years."

MELBOURNE

Melbourne is the second-most populous city in Australia. Melbourne rates highly in education, entertainment, health care, research and development, tourism and sport, making it the world's most liveable city, for the sixth year in a row in 2016, according to the Economist Intelligence Unit. The Melbourne Airport is the second busiest in Australia and the Port of Melbourne is Australia's busiest seaport for containerised and general cargo (see Exhibit 22).

Exhibit 22. Australian Sea Port Trade by State



Note: TEU = Twenty-foot Equivalent Unit.

Sources: Ports Australia, Urban Property Australia, 2016.



Economy

Victorian state demand growth surged in fourth quarter 2016, with 1.7 percent quarterly growth and 3.4 percent annual growth, following a 0.4-percent decline in third quarter 2016. Growth has been volatile quarter-to-quarter over the past two years. While business investment rebounded 3.5 percent in fourth quarter 2016, annual growth is weak at just 1.3 percent. Employment growth is expected to remain strong at 2.75 percent per annum, boosted by government infrastructure investment, which is forecast to surge 66 percent over the next year.

Office Market

Melbourne continues to host the second lowest CBD office sector vacancy rate among all of Australia's CBD markets. Melbourne's CBD office vacancy fell to 6.4 percent in the second half of 2016, its lowest rate in four years. With demand for Melbourne CBD office space double the 10-year average, strong rental growth was also recorded. Net effective rents grew at their strongest rate in five years and have hit record-high levels. Impacted by a scarcity of investment opportunities rather than diminishing investor appetite, investment activity in 2016 within the Melbourne CBD office market was lower than the preceding 12 months. In 2016, approximately AU\$2 billion was

"Investors are likely to continue to be driven up the risk curve and target suburban office assets, given that CBD office assets are scarce."

transacted, led by domestic institutions (see Exhibit 23 for a breakdown of investment by asset type). The first quarter 2017 Situs RERC/UPA survey results reveal that the average unlevered initial yield for prime Melbourne CBD office assets is 5.30 percent with an average IRR of 8.48 percent (see Exhibit 24), per respondents.

Similar to Melbourne's CBD office market, net absorption observed in the suburban office market was above the long-term average in 2016. Reflecting employment growth across Victoria, the Melbourne suburban office market recorded its highest annual net absorption level since 2010. With demand surpassing new supply delivered to the market over 2016, vacancy fell to 6.8 percent, down from 7.7 percent the previous year. With vacancy falling, net face rents increased at the fastest pace in six years during 2016. As CBD office asset prices continue to rise amid the lack of opportunities in the market, investors are likely to continue to be driven up the risk curve and target suburban office assets. Investment activity in the Melbourne suburban office market reached record highs in 2016, with more than AU\$1 billion transacted in the market for the first time in a calendar year. Investment activity was boosted by a higher-than-average number of transactions in excess of AU\$30 million. Survey responses from the first quarter 2017 Situs RERC/UPA survey reveal that the average unlevered initial yield for prime Melbourne suburban office assets is 5.98 percent with an average IRR of 9.04 percent.

Industrial Market

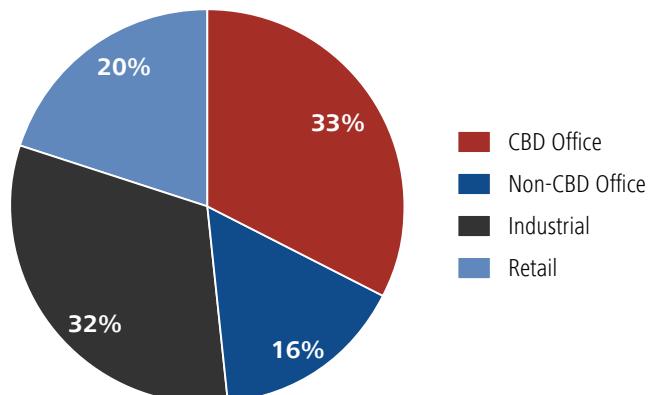
Australia's largest industrial market continues to attract investment with sales activity levels reaching all-time highs, with AU\$1.95 billion transacted across the Melbourne industrial market in 2016, boosted by a number of portfolio sales. Underpinned by Melbourne's population growth, above-average retail expenditure and strong growth in housing investment, tenant demand for industrial space in Melbourne also remains strong. The pre-commitment market remains buoyant, led by demand from retailers and third-party logistic occupiers. Despite an increase of speculative development, the high levels of leasing activity across Melbourne, particularly in the West, resulted in an overall decrease in industrial vacancy levels to approximately 5 percent. According to the first quarter 2017 Situs RERC/UPA survey results, respondents indicated that the average unlevered initial yield for prime Melbourne industrial assets is 6.33 percent with an average IRR of 9.14 percent.

Retail Market

Whilst Victoria's retail sales grew by 3.0 percent over 2016, retail sales grew by 5.8 percent during 2015. According to the Australian Bureau of Statistics, retail trade growth was led by sales of clothing and footwear, which grew by 7.3 percent over the year and cafes and restaurants (5.9 percent). Supermarket retail sales grew by 1.7 percent over 2016 and household retail trade increased by 2.1 percent, with declines recorded in electronic retail sales (-1.1 percent) and department stores (-2.0 percent). Overall, state population and employment growth has maintained tenant demand for shopping centres in Victoria; global retailers interested in expanding their presence have helped raise regional shopping centre rents by 6.2 percent over 2016. The first quarter 2017 Situs RERC/UPA survey results reveal that the average unlevered initial yield for Melbourne

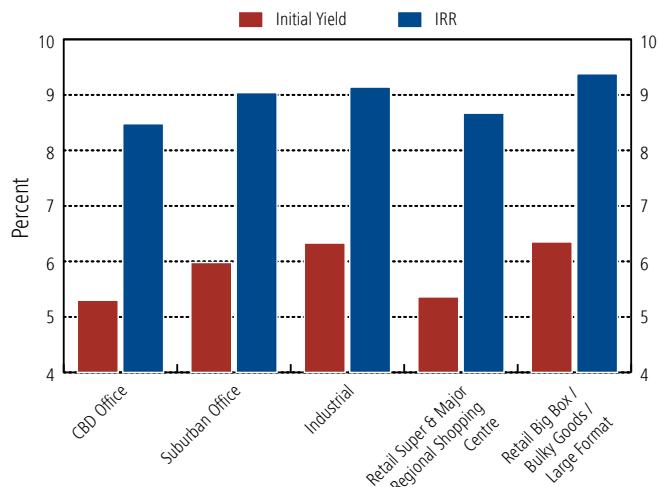
retail super & major regional shopping centre assets is 5.36 percent with an average IRR of 8.67 percent, per respondents. With vacancy rates relatively low and most shopping centres recording rental growth, investors have shown interest in large-format retail assets. Survey responses from the first quarter 2017 Situs RERC/UPA survey reveal that the average unlevered initial yield for prime Melbourne retail big box/bulky goods/large format assets is 5.36 percent with an average IRR of 9.38 percent.

Exhibit 23. 2016 Melbourne Property Investment by Asset Type



Source: Urban Property Australia, January 2017.

Exhibit 24. Initial Yields (Unlevered) & Internal Rates of Return (IRR) - Melbourne



Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.



BRISBANE

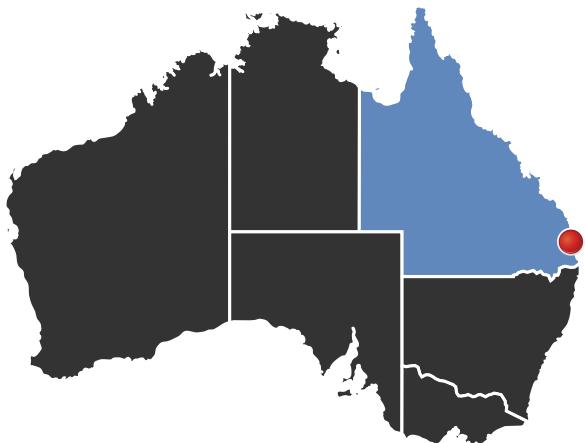
Brisbane is a popular tourist destination, serving as a gateway to the state of Queensland, particularly to the Gold Coast and the Sunshine Coast, popular resort areas immediately south and north of Brisbane, respectively. Queensland has a modern, diversified economy, underpinned by strong sectors including agriculture, resources, construction, tourism, manufacturing and services. Over the past two decades, Queensland's economic growth has generally exceeded the national average.

Economy

Despite the state's strong economic growth over the past two decades, Queensland remains in transition following the unwinding of the mining investment boom. Fourth quarter 2016 growth posted a 0.9 percent increase and an annual growth of 1.8 percent. Business investment has yet to see substantial positive growth, but the bulk of the decline has passed, annual growth having improved from -28 percent in second quarter 2015 to -2.7 percent in fourth quarter 2016. A partial offset to this substantial decline over the past year has been increased government spending. While the labour market remains soft, the outlook is improving, with most believing that the worst has passed.

Office Market

Brisbane was the most improved CBD office market for overall Australia over the second half of 2016, with its vacancy rate falling to 15.3 percent in January 2017 from 16.9 percent as of July 2016. The drop in the vacancy rate was due to a combination of rising demand for space from the expanding state government workforce, a big



reduction in space available for sub-lease and the withdrawal of buildings for other uses. Brisbane was the only resource-dependent CBD office market to record a drop in vacancy rate, as Darwin and Perth increased. While leasing activity showed signs of improvement in 2016, Brisbane CBD office sector rents have remained largely stable over the year. Investment demand for Brisbane office assets remains elevated, however, on a par with the other major East Coast cities; investment volume for 2016 was at lower levels than the past three years. With only four assets transacting above AU\$100 million, the lack of core assets and assets of significant scale has limited activity. As a result, AU\$1.1 billion was transacted in the Brisbane CBD office market in 2016 (see Exhibit 25 for a breakdown of investment by asset type). The first quarter 2017 Situs RERC/UPA survey results reveal



that respondents considered the average unlevered initial yield for prime Brisbane CBD office assets is 6.50 percent with an average IRR of 9.22 percent (as shown in Exhibit 26).

The vacancy rate fell marginally in the Brisbane Fringe office market to 12.6 percent as of January 2017. Tenant demand in the Fringe office market is being impacted by the strong deals available for tenants within the CBD market. Without the lure of available new accommodations, the Fringe office market is expected to underperform the CBD office market as tenants migrate into the CBD office market. As a result of the relatively softer demand, rents stagnated within the Fringe office market in 2016. Although there is relatively little direct prime quality office space available, competition from the CBD office market has limited the degree to which rents can be increased. Brisbane Fringe office assets continue to mature as a genuine investment alternative, accounting for 42 percent of all Brisbane office sales in 2016 with AU\$600 million transacted. Survey responses from the first quarter 2017 Situs RERC/UPA survey reveal that the average unlevered initial yield for prime Brisbane suburban assets is 6.63 percent with an average IRR of 9.25 percent.

Industrial Market

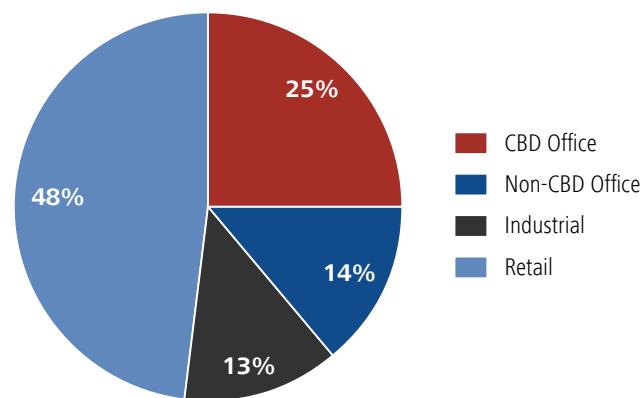
With Queensland still a long way from a sustained economic recovery, tenant demand remains soft. With vacancy relatively high, incentives are also above average with landlords increasingly under pressure to accommodate tenant demands. Currently, the Brisbane industrial sector vacancy rate has increased to 9.6 percent as of January 2017, up from 8.6 percent 12 months earlier, with the highest vacancy rates concentrated in the TradeCoast and South precincts. Prime industrial sector rents have remained steady during 2016, constrained by the high vacancy levels. While investor appetite for quality assets with long weighted average lease expiry (WALE) remains high, prime assets have been tightly held, limiting transaction volume. Sales in 2016 totalled AU\$540 million, approximately 60 percent below the peak transaction volume achieved in 2015. According to the first quarter 2017 Situs RERC/UPA survey results, the average unlevered initial yield for prime Brisbane industrial assets is 7.17 percent with an average IRR of 10.00 percent, according to respondents.

Retail Market

Queensland was one of the few Australian states to record an increase in retail sales growth rates from 2015 to 2016. During 2016, Queensland retail sales increased by 3.4 percent, up from 3.1 percent recorded in the previous year. According to the Australian Bureau of Statistics, retail trade growth was led by sales of clothing and footwear, which grew by 8.4 percent over the year, supermarket retail sales (4.1 percent) and cafes and restaurants (4.4 percent). In contrast, household good retail sales declined 0.5 percent in 2016, with department stores sales also lower (-3.1 percent). The Brisbane "2022 New World City Action Plan," aimed to drive the city's

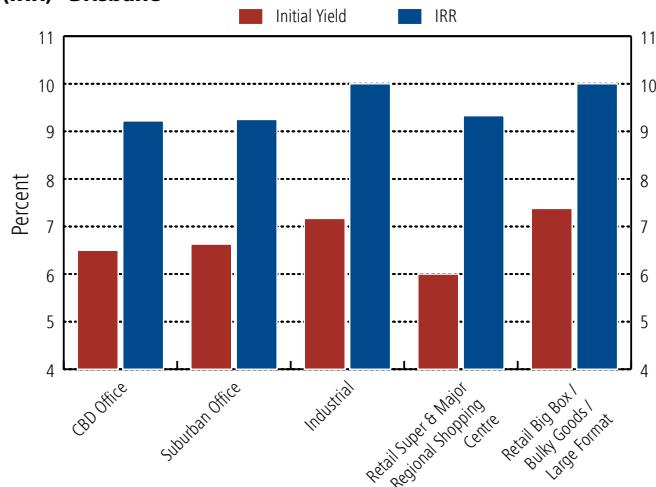
economic growth, has boosted consumer, occupier and investor confidence with groups positioning themselves to capitalise on the emerging opportunities as the economy continues to grow. During 2016, AU\$2.1 billion worth of retail property transactions were recorded, down from AU\$2.6 billion in the previous year, but higher than the five-year average. Large-format retail property sales in Queensland in 2016 specifically totalled AU\$263 million, down from the AU\$515 million recorded in 2015. The first quarter 2017 Situs RERC/UPA survey results reveal that respondents considered the average unlevered initial yield for Brisbane retail super and major regional shopping centre assets is 6.00 percent with an average IRR of 9.33 percent. According to the Situs RERC/UPA survey, unlevered initial yields for Brisbane retail big box/bulky goods/large format assets averaged 7.38 percent with an average IRR of 10.00 percent.

Exhibit 25. 2016 Brisbane Property Investment by Asset Type



Source: Urban Property Australia, January 2017.

Exhibit 26. Initial Yields (Unlevered) & Internal Rates of Return (IRR) - Brisbane



Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.

"Brisbane was the only resource-dependent CBD office market to record a drop in vacancy rate."

PERTH

WA's economy is dominated by its resources and services sector and largely driven by the export of iron ore, gold, liquefied natural gas and agricultural commodities such as wheat. In 2011, WA provided 46 percent of Australia's exports. If WA were a separate country, it would be among the Top 50 economies in the world by GDP. Many large mining and mineral companies have their headquarters in the state's capital, Perth. Booming Asian economies, particularly China, have sourced many of their raw materials from WA, resulting in high economic growth for the state and Perth.

Economy

WA posted its first gain in gross state product (GSP) in six quarters in fourth quarter 2016, although at 0.4 percent this was quite modest. However, state economic output is still 7.8 percent lower from a year ago and 16 percent below its third quarter 2012 peak. In contrast to the eastern states, WA household consumption remains weak, having fallen 0.1 percent in fourth quarter 2016 and being up only 1.5 percent over 2016. Following a 56-percent decline since third quarter 2012, total business investment rose 2.3 percent in fourth quarter 2016; however, this is unlikely to be sustained but rather reflective of a burst of mining investment in the quarter. The unemployment rate of WA has increased to 6.7 percent in the fourth quarter, a 15-year high and up from its 2012 low of 3.7 percent.

Office Market

The Perth CBD office sector vacancy rate rose to 22.5 percent as of January 2017, its highest level since January 1995. Compared to other capital cities, Perth's CBD office market vacancy rates were noticeable higher (see Exhibit 27). Perth's vacancy rate has steadily risen since January 2012, when the rate was 3.3 percent. As a result, effective rents have since decreased by more than 50 percent. Although vacancies edged up, the rise was the smallest half-year increase in the vacancy rate since 2012. This may indicate a nearing of the peak in vacancy rate. Vacancy is projected to peak in mid-2018 with softening white-collar employment growth forecast and 56,000 square metres (double the long-term average for the area) currently under construction. Investment activity remained subdued in Perth over 2016, with total transaction totalling AU\$500 million. While this represented a recovery in transaction turnover of almost 40 percent against 2015 levels, turnover remains well below the peak activity of 2013 when AU\$1.3 billion was transacted. Although investment volumes remain constrained, demand for assets with good lease profiles remains buoyant with foreign investor interest particularly robust. The first quarter 2017 Situs RERC/UPA survey results reveal that the average unlevered initial yield for prime Perth CBD assets is 7.00 percent with an average IRR of 9.50 percent (see Exhibit 28), according to respondents.

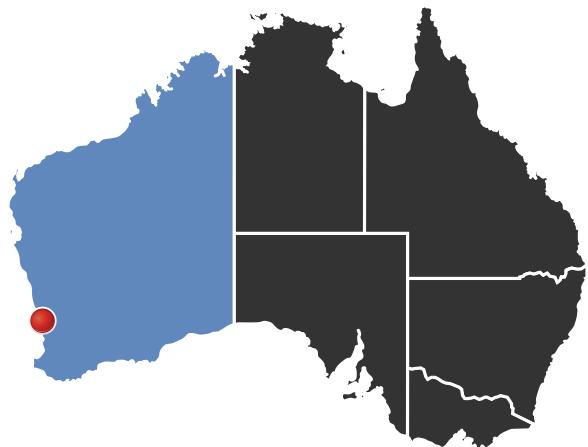
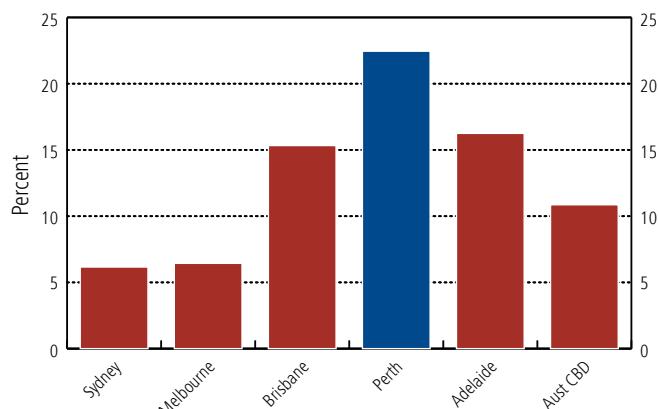


Exhibit 27. Central Business District Office Vacancy Rates



Sources: Property Council of Australia, Urban Property Australia, January 2017.

Similar to the Perth CBD office market, vacancy has been steadily rising in the West Perth office market over the past five years. With compelling leasing proposals within the CBD office market, tenants are also moving from offices in the Fringe to the CBD, contributing to a significant weakening in West Perth, a market historically favoured by junior and mid-tier mining sectors that achieved a 0 percent vacancy rate during the peak of the boom. The vacancy rate climbed from 12.2 percent to 17.9 percent over the course of 2016 in West Perth. The West Perth office market has recorded negative vacancy levels for the past three years. The continuation of soft demand in the West Perth office market in 2016 resulted in further falls in rent levels, with net effective rents falling by almost 50 percent since 2012. Investment activity in the West Perth office market has remained somewhat subdued over the past two years, impacted by the lack of quality stock and the uncertain economic conditions.

"Perth CBD office sector vacancy rate rose to 22.5 percent, its highest level since January 1995."



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Survey responses from the first quarter 2017 Situs RERC/UPA survey reveal that the average unlevered initial yield for prime Perth suburban office assets is 8.00 percent with an average IRR of 10.04 percent.

Industrial Market

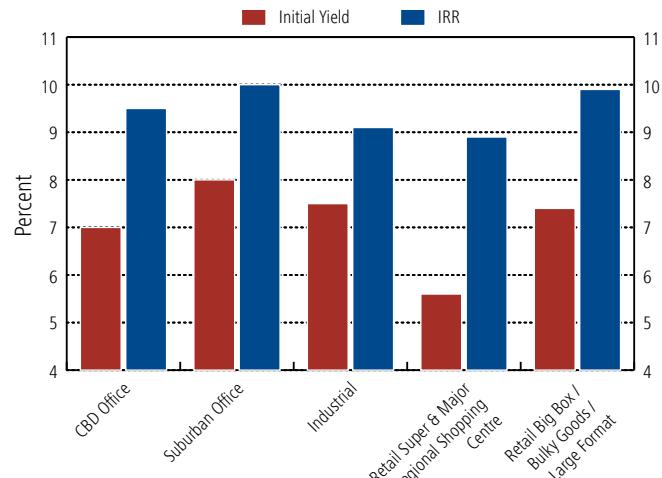
The significant impact of the economic downturn in the wake of the state's mining boom has been hardest on the industrial market, as a number of projects move into the construction phase of their life cycles. Consolidation remains the focus for occupiers as they seek to cut costs and increase efficiency. With tenant demand weak, Perth industrial sector net face rents have fallen by 6 percent for prime assets and 10 percent for secondary assets. Tenant demand is concentrated on modern assets in well-established industrial precincts led by transport and logistics users capitalising on the opportunity to improve their industrial accommodation. Despite the weak tenant demand, investor interest for Perth industrial assets remains strong with AU\$600 million transacted over 2016 (see Exhibit 29 for a breakdown of investment by asset type). According to the first quarter 2017 Situs RERC/UPA survey results, respondents reported that the average unlevered initial yield for prime Perth industrial assets is 7.53 percent with an average IRR of 9.14 percent.

Retail Market

WA's retail sales grew only marginally in 2016, rising by 0.9 percent compared to 1.2 percent during 2015. According to the Australian Bureau of Statistics, cafes and restaurants recorded the highest retail trade growth in 2016 (7.7 percent), while clothing retailing sales grew by 7.3 percent. Declines in retail sales were recorded in electrical good retailing (-8.5 percent), department stores (-7.0 percent) and household goods (-2.7 percent) over the course of 2016. Rents within neighbourhood and sub regional shopping centres declined in 2016, due to softer retail turnover growth, easing tenant demand and increasing shopping centre development. The first quarter 2017 Situs RERC/UPA survey results reveal that the average unlevered initial yield for Perth retail super and major regional shopping centre assets is 5.55 percent with an average IRR of 8.93 percent, per respondents. Somewhat surprisingly, large-format retail sales in WA increased over 2016 with AU\$100 million transacted, double the

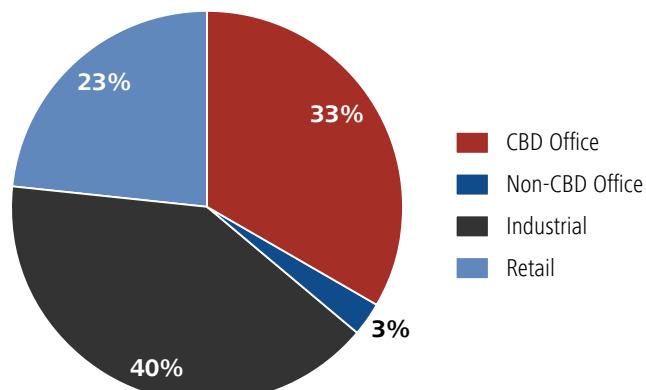
preceding year and above the five-year average. Survey responses from the first quarter 2017 Situs RERC/UPA survey respondents revealed that the average unlevered initial yield for prime Perth big box/bulky goods/large format retail assets is 7.36 percent with an average IRR of 9.88 percent.

Exhibit 28. Initial Yields (Unlevered) & Internal Rates of Return (IRR) - Perth



Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.

Exhibit 29. 2016 Perth Property Investment by Asset Type



Source: Urban Property Australia, January 2017.



ADELAIDE

South Australia's (SA's) largest employment sector is health care and social assistance, representing nearly 13 percent of the state employment. The manufacturing industry also plays an important role in SA's economy, generating 11 percent of the GSP and playing a large part in exports. The manufacturing industry consists of automotive, 44 percent of total Australian production, and component manufacturing, pharmaceuticals and defence technology. SA's economy relies on exports more than any other state in Australia. Adelaide, which is home to a large proportion of Australia's defence industries, contributes over AU\$1 billion to SA's economy.

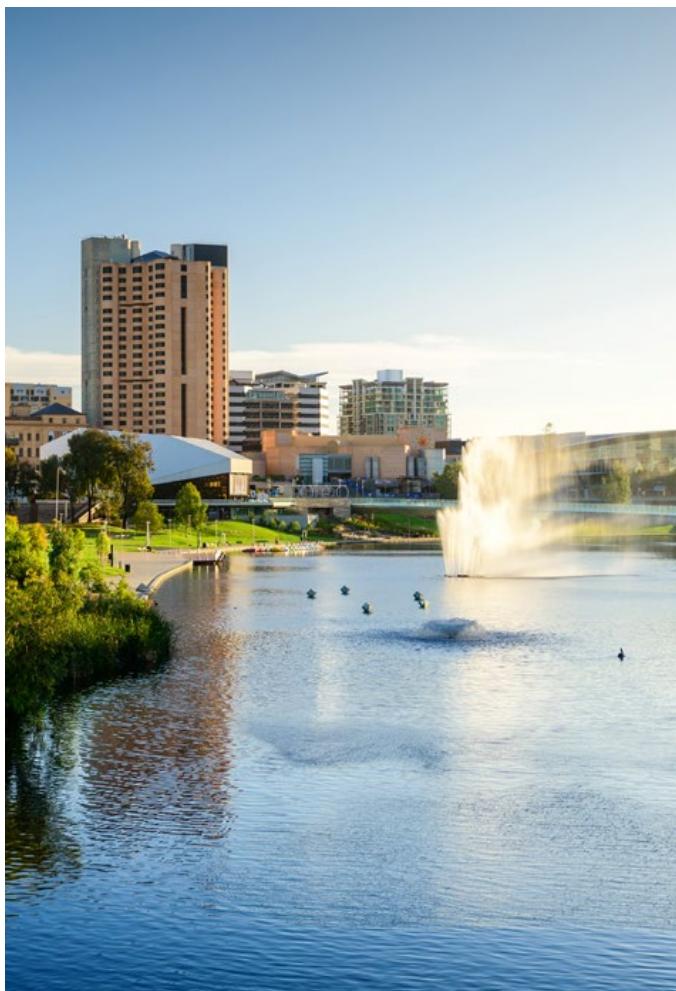
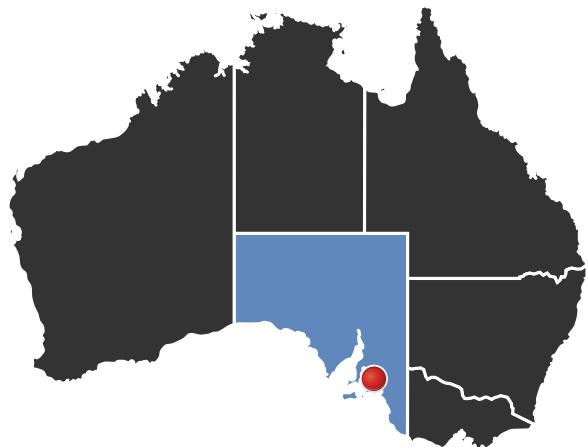
Economy

SA GSP gained 0.9 percent in fourth quarter 2016, equating to annual growth of 2.1 percent in 2016. Household consumption has risen by 2.8 percent in 2016 despite ongoing weakness in the SA labour market. The government continues to promote confidence and activity with infrastructure spending totalling AU\$5.2 billion through 2018 with the projected generation of 14,000 new full-time equivalent jobs over the next two years.

Office Market

The return of a number of refurbished properties entering the market has pushed the vacancy rate in the Adelaide CBD office sector to its highest point since mid-1999. Adelaide CBD office sector vacancy levels reached 16.2 percent, up from 14.1 percent 12 months earlier. While Adelaide CBD office sector is nearing its forecast vacancy peak in the short term, vacancy is not projected to decline until 2018. The Adelaide office market has recorded positive net absorption in the second half of 2016 as the trend of occupier consolidation over the last five years seems to be reaching a conclusion. Adelaide CBD office sales volume during 2016 reflected the high level of investor interest in Adelaide with total transactions of AU\$1.2 billion recorded, well above the AU\$170 million achieved in the previous calendar year (see Exhibit 30 for a breakdown of investment by asset type). The first quarter 2017 Situs RERC/UPA survey results reveal that the average unlevered initial yield for prime Adelaide CBD office assets is 6.88 percent with an average IRR of 10.75 percent (see Exhibit 31), per respondents.

Impacted by tenant relocations, the Adelaide Fringe office market vacancy rate increased to 11.3 percent as of January 2017, its highest level since January 1999. Leasing in the Fringe office market remains the most active for tenants under 1,000 square metres with only modest rent growth recorded in 2016. Prime Adelaide Fringe office assets with secure income streams and long-term lease covenants are anticipated to remain in high demand for investors,



"The government will spend AU\$5.2 billion on infrastructure through 2018 and generate 14,000 new full-time jobs over the next two years."

while redundant secondary stock are also being increasingly sought after by developers for redevelopment or conversion opportunities. Survey responses from the first quarter 2017 Situs RERC/UPA survey reveal that the average unlevered initial yield for prime Adelaide Fringe office assets is 7.02 percent with an average IRR of 9.55 percent.

Industrial Market

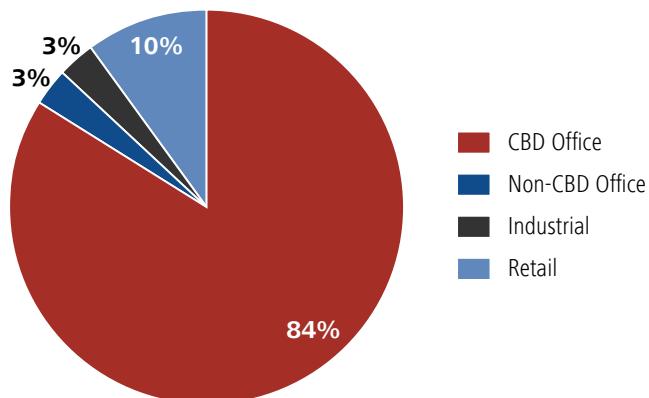
Despite the slightly improved economic outlook for SA, there remains uncertainty about the impact of the imminent 2017 closure of the GM Holden facility and associated suppliers. The likely increased level of backfill industrial space from the automotive industry is expected to moderate any rental growth from the increasing demand from logistics occupiers. While institutional investors remain active for industrial assets with secure tenancy profiles and long-term leases, investment volumes recorded for 2016 were approximately 50 percent below the long-term average with limited quality assets brought to the market. In contrast, investor interest for secondary industrial assets is weak, resulting in yield spread between prime and secondary industrial markets diverging to five-year highs. According to the first quarter 2017 Situs RERC/UPA survey results, the average unlevered initial yield for prime Adelaide industrial assets is 8.37 percent with an average IRR of 11.55 percent, per respondents.

Retail Market

SA's retail sales grew 3.9 percent during 2016, up slightly from 3.8 percent in 2015. According to the Australian Bureau of Statistics, retail trade growth was led by cafes and restaurants (which grew 11.7 percent over the year), followed by sales of clothing and footwear (which grew by 9.8 percent over the year). Supermarket retail sales grew by 2.2 percent over 2016 with household retail trade increasing only marginally (0.1 percent). Leasing conditions have softened for shopping centres in SA with consumer confidence fragile. During 2016, retail property transactions in SA totalled AU\$140 million, down from AU\$860 million transacted in the previous year and also below the five-year average. This large year-over-year drop in transactions was due to a particularly high level of transactions in 2015. Private investors were most acquisitive for SA retail assets in 2016, accounting for 65 percent of total sales. The first quarter 2017 Situs RERC/UPA survey results reveal that respondents considered

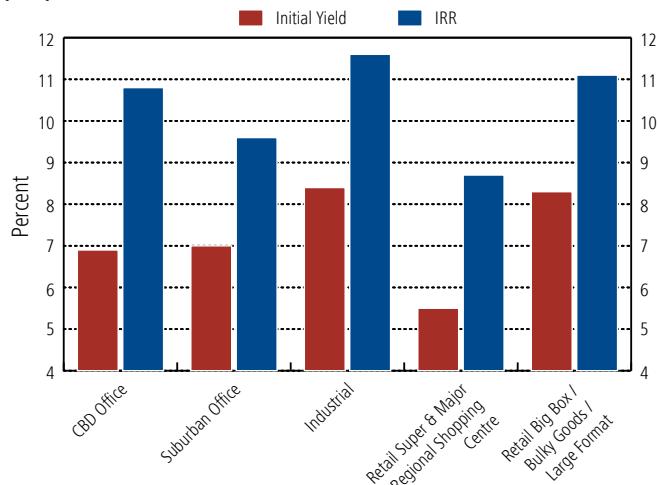
the average unlevered initial yield for Adelaide retail super & major regional shopping centre assets is 5.50 percent with an average IRR of 8.70 percent. According to Situs RERC/UPA survey respondents, unlevered initial yields for large-format retail Adelaide assets averaged 8.25 percent and an average IRR of 11.10 percent.

Exhibit 30. 2016 Adelaide Property Investment by Asset Type



Source: Urban Property Australia, January 2017.

Exhibit 31. Initial Yields (Unlevered) & Internal Rates of Return (IRR) - Adelaide



Source: Situs RERC/UPA Australian Market Expectations Survey, 1Q 2017.



INVESTMENT TERMS AND METHODOLOGY

Using Situs' global valuation and loan advisory capabilities, Situs RERC's research and analytics capabilities and UPA's Australian market expertise, the Australia Real Estate Trends is intended to offer investors, lenders and agencies research-based insight into investor sentiment and to the investment environment for commercial real estate. Below are the definitions of terms used throughout the report.

Capital Cities/Metros: Adelaide, Brisbane, Melbourne, Perth, Sydney

Effective Rent: Rent received net of all applicable expenses.

Foreign Capital: Funds originated outside of Australia.

Initial Yield: Annualised rental income based on the cash rents passing at the balance sheet date, less non-recoverable property operating expenses, divided by the market value of the property, increased with (estimated) purchaser's costs.

Interest Rate: Also known as the official cash rate (OCR), it is the rate of interest that the Reserve Bank of Australia (RBA) charges on overnight loans to commercial banks.

Internal Rate of Return (IRR): The IRR for unleveraged investments is the rate of interest that discounts the pre-income tax cash flows back to a present value that is exactly equal to the amount of the equity investment.

Investment Conditions Rating: A general survey-based rating classifying the general conditions for investing in CRE as either poor, below average, average, above average or excellent. Rating considerations include economic factors, capital market factors, CRE fundamentals and other miscellaneous factors.

Investment Surveys: Situs RERC and UPA conducts confidential surveys of investment trends with Situs RERC and UPA clients and contacts throughout Australia. We then collect results from the survey, analyse and interpret the information gathered, and report investor sentiment based on the results from the investment surveys. Because of sample size, results were not statistically significant, but the data are useful for trends analysis.

Property Sectors: CBD Office, Suburban Office, Industrial, Retail Super and Major Regional Shopping Centre, Retail Big Box/Bulky Goods/Large Format, and Retail Neighbourhood Shopping Centre.

Relative Ratings and Assessments: The ratings and opinions reflected in this report are relative to markets and metros included in our analyses. Interpretation of the ratings presented are intended to be viewed as explanations of trends within the particular market and not as definitive statistical evidence.



