Invesco

Invesco Real Estate House View

Asian Market Outlook

Autumn 2011

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(Cover Image: City View of Tokyo, Japan)

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Executive Summary

Most real estate markets in the Asia-Pacific region delivered positive returns over H1 2011. However, a weaker U.S. economic recovery, lingering European sovereign debt crisis worries and increased inflation risk in Asia weighed on the outlook from mid-2011.

Looking ahead, we believe global economic growth will be more modest as the Western economies continue to deleverage. In the face of rising global economic uncertainty, we expect returns from Asia-Pacific real estate investment to moderate, driven by:

- **Moderating rental growth**
  - Economic growth in the Asia-Pacific region in H2 2011 and 2012 is expected to decelerate, leading to more moderate occupier demand.
  - However, the anticipated softer demand is expected to be mitigated by declining new supply and current below trend vacancy rates in most markets.
  - We should expect relatively weaker, albeit positive, rental growth rates in H2 2011.
- **The yield chase continues to drive investment activity**
  - With interest rates of major currencies anticipated to remain low, global investors continuing to seek yield from real estate investing should find the relatively stronger outlook of Asia appealing.
  - Investors are likely to focus on prime properties for relatively secure income, amidst rising economic uncertainty.
  - Nevertheless, yields in certain Asia ex-Japan markets have already hardened to low levels and, hence, further gains from yield compression could be limited.
- **The commercial sectors to outperform**
  - The office sector continues to offer varying prospects. Some markets such as Beijing are likely to benefit strongly from reducing supply while markets such as Seoul are expected to continue to be burdened by the supply overhang in the near term.
  - The retail sector should gain support from steadily growing consumer demand.
  - The regulatory risks and stretched affordability could continue to cast a shadow over parts of the residential sector.

Broadly speaking, we believe the Asia-Pacific markets continue to offer positive return prospects, albeit lower than the levels achieved in 2010 and H1 2011. On average, we anticipate that approximately 60% of the total return from 2012 to 2014 would be from income.

Despite a softer outlook, we continue to see opportunities across a range of strategies:

- The higher initial yields and improving rental growth outlook are making a case for investing in Australia and Japan for income-oriented investors. In both markets, rents are stabilizing/recovering and banks are becoming more accommodative in lending. In addition, Japanese properties offer the positive yield carry which is the widest across the Asia-Pacific markets while Australian properties offer the highest initial yields across key markets and are resuming positive yield carry.
- The generally tight availability of prime assets and steady rental growth outlook support the feasibility of value-add strategies to produce assets for core investors via development, redevelopment and asset enhancement. These markets include China, Hong Kong and Singapore.
- Opportunity of acquiring assets from weak sellers remains available, albeit limited, in China, Korea and Japan. In China, the tight control in lending by the government and increasing borrowing costs are putting pressure on smaller owners/investors. In Korea, construction financing remains tight, while in Japan banks continue to selectively foreclose on non-performing loans.

Economic Fundamentals and Outlook

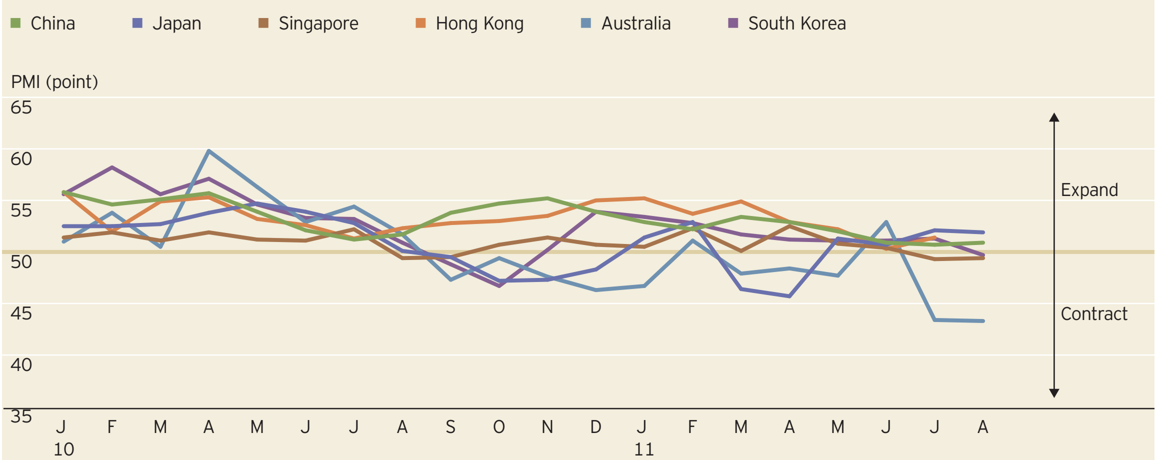
Asian economic growth is already slowing as a result of government monetary tightening. Due to the uncertain Western economic outlook, this moderation is likely to continue throughout the remainder of 2011 and into 2012. Yet, Asia should continue to outperform Europe and the U.S. in terms of economic growth.

Weaker economic growth ahead

We believe the global economy has entered a moderation phase. The recovery of major Western economies is not likely to be exciting over the next one to two years as they continue to deleverage. As we have pointed out in our previous House Views, we do not subscribe to the "decoupling" theory and, hence, we believe that the Asia-Pacific region will not be immune from an anticipated global slowdown and economic growth is set to moderate further through 2012.

- **Weaker exports amidst anemic demand from the West.** Weaker growth in the Western economies is expected to negatively impact export growth from Asia. We visited this topic in our Spring 2009 House View where we examined the relationship with U.S. consumer demand and Asian export growth. Latest PMI data have already indicated weaker industrial production in H2 2011 (Figure 1). Trade dependent smaller economies, including Hong Kong and Singapore have already seen their exports declining, driving a quarter-on-quarter gross domestic product (GDP) contraction in Q2 2011. This factor is expected to remain a drag on Asian economic growth.

Figure 1 – Weaker PMI



Sources: China Federation of Logistics and Purchasing, Japan Materials Management Association, Singapore Institute of Purchasing & Materials Management, Australia Industrial Group – PriceWaterhouseCoopers, HSBC, August 2011

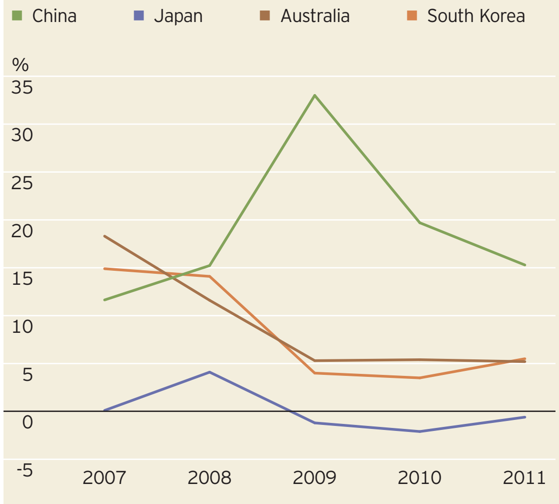
- **Volatile capital market affecting short-term sentiment.** A series of events and issues including the natural disasters in Japan and Australia, China's tightening, the European sovereign debt crisis and weakened confidence in the U.S. economic recovery have led to a severe drop in the stock markets, with major indexes in the Asia-Pacific region losing 10% to 19% from their recent peaks in March/April 2011.

Unless a widely accepted strategic plan can be agreed upon, the debt issues in the West are expected to continue to cast a cloud over the economic prospects and global financial stability. In response to the uncertainty, the advanced economies of the U.S., the eurozone and Japan are expanding their monetary loosening by keeping interest rates at their current low levels or injecting liquidity. These tactics are likely to drive capital into Asia to search for yield and interest rate arbitrage on the back of better growth prospects. However, fragile confidence in global economic growth could drive severe volatility in the capital markets, affecting general investment sentiment in the near term. The negative wealth effect is also expected to put pressure on consumption.

- **Reduced loans and, hence, broad money supply in Asia.** Credit growth has been moderating across major economies in the region (Figure 2) as a result of recent monetary tightening measures, including interest rate rises (Figure 3) and lending controls. This is likely to dampen investment growth and headline nominal economic growth rates in general. With consumer price levels elevated, governments are unlikely to loosen their monetary policy in the short term. The exception is Japan where the government expanded its quantitative easing scheme in an attempt to support a post-quake recovery. It is noteworthy that in Hong Kong, due to the peg to the U.S. dollar, official rates did not increase. Meanwhile in Singapore, the government tends to adjust currency value to mitigate inflation instead of adopting monetary adjustments.

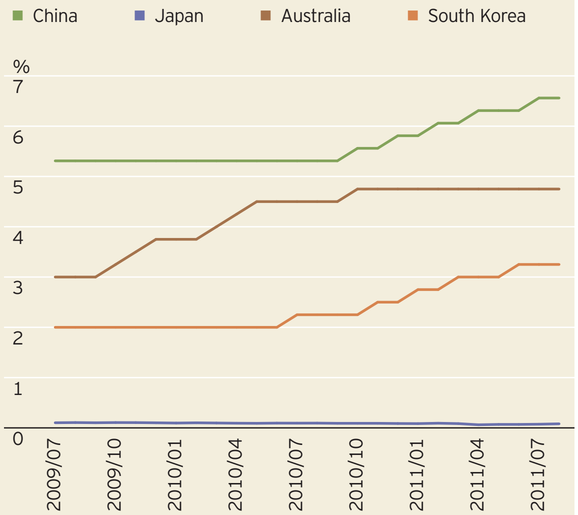
Figures 2 and 3 — Monetary Tightening

Figure 2 — Growth of Total Outstanding Loan of Selected Economies



Sources: People's Bank of China, Bank of Japan, Reserve Bank of Australia, Bank of Korea, August 2011

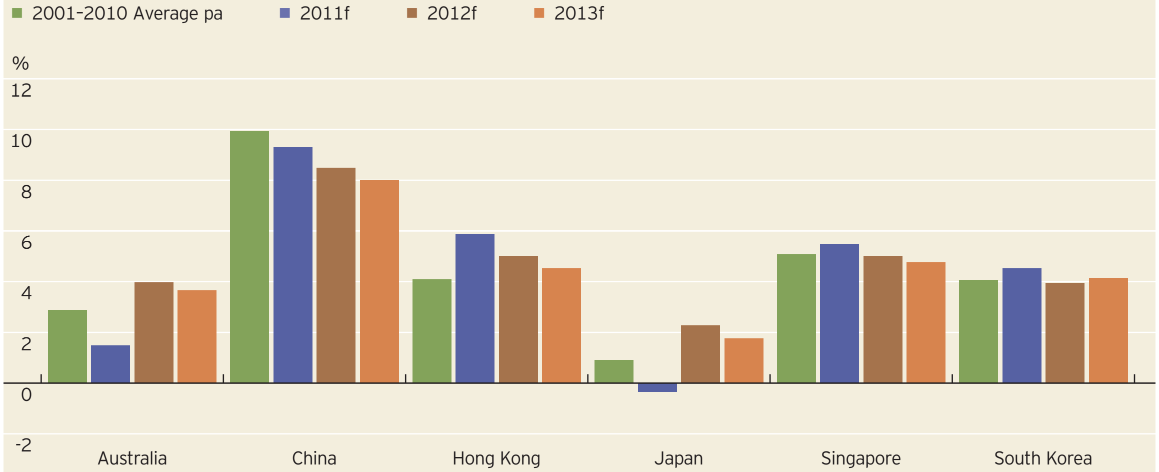
Figure 3 — Interest Rate Rises



Sources: Reserve Bank of Australia – Cash Rate, People's Bank of China – 1-year base lending rate, Bank of Korea – Monetary Rate, Bank of Japan – Overnight Call Rate, August 2011

These factors have driven downward revisions to GDP forecasts across the board. According to Consensus Economics, the overall GDP growth forecasts for 2011 for the Asia-Pacific region was revised down from 5.2% in February to 4.6% in August. Individually, Japan and Australia received the sharpest downgrades, due largely to the damage by natural disasters earlier this year. Looking ahead, the recovery from a lower base and rebuilding of the damaged facilities should drive economic growth of these two countries higher in 2012. However, other economies in the region are expected to see economic growth in 2012 moderate further from their 2011 levels (Figure 4).

Figure 4 – GDP Growth



Source: Experian, July 2011
f = forecast

Asia is still expected to outperform the U.S. and Europe
Despite the softer outlook, we believe that the Asia-Pacific region should weather the anticipated economic slowdown better than the Western world for the following reasons:

- **Healthier balance sheets.** Strong private and public balance sheets proved key to weathering previous financial and economic storms. The exception is Japan, the indebtedness of economies in the Asia-Pacific region (measured by the gross national debt to GDP ratio) is considerably lower than the Western economies, while gross national savings are considerably higher (Figure 5 and 6).

Figures 5 and 6 – Strong Balance Sheets

Figure 5 – National Debt to GDP Ratio, Estimates for 2011

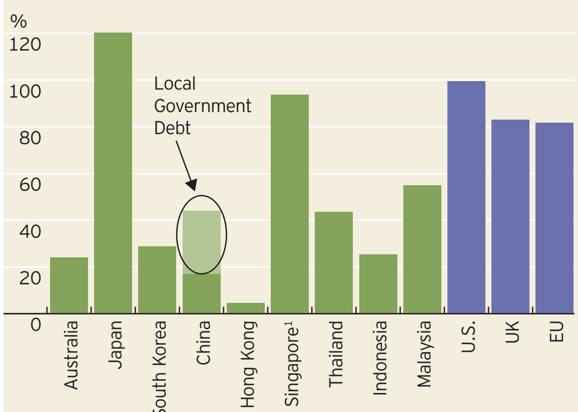
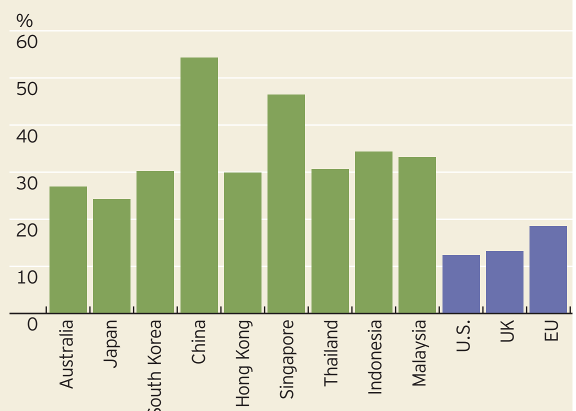


Figure 6 – Gross National Savings to GDP Ratio, Estimates for 2011



Sources: EconomyWatch, IMF, China's National Audit Office, August 2011

1 Public debt consists largely of Singapore Government Securities (SGS) issued to assist the Central Provident Fund (CPF), which administers Singapore's defined contribution pension fund; special issues of SGS are held by the CPF, and are non-tradeable; the government has not borrowed to finance deficit expenditures since the 1980s (Source: CIA World Factbook).

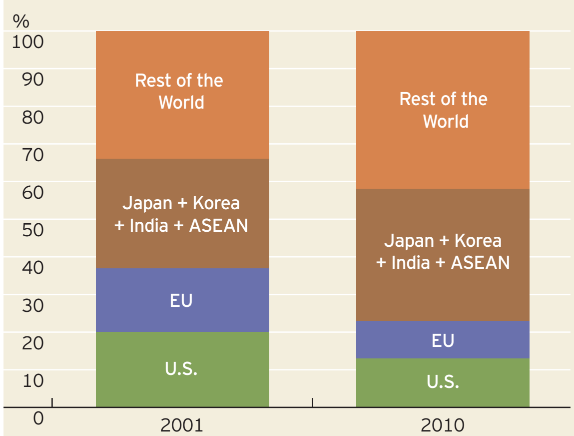
In Japan, despite a staggering debt to GDP ratio, only 5% of the total national debt is held by foreign investors. In China, the scale of local government debt has been widely reported, however, the aggregate local (27%) and national government debt (17%) is only 44% of GDP, far lower than the levels in the Western economies. As such, the Asia-Pacific governments are more financially capable of rolling out supportive fiscal measures if needed. In addition, after the recent round of tightening, regional central banks are well equipped for monetary easing to fight any sharp economic slowdown.

It is noteworthy that in the household sector, debt is largely in the form of housing loans. While the loan-to-value ratio of housing mortgages has generally been strictly controlled in the 60% to 80% range, economies including China, Hong Kong and Singapore have further reduced this ratio to avoid over-leverage in the household sector, amidst elevated residential prices and the risk of a downturn.

- **Less reliant on western demand.** Intra-regional trade volumes have been increasing over the last decade. This should help mitigate some of the downside risk from weaker western demand. The share of the U.S. and European Union (EU) of China's total exports fell from 37% in 2001 to 23% in 2010 (Figure 7). While intra-regional trade flow increased, trade volumes with the Latin American and African economies have also been rising. In Japan, the U.S. and EU together accounted for 26% of total exports in 2010, down from 46% in 2001 (Figure 8).

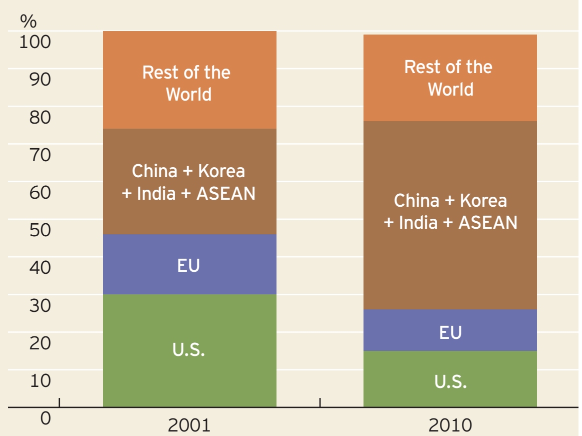
Figures 7 and 8 – Declining Significance of Western Demand

Figure 7 – Export Destinations of China



Sources: China Statistics Bureau, General Administration of Customs of China, August 2011

Figure 8 – Export Destinations of Japan

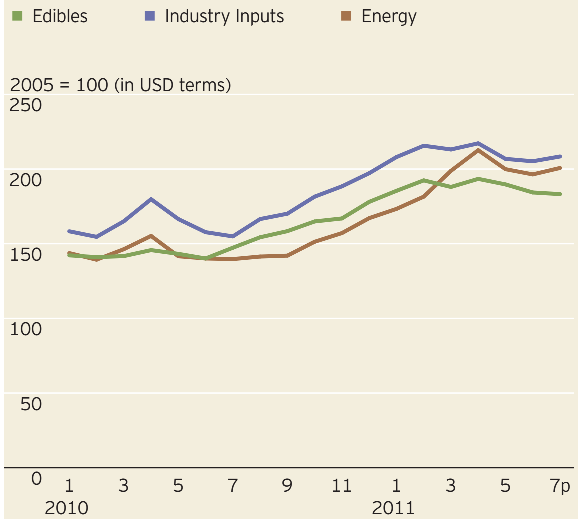


Source: Japan Statistics Bureau, August 2011

- **Solid consumer demand.** Consumption growth has been supported by employment and wage growth. In particular, consumption in China contributes a much lower portion of the economy and gradual shifts in spending behavior coupled with rising wealth should continue to spur private consumption expenditure growth.

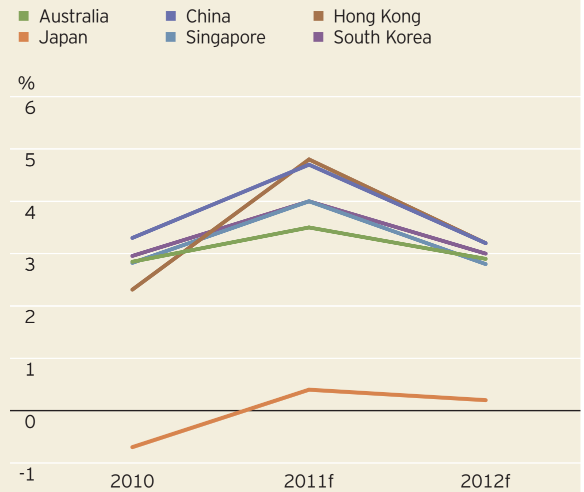
Figures 9 and 10 – Inflation Peaking

Figure 9 – Commodity Prices



Source: IMF, August 2011
p = preliminary

Figure 10 – CPI Forecast



Source: Experian, July 2011
f = forecast

- **Plateauing commodity prices.** There are signs that inflation is peaking. On the one hand, as mentioned, credit growth is declining in key Asian economies. On the other hand, commodity prices including energy, raw materials and food, appear to be plateauing (Figure 9), easing the pressure of supply driven inflation.

  Overall, the CPI of the major Asian economies are expected to peak in 2011 (Figure 10). This leaves room for central banks to end the current round of tightening sooner than expected, mitigating the downside risk on economic growth.

In summary, we expect the Asia-Pacific economic growth to follow the global trend of deceleration, albeit at a milder pace.

Briefly by region, the natural disasters in **Australia** contributed to a substantial downward revision of the GDP forecast for the whole year 2011. Nevertheless, given stabilizing commodity prices, the Reserve Bank of Australia (RBA) has had room to put the brakes on raising interest rates. Moderating demand from China may help further temper commodity prices, which could ease inflationary pressure in Australia. The one-off effect from the natural disasters on consumer prices is also likely to fade.

Although **China** is likely to maintain a tight monetary policy stance for the remainder of 2011, in view of slowing global economic conditions, the People's Bank of China (PBOC) is expected to become more careful despite concerns over inflation. GDP growth is likely to moderate as a result of weaker exports and investments while consumption growth is expected to remain solid. Meanwhile, **Hong Kong** continues to be between relatively strong economic growth in China and loose monetary environment by the U.S. This helps sustain growth on the one hand, but elevate inflation on the other hand. Meanwhile, being a small and open economy, it has already felt the impact of a global slowdown with GDP contracting in Q2 2011 on a q-o-q basis.

In North Asia, **Japan** is on track to recover from the massive earthquake and tsunami. Many quake-hit facilities have already been back in operation as of August and this should drive better GDP growth numbers from Q4 2011, if not earlier. Nevertheless, the full year GDP is likely to be negative. The Bank of Japan's (BOJ) monetary easing should lend support to the recovery and ensure liquidity in the capital market. However, the current strong JPY value is negatively impacting its exports and is a downside risk on the economic recovery. In **Korea**, inflation remains above the Bank of Korea's (BOK) target range and hence interest rates may be raised in the short term despite moderating economic growth. Korea's economic growth is also vulnerable to the global economic slowdown.

In Southeast Asia, **Singapore's** economic growth decelerated significantly from the impressive 14.5% recorded in 2010. Its reliance on external demand makes it more vulnerable to the Western slowdown. Meanwhile, **Thailand** seems to have cleared some political uncertainty following the elections in July. This should support foreign investment and economic growth despite ongoing concerns of inflation.

Increasing risks

Key central banks around the world have been trying to stabilize the global financial markets. At the time of this writing, President Obama announced another support package to help create more jobs, while the eurozone discussed a Eurobond scheme to rescue debt-ridden economies such as Italy and Greece. Nevertheless, we continue to see strong headwinds:

- **European debt**. So far, mainstream forecasts assume that debt issues would be resolved in an orderly manner, albeit gradually. However, if the situation surprises the market on the downside, the solvency of certain commercial banks could be affected with ripple effects on the global financial system, liquidity and confidence.
- **U.S. growth**. The U.S. remains the world's largest economy and its economic prospects continue to impact global growth significantly. Our base case scenario assumes anemic U.S. growth but no double dip recession. However, the U.S. government has limited options remaining for further monetary easing and fiscal support measures due to the debt situation therefore the downside risks remain considerable. In addition, with the election drawing closer, the opposing views between competing political parties could affect the efficiency and implementation of any support policies.
- **Currency**. The situation in Europe and the U.S. has led to concerns over the sustainability of the euro and further depreciation of the U.S. dollar. Rising values of Asian currencies are likely to hurt exports. A number of central banks, including Japan and Switzerland, have intervened or threatened to intervene in the foreign exchange market in an attempt to avoid further appreciation of their respective currency. This adds to the uncertainty of the global capital market and to systemic risks.
- **Commodity prices**. As discussed, both the demand and supply side factors suggest that inflationary pressure is moderating but the impact of quantitative easing by various countries could skew the picture, e.g., further depreciation of the major currencies could drive precious metal and oil prices up.

Real Estate Market Outlook

Yield chasing activity in a low interest rate environment is expected to continue to support real estate investment flows. In the meantime, the rental growth outlook remains positive, but less robust, in most sectors.

Continued yield seeking to keep prime property yields low

Real estate investment activity in Asia has been rising since the global financial crisis in 2008. According to Real Capital Analytics, total commercial real estate transaction volumes increased by 18% in H1 2011 compared with the same period last year. This is despite disruptions in transaction activity in Japan by the earthquake; and in China by government tightening. As of H1 2011, the Asia-Pacific region accounted for 22% of the world's total commercial real estate transactions, compared with 10% in H1 2007, reflecting an increasing allocation of capital to this region.

Amidst low interest rates, a strengthening desire for income has driven investment capital into markets offering higher initial yields with positive yield carry. These markets include Hong Kong, Singapore and Australia where commercial transaction volumes increased by 50%, 90% and 43%, respectively, on a year-on-year (y-o-y) basis in H1 2011. This demand drove commercial transaction volume in Q1 2011 to the highest level since Q1 2008. Japan should have fallen into this category as the market offers the widest yield spread over bond yields across key markets globally, fulfilling the needs of yield hungry investors. However, the massive earthquake largely halted the market in Q2 2011. In H1 2011, total Japanese commercial real estate transaction volumes fell by 17% y-o-y, with a further breakdown revealing an 8% y-o-y increase in Q1 and a 56% y-o-y decline in Q2.

Figures 11 and 12 — Rising Activity Levels and Firm Pricing

Figure 11 — Commercial Real Estate Transaction Volumes

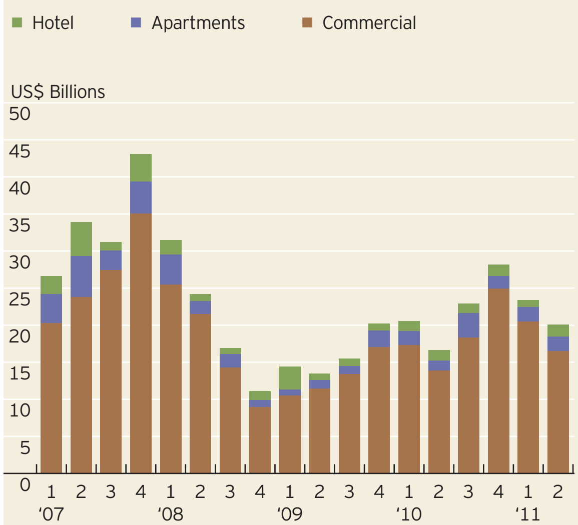
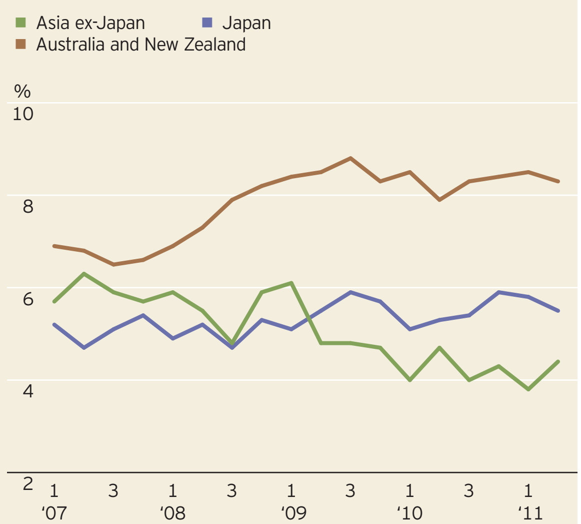


Figure 12 — Average Transaction Yields



Source: Real Capital Analytics, August 2011

Investors strongly prefer stable income streams and centrally located assets, driving yields for prime properties lower. The yield compression trend started in Asia ex-Japan where these markets have generally been less affected by the global financial crisis due to stronger private and public sector balance sheets. The recent uptick in yields was due primarily to increasing transaction activity in smaller markets including South Korea and Taiwan. This may reflect that certain investors have started to seek returns by moving up the risk curve. Japan also saw yields compressing in recent quarters. The expanded monetary loosening measures after the earthquake suggest interest rates will remain low for an extended period. Yields in the Australia/New Zealand markets have also begun to harden.

Generally speaking, we believe the yield chasing trend is expected to continue. In most markets, yields are still above borrowing rates while inflation remains high. As we do not anticipate significant increases in interest rates, the opportunity cost for holding and financing properties should remain low.

These supportive factors are, however, likely to be countered by a weaker economic outlook and hence softer rental growth expectations. We therefore expect yields to be fairly stable. Low holding costs should give owners room to persevere through market turmoil, especially in the Asia ex-Japan markets where household and corporate indebtedness have been low.

Softer occupier demand coincides with declining new supply

The rental growth outlook remains positive, albeit subdued, in most markets. On the demand side, a dimmer economic outlook suggests occupier demand should soften. Amidst rising uncertainty, some of the largest financial institutions have recently announced global headcount reduction plans and there have also been anecdotal reports about factory closings in China. While we do not expect a significant downturn in employment growth, the less promising outlook is expected to weigh on sentiment.

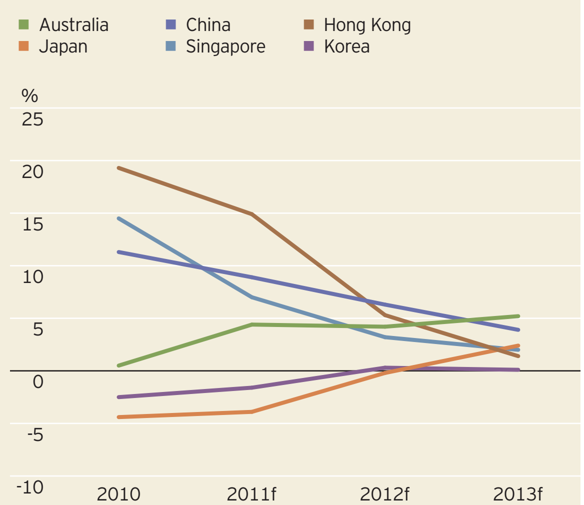
Nevertheless, the weaker outlook on demand is generally coinciding with declining new completions across many market sectors (Figure 13). This is especially true for the developed markets such as Australia, Japan and Hong Kong. Meanwhile, although high volumes of new completions are expected in some of the rapidly developing markets such as China, Thailand and Malaysia, buildings in these markets, due to poor property management, could become obsolete more quickly and demand is also expected to be relatively stronger.

Figures 13 and 14 — Falling Supply Supports Rents

Figure 13 — Supply Cycle Peaked

Source: Invesco Real Estate estimates using data from Jones Lang LaSalle Research, Q2 2011
f = forecast

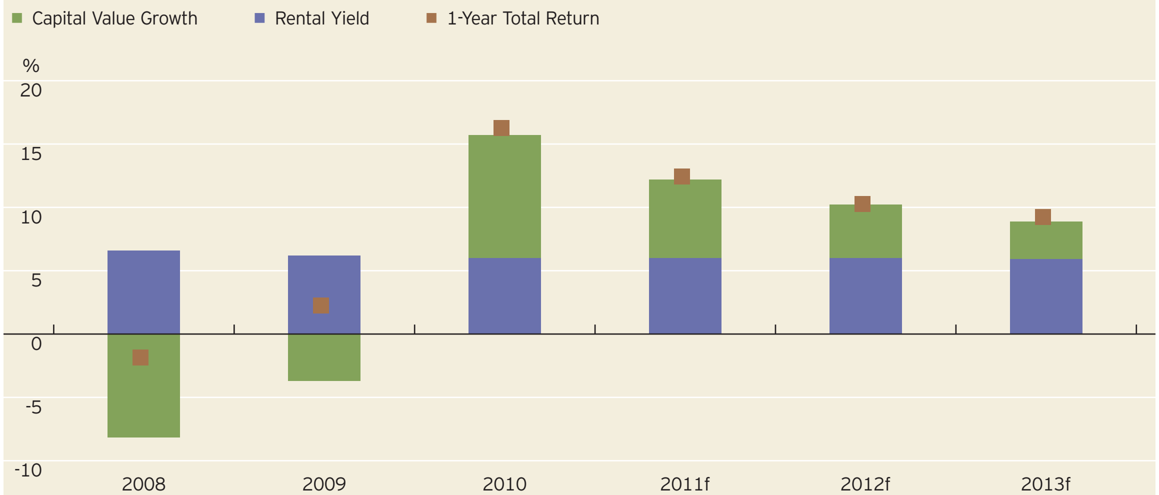
Figure 14 — Rents Rising at Slower Rates



Source: Invesco Real Estate estimates using data from Jones Lang LaSalle Research, Q2 2011
f = forecast

Indeed, most markets (23 out of 35) are operating at vacancy rates below their 10-year historic average levels, of which five are at their decade low. As such, landlords could remain firm on asking rents. Overall we expect rents in 18 out of our 35 market sectors to rise. Nonetheless, the rate of rental growth is set to moderate (Figure 15).

Figure 15 – Average 1-Year Total Return[1] of Asia-Pacific Markets



Source: Invesco Real Estate Estimates August 2011 based on current market conditions, subject to change
f = forecast

Overall, based on the anticipation of stable yields and slower rental growth, we expect total return for the Asia-Pacific real estate market to moderate from 2011 onward (Figure 15), in line with the softening economic growth trend. Over 2012 to 2014, total return should average approximately 10%, of which:

- Approximately 60% of the total return is expected to come from income return;
- Capital returns represent the remaining 40%, of which approximately 90% is expected to be driven by rental growth; and
- Yield shifts are likely to be a marginal driver of total return but Japan is likely to be an exception where we believe yields are likely to compress from their current levels.

The commercial sectors are expected to outperform

Our preference by property sector remains the same as that in our Spring 2011 House View. We believe:

- The retail sector is expected to be a sustainable long-term performer, especially in China where personal incomes are on a secular rising trend and the middle class is growing rapidly. Retail assets strategically located near key infrastructure should continue to outperform. As we have stressed before, strong bottom up asset selection and tenant mix management capability are crucial in realizing retail market potential and investment returns. In fast growing markets like China, accompanying the promising growth potential are usually high volumes of new completions and fast changing consumer tastes. Investors/landlords should be prepared for these challenges.

1 Unlevered, gross return before taxes, transaction costs, CAPEX and depreciation

- Performance of the office markets depends on supply conditions of individual markets. A number of markets such as Beijing and Sydney have passed through their supply peak with new completions being taken up steadily. In some markets where current vacancy rates are high, a flight-to-quality among tenants could drive diverging performance between well located quality buildings and the peripheral ones. With this reasoning, given steady demand, value-add investments which convert non-core assets to core are feasible. Meanwhile, there are some oversupplied markets such as Osaka and Seoul where investors need to assess investment opportunities more cautiously.
- Regulatory risks remain the key concern in the residential markets as local governments continue to ensure affordability. This is becoming more a political topic rather than an economic consideration. With elections coming up in Korea and Hong Kong, and the change of government in China in 2012, housing affordability is likely to continue to be scrutinized by political parties. In Singapore, after the recent election, the new government has been very firm on increasing housing supply. The exception is Tokyo where there are minimal policy risks and yields are high.

Opportunity for core and value-add investing

Despite the economic uncertainty, we believe that the Asia-Pacific real estate market continues to offer opportunities to investors:

- **Markets continue to offer high initial yield and positive carry.** As a result of the strengthening desire for yields, core assets with stabilized income are expected to be sought after. The Japanese and Australian markets are well positioned to capitalize on this trend. Both markets offer higher initial yields relative to the rest of the region, appealing to income-oriented investors. The average lending terms in Japan allow a decent 250 to 350 basis points positive carry. Australian banks are also becoming more accommodative and have recently lowered the loan spread for non-recourse lending and as a result positive carry is re-emerging even for prime properties in Sydney.

- **Tight supply creates opportunity for value-add investing.** Where there are strong interests for core, prime properties are usually tightly held and well-bid. In light of generally declining new completions and current low vacancy, opportunities for development or redevelopment are available. Curing underperforming assets of problems via refurbishment, re-tenanting or repositioning or change of use to improve rental income is feasible in markets where new supply is expected to be limited or solid rental growth is expected, such as the office and retail sectors of selected Chinese cities, Hong Kong and Singapore.

- **Capitalize on weak sellers.** Overall, distressed opportunities should be minimal given the generally healthy balance sheets of the private sector. Even if they arise, competition is usually fierce. Nevertheless, in markets where financing of development projects is more restricted such as Korea and Australia, there are developers/construction companies in need of capital to complete their projects. Similar opportunities could arise in China from smaller developers/landlords due to the government's strict control on lending. In Japan, investors could take the opportunity to purchase distressed assets from banks. Asking prices for these assets could present a discount to market prices. These opportunities are normally not widely marketed and on-the-ground local knowledge is vital to accessing them.

Managing risk

Stemming from the uncertain global economic climate, there are also clear risks in the above analysis:

- **Fundamentals**. A sharper-than-expected global economic downturn could crimp occupier demand. Investors should be maintaining and improving occupancy via pro-active negotiation in pre-leasing or rental reviews/renewals despite tightening new supply.
- **Liquidity**. The lingering European debt problems could intensify volatility in the capital market and affect bank liquidity. Borrowing costs could rise and the availability of loans could decline should the situation worsen. Investors should therefore be mindful of over-leverage.
- **Regulatory**. Domestically, government control policy has been a major threat to the real estate market, especially in the residential sector. This risk could become less significant should inflation start easing. Globally, governments' extensive interventions in the macro economy and financial markets (including quantitative easing, austerity measures, lending control, and currency stabilization) are augmenting systemic risks and complicating the outlook for economic prospects, the stability of the financial system and real estate market performance.

Below is a summary of our comments on individual markets and our forecast of key parameters is summarized in Figure 16 on page 16.

Outperforming markets

We believe the following market sectors will deliver stronger-than-historic returns:

- **Tokyo offices** and **residential** are well positioned for income-oriented investors given the decent yield spread over bond yields and positive carry. Well-located buildings with good specifications are also set to enjoy rental recovery earlier than the rest of the market.
- In **China**, the **retail** markets continue to offer promising growth prospects amidst rapidly rising private consumption. Retail assets appealing to the middle to high income catchment and strategically located near major transport infrastructure are expected to excel. Meanwhile, selective office markets are showing good rental growth prospects. We expect **Beijing offices** to be one of the strongest markets in terms of rental growth as the substantial amount of new office space completed in 2008 to 2009 was well taken up while future supply is rather low. **Shanghai offices** are also expected to deliver stable rental growth although new completions are expected to stay at a relatively high level.
- The stabilizing office leasing market and high initial yields attracted income oriented investors like the Canadian Pension Plan Investment Board to invest in **Australia offices**. In addition, there are signs that banks are becoming more accommodative on lending, especially to core income producing properties. Recently, banks' lending spread over the cash rate is reportedly approximately 150 to 250 basis points, versus 250 to 300 basis points post the global financial crisis, bringing the all-in finance cost down to below 7% on average. The lowered finance cost has helped restore the positive yield carry for prime properties, further strengthening the investment case for Australia.

Underperforming markets

Market sectors in this category are characterized by high rental decline risk and unattractive current pricing. These market sectors are normally characterized by substantial upcoming completions, thus weighing on rents in the next two years. Strong bottom-up execution capabilities, including cautious and selective asset selection, prudent underwriting assumptions and comprehensive value-add plans, are very important in attempting to invest in these markets.

- We are generally cautious about the near-term prospects of the **residential** markets in **China, Hong Kong** and **Singapore**, largely due to policy overhang. We believe a price correction is possible in the near term. Nevertheless, we remain a firm believer in the long-term growth potential of these markets, especially **China**. We expect the market to recover quickly once the Chinese government starts to relax the current abnormal extent of control. In the meantime, Chinese cities currently excluded from the policy control are less affected.
- The **office** markets of **Osaka, Kuala Lumpur** and **Guangzhou** remain burdened by massive upcoming new supply. Rents are likely to remain suppressed as landlords continue to fight for tenants.

Market performers

In our view, these market sectors offer opportunities for investors to capitalize on rental growth or high cap rates/spreads. We believe that market timing, asset enhancement and precise asset specific risk management are required to operate in these market sectors.

- The continued household deleveraging has capped discretionary spending and weakened the growth outlook of **Australian retail**. Yet, with stable employment and income growth, demand for necessities shopping is well underpinned. Assets with long leases and CPI indexed rents by credible, necessity-oriented retailers are sought after by income-focused investors despite low yields.
- Although the **Hong Kong office** and **retail** markets are underpinned by limited new supply and steady demand, we expect returns to temper considerably from H2 2011. Further upside on rents could be much lower given their current historic peak levels as inflation and high occupational costs start to trim corporate profit. The narrowing positive carry due to compressed yields and less aggressive bank lending is also dampening investor interest. In addition, the city's exposure to global economic conditions also makes its economic fundamentals more vulnerable. Similarly, the less rosy economic outlook due to global economic uncertainty is subtracting from the rental growth outlook of the **Singapore office** and **retail** markets.
- While the **Seoul office** market remains burdened by the supply overhang, new completions are expected to become more muted from 2013. While financing conditions remain relatively restricted, distressed opportunities could be available.

Figure 16 – Forecast Summary

			GDP Growth Rates (Country Level)					Vacancy Rates					Rental Growth					Market Yield				
Country	City	Sector	Historic Avg.	2010	2011f	2012f	2013f	Historic Avg.	2010	2011f	2012f	2013f	Historic Avg.	2010	2011f	2012f	2013f	Historic Avg.	2010	2011f	2012f	2013f
Australia	Brisbane	Office	3.1%	2.7%	1.5%	4.0%	3.7%	4.1%	5.4%	3.8%	3.8%	3.4%	11.0%	-17.1%	-2.3%	5.2%	7.6%	7.3%	7.6%	7.6%	7.5%	7.4%
Australia	Melbourne	Office	3.1%	2.7%	1.5%	4.0%	3.7%	5.2%	4.4%	5.3%	5.8%	6.1%	0.6%	12.3%	6.7%	5.0%	4.8%	7.3%	7.4%	7.2%	7.3%	7.2%
Australia	Perth	Office	3.1%	2.7%	1.5%	4.0%	3.7%	5.9%	5.6%	4.7%	7.7%	6.2%	17.3%	-5.2%	11.8%	0.8%	3.0%	7.7%	8.0%	7.8%	7.9%	7.9%
Australia	Sydney	Office	3.1%	2.7%	1.5%	4.0%	3.7%	7.9%	7.7%	7.8%	5.7%	5.8%	0.5%	4.5%	4.9%	5.7%	4.8%	6.6%	6.9%	6.7%	6.6%	6.6%
China	Beijing	Office	10.5%	10.3%	9.3%	8.5%	8.0%	17.4%	12.4%	10.4%	7.6%	7.7%	-1.1%	25.2%	21.6%	10.6%	6.0%	9.1%	6.4%	6.3%	6.2%	6.2%
China	Guangzhou	Office	10.5%	10.3%	9.3%	8.5%	8.0%	17.9%	11.7%	11.8%	13.3%	16.0%	3.1%	15.0%	9.4%	5.0%	2.8%	7.4%	5.9%	5.9%	5.8%	5.8%
China	Shanghai	Office	10.5%	10.3%	9.3%	8.5%	8.0%	10.3%	8.5%	9.0%	8.4%	7.0%	7.9%	21.0%	15.6%	12.5%	4.5%	7.7%	5.9%	5.9%	5.9%	5.9%
China	Shenzhen	Office	10.5%	10.3%	9.3%	8.5%	8.0%	13.4%	15.8%	14.5%	14.1%	12.1%	7.3%	22.2%	12.6%	9.3%	4.4%	5.4%	4.3%	4.3%	4.3%	4.3%
Hong Kong	Hong Kong	Office	4.1%	7.0%	5.9%	5.0%	4.5%	7.0%	4.7%	4.8%	5.2%	5.3%	10.4%	28.5%	19.9%	5.2%	4.8%	4.1%	3.6%	3.6%	3.6%	3.8%
India	Mumbai	Office	7.6%	8.8%	8.2%	8.5%	7.9%	12.3%	15.6%	21.0%	18.7%	16.1%	4.8%	-0.3%	0.0%	2.3%	3.4%	11.4%	10.4%	10.3%	10.3%	10.2%
Japan	Osaka	Office	0.7%	4.0%	-0.3%	2.3%	1.8%	3.8%	7.8%	7.4%	7.0%	9.2%	-0.4%	-8.9%	-7.9%	-5.7%	-5.0%	5.0%	5.2%	5.1%	5.0%	5.0%
Japan	Tokyo	Office	0.7%	4.0%	-0.3%	2.3%	1.8%	4.3%	5.8%	5.4%	5.1%	3.4%	-0.2%	-4.7%	-3.8%	4.2%	6.9%	3.9%	3.6%	3.7%	3.6%	3.5%
Korea	Seoul	Office	4.2%	6.2%	4.5%	4.0%	4.2%	4.0%	9.0%	8.0%	8.6%	7.7%	3.0%	-2.5%	-1.6%	0.3%	0.1%	7.7%	6.5%	6.5%	6.5%	6.5%
Malaysia	Kuala Lumpur	Office	4.6%	6.4%	5.5%	6.0%	5.6%	12.8%	12.8%	18.3%	19.2%	17.3%	0.4%	-2.1%	-3.3%	0.9%	1.6%	7.6%	7.3%	7.3%	7.4%	7.4%
Singapore	Singapore	Office	5.7%	14.5%	5.5%	5.0%	4.8%	7.1%	6.1%	10.4%	9.1%	8.7%	8.6%	23.4%	14.2%	5.6%	4.3%	4.8%	4.0%	4.2%	4.3%	4.4%
Taiwan	Taipei	Office	3.9%	10.9%	4.5%	5.0%	4.2%	13.0%	17.6%	12.6%	11.5%	16.1%	-2.2%	-1.3%	1.9%	3.3%	1.4%	5.0%	3.9%	3.9%	4.0%	4.0%
Thailand	Bangkok	Office	4.4%	7.8%	4.3%	5.1%	5.0%	18.1%	19.7%	20.8%	19.5%	18.6%	6.3%	-3.1%	-2.3%	1.5%	3.8%	7.9%	7.7%	7.9%	7.9%	7.9%
Australia	Brisbane	Retail	3.1%	2.7%	1.5%	4.0%	3.7%	3.7%	3.2%	3.1%	3.0%	2.8%	2.2%	0.8%	4.4%	1.9%	2.4%	6.0%	7.8%	7.5%	7.4%	7.4%
Australia	Melbourne	Retail	3.1%	2.7%	1.5%	4.0%	3.7%	2.9%	1.3%	2.6%	2.4%	2.3%	6.6%	1.6%	0.9%	2.9%	3.5%	7.2%	7.5%	7.3%	7.3%	7.4%
Australia	Perth	Retail	3.1%	2.7%	1.5%	4.0%	3.7%	4.7%	5.6%	5.0%	5.2%	4.0%	2.0%	0.0%	2.6%	1.8%	3.8%	7.9%	8.0%	8.0%	7.8%	7.8%
Australia	Sydney	Retail	3.1%	2.7%	1.5%	4.0%	3.7%	2.8%	1.6%	2.6%	2.5%	2.4%	4.7%	6.8%	3.9%	3.8%	4.7%	6.5%	6.6%	6.6%	6.6%	6.6%
China	Beijing	Retail	10.5%	10.3%	9.3%	8.5%	8.0%	13.1%	13.9%	10.2%	11.6%	12.6%	5.5%	16.4%	6.4%	4.6%	4.2%	8.9%	6.6%	6.3%	6.3%	6.2%
China	Guangzhou	Retail	10.5%	10.3%	9.3%	8.5%	8.0%	7.8%	3.7%	11.9%	12.0%	12.6%	5.2%	9.6%	5.0%	5.8%	7.6%	8.0%	8.0%	8.0%	7.9%	7.8%
China	Shanghai	Retail	10.5%	10.3%	9.3%	8.5%	8.0%	5.3%	0.7%	1.4%	3.6%	2.3%	10.7%	2.4%	7.2%	6.6%	5.7%	8.6%	7.0%	6.8%	6.7%	6.6%
China	Shenzhen	Retail	10.5%	10.3%	9.3%	8.5%	8.0%	4.7%	4.9%	9.7%	10.9%	9.3%	-3.9%	-7.1%	3.5%	2.4%	2.0%	8.6%	8.6%	8.5%	8.4%	8.4%
Hong Kong	Hong Kong	Retail	4.1%	7.0%	5.9%	5.0%	4.5%	4.7%	3.2%	3.1%	2.8%	2.8%	6.4%	10.2%	9.5%	5.5%	2.3%	6.1%	5.2%	4.7%	4.6%	4.6%
Singapore	Singapore	Retail	5.7%	14.5%	5.5%	5.0%	4.8%	1.2%	2.1%	1.9%	2.1%	2.3%	0.9%	1.7%	2.5%	1.5%	0.6%	5.5%	5.0%	5.0%	5.1%	5.1%
Thailand	Bangkok	Retail	4.4%	7.8%	4.3%	5.1%	5.0%	7.5%	7.4%	9.7%	8.5%	7.7%	1.4%	1.3%	0.7%	1.9%	3.4%	13.0%	12.9%	12.9%	12.8%	12.7%
China	Beijing	Residential	10.5%	10.3%	9.3%	8.5%	8.0%	21.1%	15.7%	13.8%	11.9%	10.0%	-2.7%	7.4%	4.8%	4.5%	5.3%	7.7%	2.8%	3.0%	3.0%	2.9%
China	Guangzhou	Residential	10.5%	10.3%	9.3%	8.5%	8.0%	17.8%	11.2%	8.1%	10.3%	11.6%	2.9%	4.5%	6.4%	2.8%	-1.2%	3.4%	3.0%	3.1%	3.1%	3.1%
China	Shanghai	Residential	10.5%	10.3%	9.3%	8.5%	8.0%	26.0%	8.9%	8.4%	9.1%	11.9%	1.1%	7.9%	4.8%	5.4%	5.0%	4.0%	2.3%	2.4%	2.3%	2.3%
Hong Kong	Hong Kong	Residential	4.1%	7.0%	5.9%	5.0%	4.5%	11.1%	12.9%	11.8%	11.4%	10.6%	3.8%	19.3%	15.3%	5.1%	-2.8%	3.2%	2.2%	2.3%	2.5%	2.5%
Japan	Tokyo	Residential	0.7%	4.0%	-0.3%	2.3%	1.8%	5.8%	5.1%	5.4%	5.3%	5.0%	-0.0%	0.3%	-0.5%	0.5%	4.6%	5.4%	5.7%	5.7%	5.6%	5.3%
Singapore	Singapore	Residential	5.7%	14.5%	5.5%	5.0%	4.8%	7.7%	5.9%	6.9%	6.0%	5.7%	4.1%	18.4%	4.4%	2.6%	1.2%	3.8%	3.0%	3.0%	3.1%	3.2%
Thailand	Bangkok	Residential	4.4%	7.8%	4.3%	5.1%	5.0%	2.7%	3.4%	4.0%	2.9%	3.6%	-1.1%	-6.8%	-4.1%	0.8%	1.5%	5.7%	4.4%	4.1%	4.0%	4.0%

Source: Invesco Forecasts based on data from Experian, Moody's Economy.com, Jones Lang LaSalle, Japan Real Estate Institute and Association for Real Estate Securities, June 2011
f= forecast and is not guaranteed.
Note: Market yield for Australian markets are cap rates. Tokyo office forecasts are based on an international grade "A" basket in the central 3 wards.

Key Market Summaries

Australia

The Australian economy has slowed with the global economy. However, we believe vacancy will decrease in 2012, backed by steady foreign demand for resources, healthy domestic labor markets and declining supply. Prime commercial assets with stable income yields may continue to attract longer-term, income-oriented investors.

Opportunities: Convincing income yield play

- We forecast that the Australian office markets will be among the leading performers in the region. With generally declining vacancy rates, office rents are in the early stages of the recovery and gaining momentum. High initial yields and steady rental growth over the medium term are forecast to contribute heavily towards total returns.
- Prime retail assets located in core areas continue to attract keen interest from foreign pension funds and institutional investors, which are driving transaction volumes and hardening cap rates.

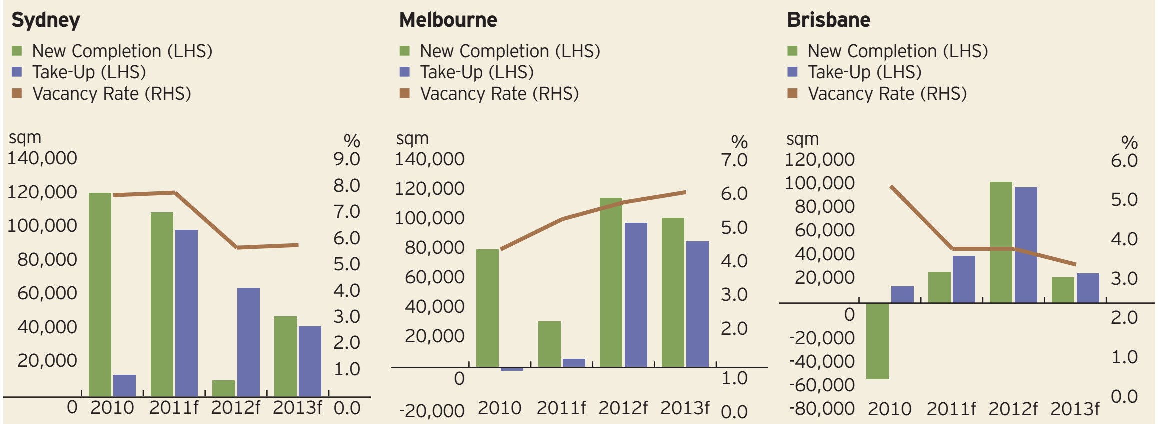
Macro Themes: Near-term growth stifled by tightening in China, global headwinds and inflation; medium-term outlook suggests traction gaining in 2012

- Australia's full year 2011 economic growth is expected to be lackluster given the flooding disaster in the first half of the year, followed by unfolding debt turmoil in Western countries and China's tightening in the second half.
- Policymakers are balancing rising inflation from an upswing in mining investment against global headwinds and cautious consumer sentiment. Relatively high borrowing costs and a strong currency are stemming inflationary pressure, although it still stood above the 2% to 3% target range as of June 2011. Nevertheless, the Reserve Bank of Australia continues to prudently hold interest rate increases until there is further clarity in the global economy.
- Despite a low unemployment rate and rising wages, households continue to deleverage, resulting in higher saving rates and subdued consumer sentiment.
- Nevertheless, Australia's energy and commodity cycle remains largely underpinned by China's longer-term economic development and strengthening intra-regional trades. China and Japan are Australia's top export markets comprising 25% and 19% of total 2010 exports, respectively. Australia is expected to deliver stronger economic growth in 2012 off the low base of 2011, assuming China is able to engineer a soft-landing. Consensus Economics forecasts project 3.8% growth next year, which would be a post-financial crisis high.
- With current investment sentiment weighted towards low-risk asset classes, prime real estate assets are positioned to remain favorable by domestic and foreign investors.

Real Estate Market Update: Robust take-up of ample new office supply supporting rental growth

- In the office markets, leasing demand is underpinned by expansion and new investment from resources and mining companies, which in turn is driving business support from financial institutions and service providers. Looking ahead, the new supply pipeline is forecast to be below historical averages (Figure 17).

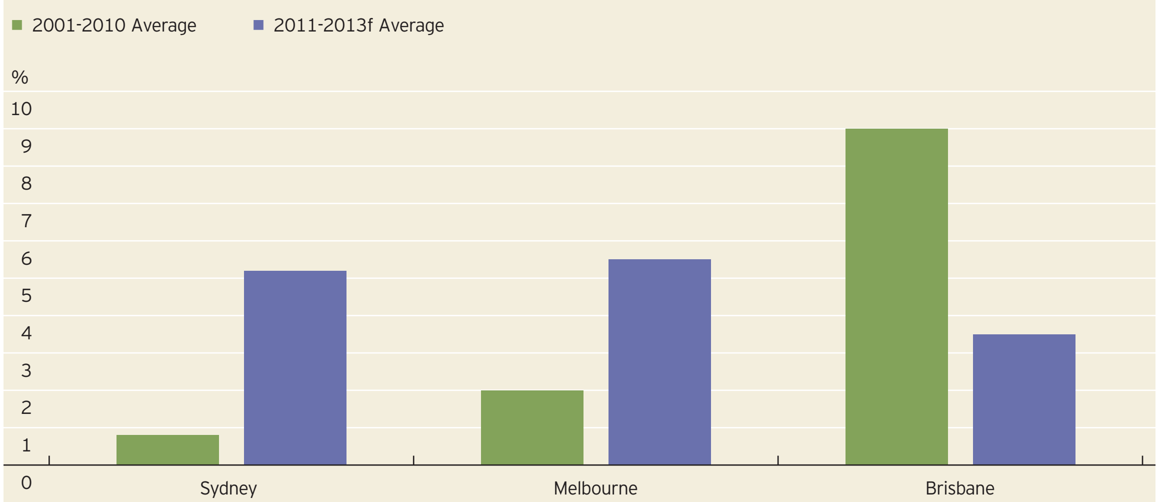
Figures 17 – Office Supply, Take-Up and Vacancy Rate Outlook



Source: Invesco Real Estate Forecasts using data from Jones Lang LaSalle Research, Q2 2011
f = forecast

- As a result, there should be steady improvement in occupancy across major office markets through 2012 to 2013, particularly in Sydney and Brisbane. Landlords in some markets have begun reducing incentives as building occupancies increase. We expect annual net effective rental growth in Sydney to average around 5% over the next three years (Figure 18).

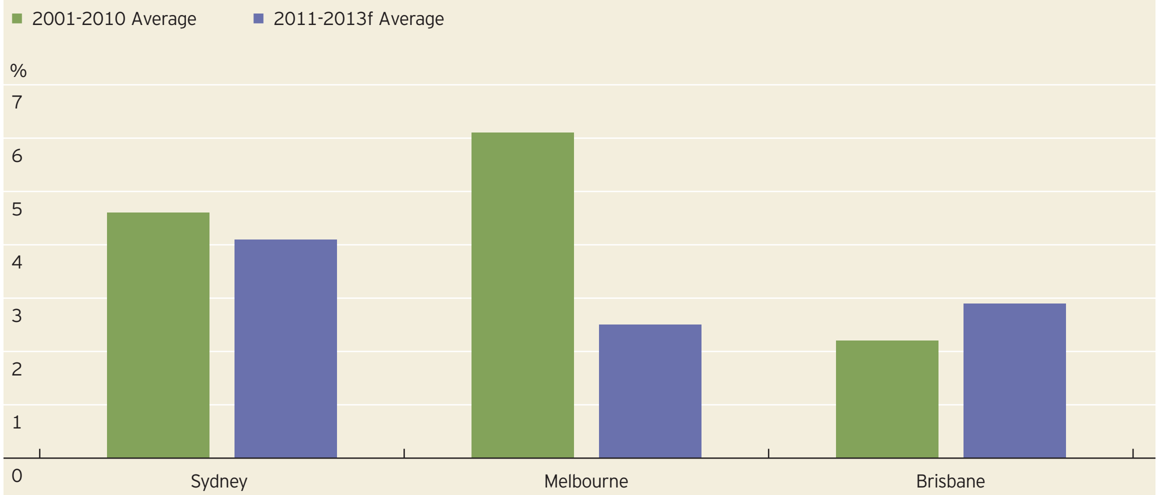
Figure 18 – Forecasting Solid Office Rental Growth



Source: Invesco Real Estate estimates using data from Jones Lang LaSalle Research, Q2 2011
f = forecast

- Retail sales turnover appears to be stabilizing in Q3 2011 after previous declines earlier in the year. Recent consumer trends indicate continued household deleveraging with less discretionary spending and higher household savings rates. This trend is the reverse of the negative saving habits recorded before the global financial crisis. Nevertheless, consumption fundamentals should hold firm with a low unemployment rate, population growth and wage increases.
- Retail vacancy levels are forecast to remain relatively stable over the next two to three years near historical average levels. Mild rental growth is expected across major markets (Figure 19).

Figure 19 – Forecasting Mild Retail Rental Growth



Source: Invesco Real Estate forecasts using data from Jones Lang LaSalle Research, Q2 2011
f = forecast

- With the positive outlook for commercial real estate performance, cap rates have hardened and pricing is negligibly above the local government bond rate. Nevertheless, investment activity has been quite buoyant with acquisitions by longer-term overseas investors who are able to enjoy tax incentives such as the Canadian Pension Plan Investment Board, GIC and NPS. Global funds, A-REITs and institutional investors continue to see Australian prime office assets as a safer, defensive holding and yields may mildly compress over the next two years.

China

China's economic fundamentals are underpinned by its ability to launch supportive fiscal measures, leeway to ease monetary measures and resilient domestic demand amidst global headwinds. Office and retail sector performance is forecast to remain attractive.

Opportunities: Office and retail sectors to lead returns; short-term caution in the residential markets

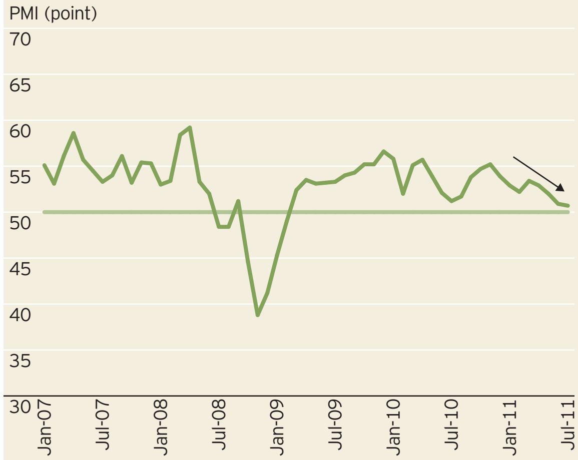
- We forecast Beijing and Shanghai offices to produce attractive returns with leasing demand underpinned by strong business confidence and a growing tertiary sector. Solid rental growth continues to attract strong investment demand and yields are expected to marginally decline, particularly for prime assets.
- The retail sector remains positioned to benefit strongly from China's rising middle class. On the whole, retail space per capita does not appear to be saturated and retailers are snapping up space in core areas. We expect retail assets to remain in demand and for yields to slightly compress in the medium term. In particular, well-designed shopping centres located in prime retail hubs are expected to capitalize on the sector's growth trend.
- We are cautious about residential investments and the risk of regulatory overhang. In addition, price, ownership and mortgage controls could dampen prices and short-term returns. With home purchase restrictions now enacted in second and third-tier cities, we forecast a more pronounced short-term correction followed by a longer-term run up in solid end-user demand for projects/cities with more reasonable pricing.

Macro Themes: Outlook marked by inflation and slower, but still solid economic growth

- China is engineering a balance between taming inflation and keeping economic growth on track. Recent PMI indicators signal slowing manufacturing growth and China remains particularly vulnerable to a shock in external demand for its exports (Figure 20).
- Rising capital costs following benchmark rate increases (Figure 21) and tightened lending policies continue to dampen investment activity. Restricted onshore lending has forced some cash-strapped developers to access higher cost private debt/mezzanine markets.
- In the meantime, Chinese consumers play an integral role to help drive a more diversified economy to complement investment and export growth drivers. Steady urbanization and an emerging middle class remain fundamental drivers that will support the local economy. Recent policy discussions on lowering salary taxes and reducing the import tax on luxury goods could also further bolster domestic spending.

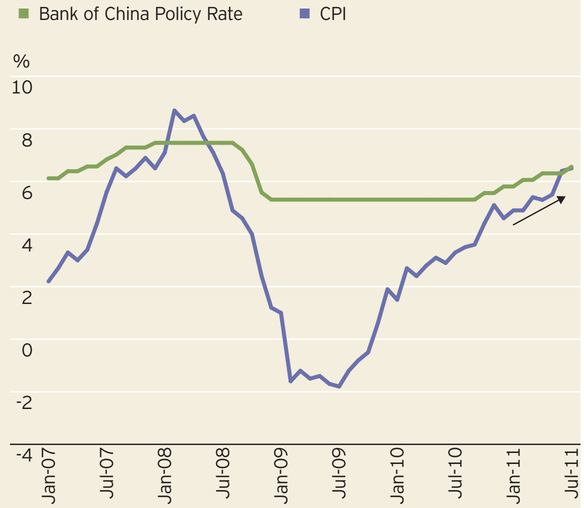
Figures 20 and 21 – Cautious Market Indicators

Figure 20 – PMI Manufacturing



Sources: Bloomberg; China Federation of Logistics & Purchasing, August 2011

Figure 21 – Inflation and Policy Rate



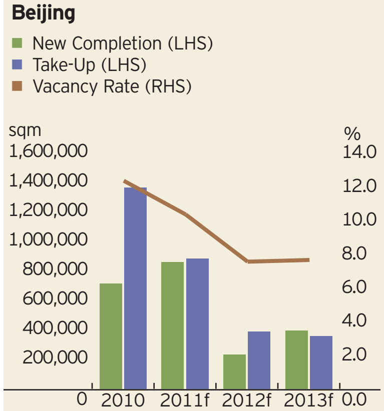
Sources: People's Bank of China, National Bureau of Statistics of China, August 2011

Real Estate Market Update: Commercial real estate attractive; residential weighed down by rising inventories and discounts

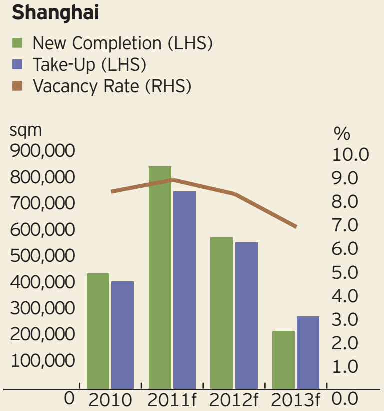
- In the office sector of first tier cities, strong take-up has helped mitigate downward pressure from oversupply (Figure 22). We forecast rents in both Beijing and Shanghai to continue to rise.
- Guangzhou remains an exception with extensive ongoing construction (and traditionally less absorption than Shanghai), which should keep rental growth relatively subdued in the next two to three years.

Figures 22 – Imminent Office Pipeline Fading in Beijing and Shanghai

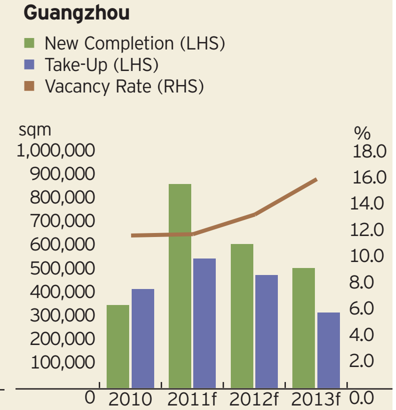
Beijing



Shanghai



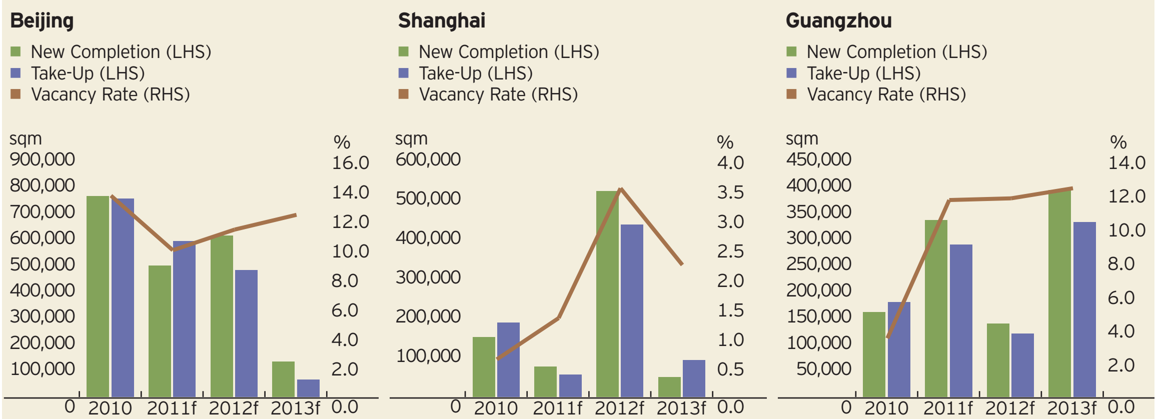
Guangzhou



Source: Invesco Real Estate Research forecasts using historical data from Jones Lang LaSalle Research, Q2 2011
f = forecast

- In the retail sector, the trajectory of consumption fundamentals remains solid and continues to attract major retailers. International brands and domestic retailers such as Apple, Gap, Carrefour, Wumart, Zara and Mango are still aggressively expanding in Tier I and II cities.
- The retail markets remain resilient despite an abundant number of quality projects. New shopping mall space has seen explosive growth over the last decade. However, highly populated cities suggest there is still room for even further increases in per capita retail space. With the exception of Guangzhou, we expect vacancy rates to stay below historical levels and remain relatively stable (Figure 23). Rental growth is forecast for solid performance despite slight moderation.

Figures 23 – Retail Supply, Take-Up and Vacancy Across Major Cities



Source: Invesco Real Estate Research forecasts using historical data from Jones Lang LaSalle Research, Q2 2011
f = forecast

- The residential sector continues to face downward pressure with falling volumes and price corrections. Although the long-term fundamentals remain attractive, the next couple of years will be closely monitored by the government which may intensify policy measures to achieve more affordable housing. The combination of increasing new supply, rising inventories and tight cashflows are leading some developers, particularly small and medium-sized ones, to cut prices between 5% to 15% at some projects.
- The Chinese government has signaled that home purchase restrictions will also be implemented in second and third-tier cities for the first time. Further tightening may be imposed if prices keep rising. As a result, we expect prices to continue correcting during the year through the period of heightened regulatory risk and stable interest rates. In the meantime, investor interest will remain shifted to the commercial sector.
- Despite higher interest rates, we expect investment activity to remain robust with investment demand from domestic companies, foreign investors and institutional investors (such as insurance companies) attracted by strong rental growth prospects. Office yields are forecast to remain relatively stable until new supply is absorbed.
- China's rising consumption remains a compelling macro trend for investors seeking steady growth plays. Retail yields are expected to continue compressing by 20 to 30 basis points over the medium term.

Hong Kong

We expect more moderate returns due to the slowing growth in China and cautious business sentiment amidst a global economic slowdown. Nevertheless, tight office vacancy should support rents over the next one to two years. Meanwhile, the residential sector should be dampened by policy overhang.

Opportunities: Steady returns in office and retail opportunities; cautious with residential investments

- We like the office sector despite moderate return forecasts from H2 2011 going forward. While prime commercial assets are scarcely on the market, secondary assets in key locations should benefit from major infrastructure projects and continual gentrification in older districts. Good assets in peripheral office areas should also achieve attractive rental growth with high occupancy given the wide rental gap compared to central locations.
- Similarly, we also like the retail sector which is underpinned by solid labor market conditions and record tourist spending. Prime retail properties continue to upgrade tenant mixes and charge higher rents. Similarly, we would target under-utilized retail assets or convertible office buildings in core locations for refurbishment and repositioning to attract high-end retailers. We forecast steady rental growth over the next two to three years which would help achieve attractive risk-adjusted returns.
- We are currently more cautious with residential opportunities with short-term downside risks outweighing upside potential. Despite the looming global headwinds and policy overhang, we see low interest rates supporting holding costs and preventing a substantial fall in prices over the next 12 months. With a mild correction likely, investment opportunities shall be prudently assessed.

Macro Themes: Growth tied to China and resilient domestic demand

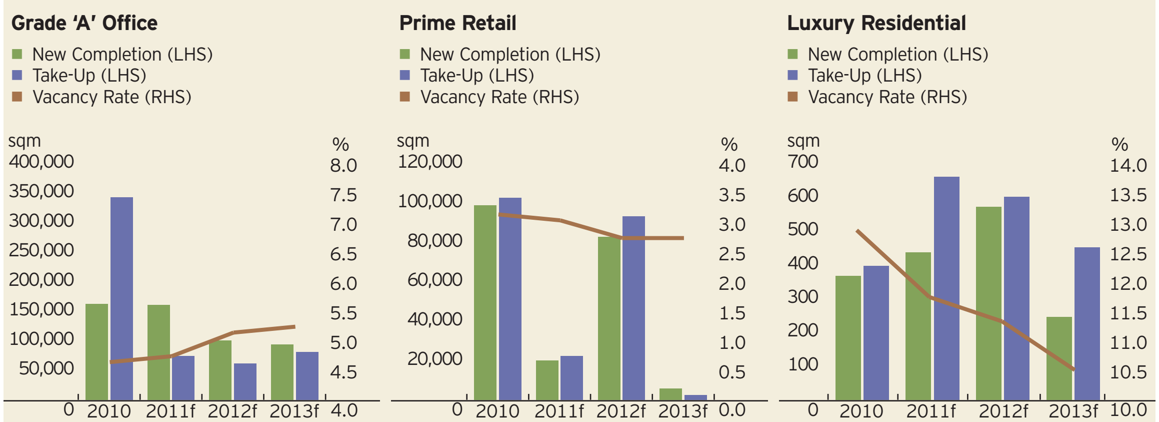
- Despite slowing down and contracting 0.5% in the second quarter, Hong Kong's economy remains underpinned by steady business growth, low unemployment, buoyant tourist spending and close ties with China. In particular, backing by China to be the country's leading offshore RMB centre should enhance Hong Kong's position as a global financial centre.
- At the same time, while some financial institutions have signaled future layoffs, overall hiring intentions appear to be stable according to the Manpower Employment Outlook Q3 2011. Private consumption remains a key driver of Hong Kong's economy and should help compensate for weakening export growth.
- With overall price levels remaining lifted and with little monetary autonomy due to the HKD-USD peg, the government is expected to announce further one-off inflation relief measures.

Real Estate Market Update: Income driven by low vacancy and limited supply

- In the office sector, leasing activity slowed down amidst rising economic uncertainty and landlords have shown a willingness to increase incentives to secure tenants. In this regard, despite vacancy rates falling near historic low levels across all districts, our rental growth forecasts moderate from H2 2011 onwards to roughly 5% pa. Nevertheless, we expect investment interest to remain keen over the next one to two years, keeping yields relatively steady.

- In the retail sector, buoyant domestic consumption and spending from Mainland Chinese tourists are the backdrop for aggressive retailer expansion, particularly from jewelry and global fashion shops in prime locations. Vacancy rates remain extremely low and rents continue to rise, widening the gap between core tourist areas and suburban centers. Going forward, the luxury goods tax reduction in China is a material threat looming over the sector's longer-term outlook. Nevertheless, we expect this to be implemented gradually and forecast solid retail fundamentals to continue into 2013 with rental growth around 4% pa.

Figures 24 – Supply, Take-Up and Vacancy Rate Outlook Across Sectors

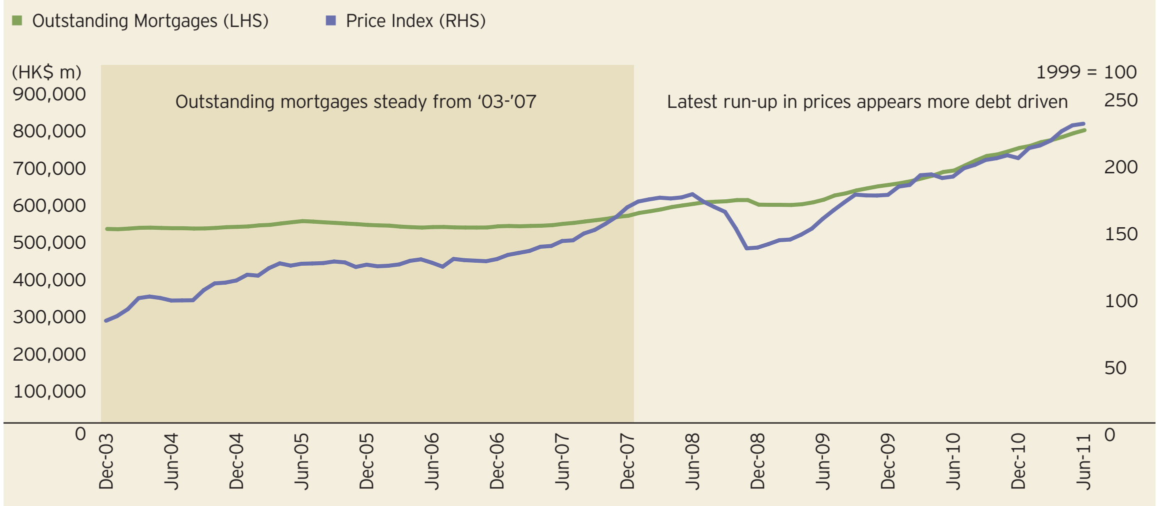


Source: Invesco Real Estate Forecasts using data from Jones Lang LaSalle Research, Q2 2011
f = forecast

- Hong Kong's luxury residential market has benefitted from monetary easing on a global scale, particularly from China and the U.S. Capital inflows have found their way into the property market and recent data since 2009 show that price growth has been markedly cheap mortgage-driven (Figure 25).

- As a result, we expect prices to mildly correct over the next one to two years as tighter mortgage lending and lower LTV ratios coupled with higher mortgage rates filter through the market. A more pronounced downturn is likely to be dragged out with speculators on the sidelines (due to the Special Stamp Duty tax) and extended low interest rates in the U.S. Low holding costs and rising rents are providing leeway for current landlords to hold steady. Hence, a potential downturn appears more likely in 2013 when interest rates are anticipated to normalize in the U.S. and increased supply from recent government land auctions come onto the market.

Figure 25 — Recent Debt Driven Run-Up in Luxury Residential Prices



Sources: Hong Kong Rating and Valuation Department, Hong Kong Monetary Authority, Invesco Real Estate Research, Q2 2011

- From our in-house experience, there are signs of tightened lending conditions following the unfolding debt crisis in Europe and the U.S. Some banks have increased spreads for investment properties and are attracting deposits with higher savings rates. Nevertheless, in the short term, negative real interest rates should continue to drive investor demand for real estate.
- Investment activity remains shifted from the residential sector to the office and retail markets following the government's anti-speculative measures. Local and Mainland Chinese investors have been the major players, acquiring commercial and hotel assets along with smaller strata-titled office units. Over the longer term, we expect normalizing interest rates to limit upside in capital values but the office and retail markets should still perform solidly, although below-trend.
- In the residential sector, cautious sentiment is pervasive with the cloudy global economic outlook and policy overhang from tightened mortgage lending, increased land auctions and imposed development restrictions for newly sold land sites. Nevertheless, near-term residential rental growth is underpinned by tight vacancy and low interest rates should keep holding costs affordable for landlords.

Japan

The Japanese economy is set to recover as reconstruction works pick up and supply constraints ease, thus gathering momentum. Moreover, capital market conditions are favorable for property investment given the positive yield carry and improving bank lending.

Opportunities: Tokyo office and residential sectors are poised to benefit from the stabilizing economy while Osaka offices should remain subdued

- We favor Tokyo offices and would target assets within and around the core wards which would benefit from the ongoing flight-to-quality trend and two-speed recovery. We are forecasting attractive returns to be supported by stabilizing rents, positive carry and subsequent yield compression from 2012 onwards.
- The Tokyo residential sector is well underpinned by solid local demand. Projects located in core traditional neighborhoods should retain steady end-user demand, particularly as rebuilding efforts gain traction and the employment situation stabilizes.
- We are cautious about Osaka offices, which will be plagued by excessive oversupply and high vacancy rates over the next couple of years.

Macro Themes: A weak 2011 followed by a stronger 2012

- Due to the massive earthquake in March, the consensus forecasts of GDP was revised down to contract by 0.7% for the full year 2011 (as of August 2011), a remarkable downward revision from the 1.5% forecasted in February 2011. However, reconstruction of quake-hit facilities coupled with public and business investment should help resume growth and 2012's GDP growth rate forecast was revised upward from 2% to 3.1%, compared with an average annual growth rate of 0.9% over the last 15 years.

Figures 26 and 27 — Stabilizing Economy

Figure 26 — Industrial Production

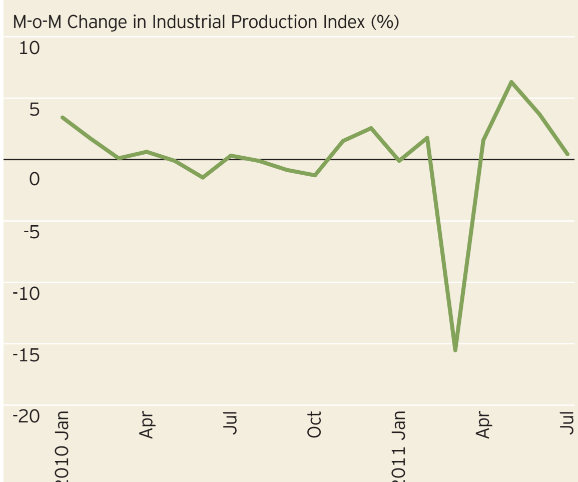
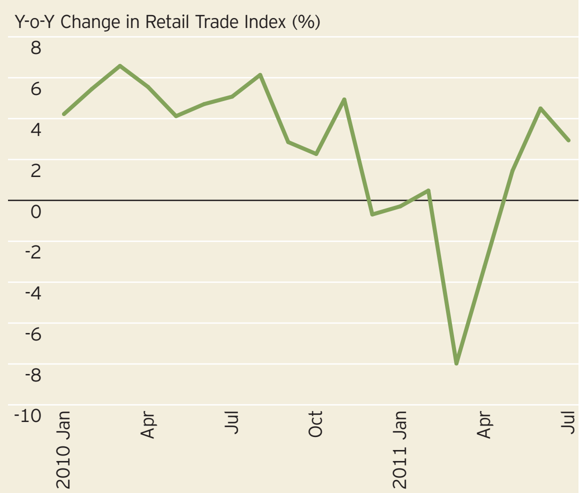


Figure 27 — Retail Sales



Source: Ministry of Economy, Trade and Industry, August 2011

- In fact, the rebuilding of quake-hit facilities is on track and as the supply constraints continued to ease, industrial production has been resuming. Consumer sentiment has also been stabilizing with retail sales growth normalizing (Figures 26 and 27).
- A strong yen remains a key concern as it hampers Japan's exports which are a significant economic growth driver. Nevertheless, this may facilitate rebuilding efforts with lower import costs, in particular, energy, construction materials and foodstuffs.

Real Estate Market Update: Improved outlook for investment returns driven by stabilizing rent and prospect of yield compression

- Office leasing demand could be generally subdued this year before gathering momentum in 2012. We forecast vacancy rates to remain elevated but trend downwards (Figure 28). According to Miki Shoji Co. Ltd., office vacancy rates of the central five wards have been edging down since March. Meanwhile rents are anticipated to slightly decline before stabilizing next year.
- A similar trend is expected for the residential sector, however with milder adjustments due to the relatively more stable historical trend. Therefore, we expect a slight dip in rents to occur by year-end, followed by a recovery in 2012 (Figure 29).

Figures 28 and 29 – Rents to Stabilize in 2012

Figure 28 – Tokyo 23-wards Average All Grade Office Vacancy Rates and Rents

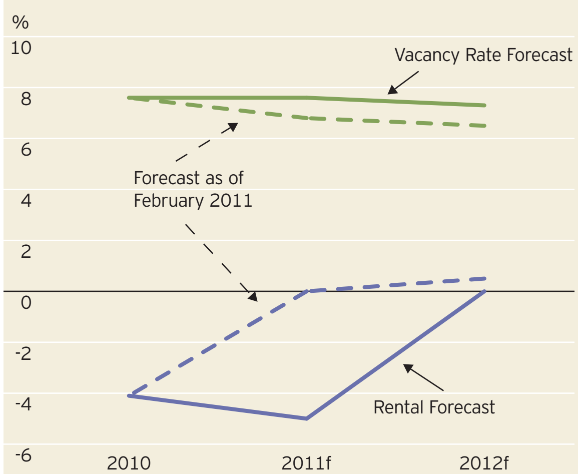
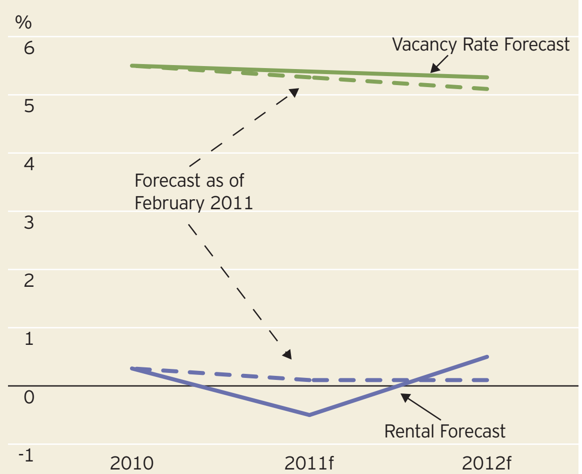


Figure 29 – Tokyo 23-wards Average Residential Vacancy Rates and Rents



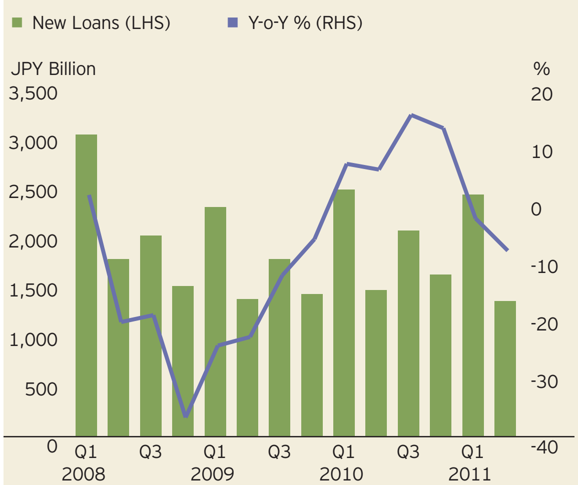
Source: Invesco Real Estate forecasts using data from CBRE, Japan Real Estate Institute, Association of Real Estate Securities and Experian, July 2011.
f = forecast

- Tenants currently remain quake-cautious and continue to target buildings that provide business continuity, are seismic-code compliant, equipped with back-up power and located within the core three wards where the risk of blackout is minimized. This is driving strong interest in new prime buildings, where vacancy rates have been falling and asking rents have been rising. General leasing demand has focused on business consolidation and for some owner-occupiers to relocate to newer, higher quality office space. That said, a flight-to-quality trend is likely to strengthen. We, therefore, expect a multi-speed recovery with larger, newer buildings recovering faster and stronger.
- In the meantime, we believe Japan real estate yields will compress due to the following reasons:
  - Cap rates held steady after the quake at levels above their historic averages. On average, the cap rate spread over local long-term government bond yields offered by Japan properties was the highest among key global markets. Tokyo residential and office properties generally offer positive carries of approximately 200 to 300 basis points.

- The BOJ's continued monetary loosening is expected to keep interest rates at their current low levels for an extended period, supportive of investment sentiment in general.
- As part of its monetary loosening measure, the BOJ has expanded its asset purchase scheme twice after the Tohoku earthquake to purchase more JREITs, stocks. This is likely to support acquisition activity among JREITs and hence, improve liquidity of the overall real estate market.
- Banks continue to lend. Since Q1 2010, the situation has been improving with new bank loans to finance real estate investments increasing and more companies finding the lending environment to be less severe. LTVs are back to normal at around 70% levels according to our in-house experience.
- According to statistics from the BOJ, the amount of new bank loans to finance real estate investments was falling after the quake (Figures 30 and 31). However, this could be attributable to the declined level of transaction activity, rather than a change in banks' lending attitudes.
- Our observations suggest that lending terms offered by banks have remained largely unchanged before and after the earthquake. The short-term business survey conducted by the BOJ also showed that real estate companies perceived that the lending conditions have become much less severe. Large real estate companies have started to perceive that banks are becoming accommodative in lending.

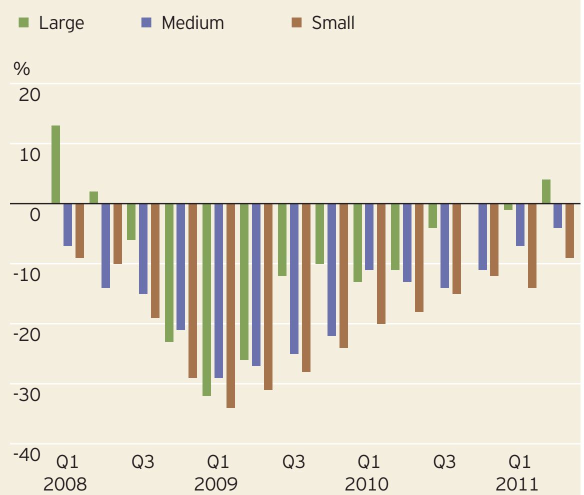
Figures 30 and 31 — Improving Lending Environment Despite Decreasing New Loans Right After the Earthquake

Figure 30 — New Loan for Equipment Funds to the Real Estate Industry[1]



Source: Ministry of Land, Infrastructure, Transports and Tourism, Bank of Japan, May 2011

Figure 31 — Financial Institutions Lending Attitude Perceived by Real Estate Companies[2]



Source: Ministry of Land, Infrastructure, Transports and Tourism, Bank of Japan, May 2011

1 Referring to loans borrowed to fund rental buildings, land for construction of rental housing, and other leasing purposes

2 Subtracting "Severe" Ratio from the "Accommodative" Ratio, ie the larger the reading, the more companies perceive financial institutions lending attitude to be accommodative
Large companies: Capitalization ≥ JPY1 bil
Medium: Capitalization ≥ JPY100 mil and < JPY1 bil
Small: Capitalization ≥ JPY20 mil and < JPY100 mi

- Hence, with the current high spread, overall improving liquidity in the market and, albeit delayed, expected improvement in rental income, yields are expected to compress to contribute strongly to total returns. A caveat to this is that in-place rents of individual assets could still be above market as market rents have been falling since 2008. Investors should be mindful when underwriting investment opportunities as rental income may decline in the near term, despite a generally improving outlook.

Korea

Korea's strengthening trade with China and the Asia region should help mitigate the impact of softening global demand. While the office oversupply situation is expected to gradually improve, tenant-friendly conditions are forecast to persist through 2012.

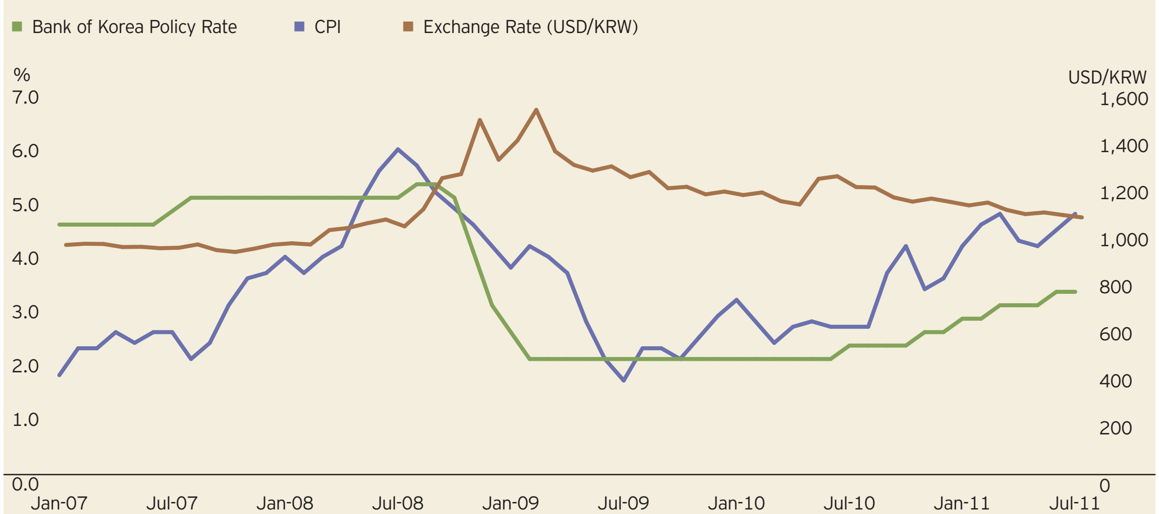
Opportunities: Cautious with office opportunities

- Against the looming oversupply backdrop, we remain cautious about the Seoul office sector. The tenant-friendly market conditions are expected to persist with rents edging downwards and incentives remaining attractive.
- We will continue to monitor the market and conservatively underwrite distressed commercial assets, which may provide good risk-adjusted returns after refurbishing and repositioning.
- The increasing number of foreign tourists, especially from Mainland China, strongly supports the prime retail market in Seoul. With steady retail sales growth, assets strategically located in well-established retail areas are expected to deliver good income returns. Meanwhile, the strengthening tourism sector lays strong fundamentals for the hotel sector. Investors with relevant expertise should continue to monitor opportunities in this market.

Macro Themes: Lower growth prospects due to global uncertainty and inflation

- Korea's economic outlook is largely dependent on external trade. While China and strengthening intra-regional trade should provide support for export demand amidst global debt concerns, the weakening eurozone and U.S. regions should lead to lower overall performance in the second half of 2011. According to Samsung Economic Research Institute (SERI), a 1% drop in U.S. economic growth would have a combined direct and indirect impact of a 0.2% drop in Korea's economic growth, largely because of fewer exports to the U.S. and emerging countries. In addition, if inflationary pressure continues to build, potential further currency appreciation and interest rate increases could hinder growth (Figure 32).

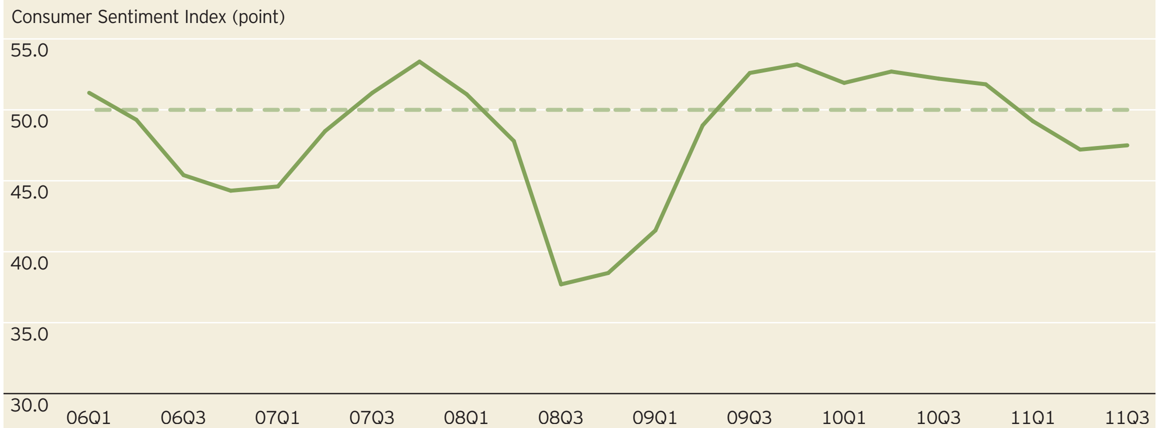
Figure 32 — Inflationary Pressure Leading to Interest Rate Hikes and Currency Appreciation



Sources: Bank of Korea, Statistics Korea, August 2011

- We believe the labor market remains healthy with low unemployment and rising wages. Retail sales continue to increase with households purchasing big ticket items such as passenger cars and household appliances and with a growing number of tourist arrivals from China and Southeast Asian countries.
- Nevertheless, there are rising concerns over a record high household debt of KRW876 trillion (US$ 816 billion) in Q2 2011 and a subdued consumer sentiment, which fell below the benchmark score of 50 (Figure 33).

Figure 33 — Consumer Sentiment Recently Dropped Below the Benchmark

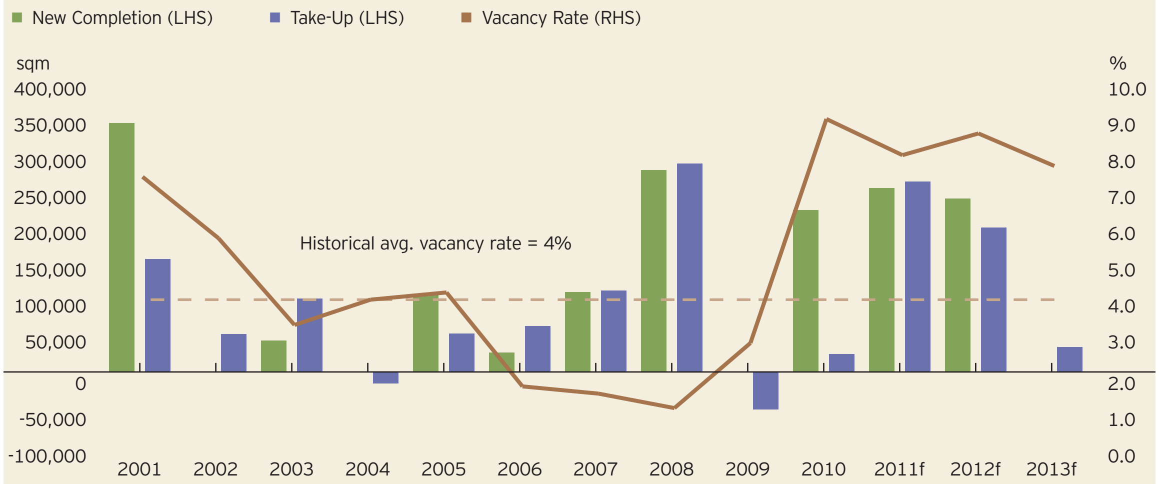


Source: Samsung Economic Research Institute, August 2011

Real Estate Market Update: Abundant office supply creating tenant-friendly conditions

- In terms of the policy rate, the Bank of Korea's tightening path is likely to be paused in the coming few months until there is more economic clarity. As a result, borrowing costs and, subsequently, cap rates are likely to hold steady.
- While an extensive pipeline is flooding the CBD market from 2010 to 2012, (average net new supply of 240,000 sqm per year of prime offices versus historical average of 97,000 sqm per year), new completions are forecast to fade from 2013 onwards.
- We forecast the vacancy rate to have peaked in 2010 (Figure 34). With landlords reducing rents and offering attractive incentives, strong take-up has been recorded over the past 12 months largely in new buildings.
- Landlords of prime office buildings are offering historically high incentives including 10 months' rent free over the lease term and tenant improvement budgets to compensate for relocation costs.

Figure 34 – Prime Office Vacancy Rate Forecast to have Peaked in 2010 but Remain Elevated Until 2013



Source: Invesco Real Estate Forecasts based on historic data from Jones Lang LaSalle Research, Q2 2011
f = forecast

- Looking ahead, we anticipate the office market to stabilize and for rental growth to resume in 2012 to 2013 when excess supply is absorbed. In the meantime, a lack of available large-scale institutional assets should keep investment capital focused on secondary, smaller-sized office buildings. In particular, domestic institutional investors have been actively acquiring these assets.
- The retail market continues to perform steadily on the back of rising tourist spending and stable domestic consumption. Vacancy rates have held stable with leasing demand from local and overseas cosmetic and fashion brands. Rents have generally edged upwards in line with fixed escalations and steady retail sales growth.
- During 2005 to 2010, the total number of foreign tourists increased from 6.0 million to 8.8 million, or by approximately 8% pa compounded. According to the Korea Tourism Organization, this growth is expected to continue to average more than 7% pa over the next five years and total foreign tourist arrivals are expected to exceed 11 million by 2015.
- The anticipated rising number of foreign tourists supports hotel demand. In the meantime, new hotel room supply in Seoul appears to have lagged the growth of tourist arrivals, driving occupancy rates and RevPAR up.

Singapore

Our sector outlooks are stable with the bulk of returns occurring in H1 2011. Milder performance is forecast for all sectors with downside risks heightened by the credit turmoil in the U.S. and the eurozone, policy overhang and the combination of both currency appreciation and normalizing interest rates to tackle inflationary pressure.

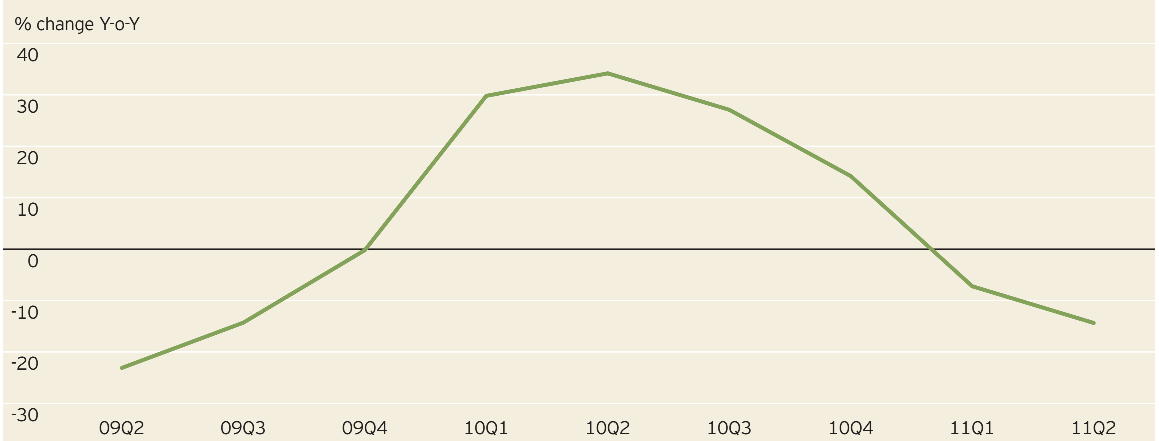
Opportunities: More selective with the office market following some softening in leasing demand

- We have turned more selective in the office market given the softer, sub-trend rental growth outlook. While core assets in prime locations continue to be expensively priced, income-oriented investors can still benefit from assets with decent positive yield carry and positive, albeit mild, rental growth. Opportunities for asset enhancement strategies are also available and could bolster overall investment returns as medium-term supply declines.
- We are selective with retail assets, which should continue to provide stable income and mild growth. Buoyant domestic demand and tourist spending are underpinning retail sales growth in prime areas and the new supply pipeline is largely focused in suburban neighborhoods.
- Heightened regulatory risk, global volatility and abundant new condominium supply make us cautious about the residential sector. The luxury sector is traditionally more vulnerable to global shocks and has shown signs of weakening. Although underpinned by low mortgage rates and steady local upgrader demand, prospects in mass and mid-market projects are weighed down by an abundant condominium supply pipeline and policy overhang.

Macro Themes: Solid local fundamentals but external slowdown

- We remain positive on Singapore's underlying macro fundamentals but recognize its economic vulnerability to external global headwinds. In particular, Q2 2011 GDP growth retreated after experiencing a drop in tech demand largely caused by the supply chain disruption following the Japan earthquake (Figure 35).

Figure 35 – Slower Tech Exports Weighing on Growth



Source: Singapore Department of Statistics, August 2011

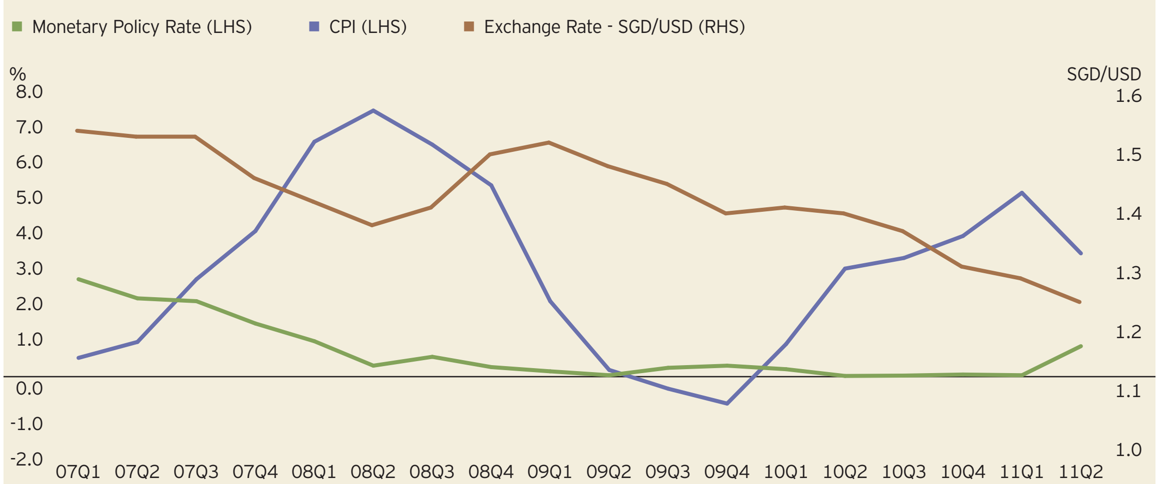
- Nevertheless, low unemployment, resilient household spending and strong immigration growth, continue to support a buoyant domestic economy and longer-term outlook. In particular, Singapore's favorable immigration policy has helped attract foreign-skilled professionals and accompanying wealth into the country. The non-resident population has registered one of Asia's strongest growth rates averaging 8.2% per year since 2005 (Figure 36).

Figure 36 – Singapore Population Growth

Source: Singapore Department of Statistics, December 2010

- The impact of the strengthening of the Singapore dollar combined with an interest rate increase has helped to ease inflationary pressure, which appears to be peaking (Figure 37).

Figure 37 – Inflationary Pressure Leading to Currency Appreciation and an Interest Rate Increase

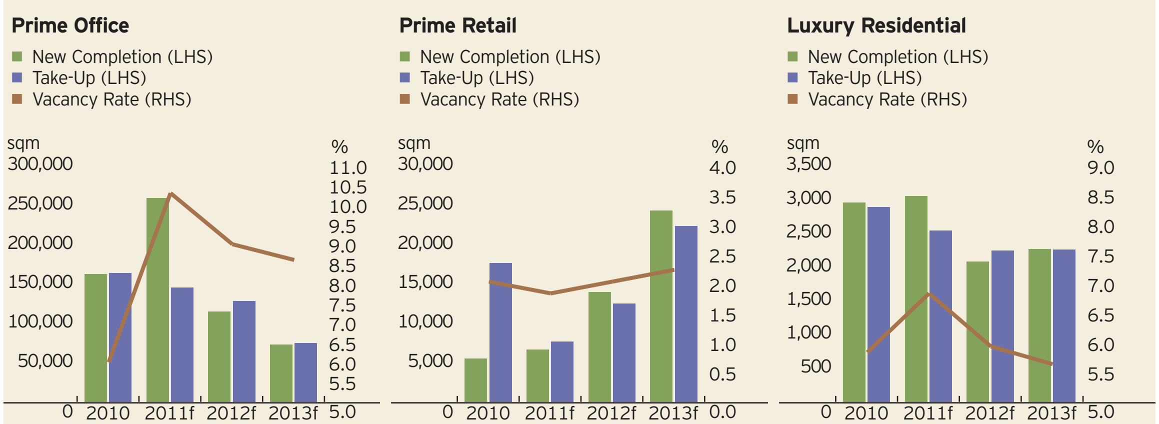


Source: Economy.com, August 2011

Real Estate Market Update: Commercial assets softening but performance stable; residential subdued

- In the office sector, hiring intentions and occupier demand among financial institutions and service providers have recently slowed following a few quarters of strong take-up. Quality new supply continues to complete on schedule and help relieve tight vacancy in prime areas. Rental growth has softened in line with moderating business confidence and landlords have generally turned less aggressive. Nevertheless, local and foreign investors remain generally active, attracted by the positive yield carry and steady growth prospects of income-producing assets, keeping office yields relatively stable.
- The prime retail market continues to perform consistently as retail demand is backed by a solid domestic economy and rising tourist arrivals. The Singapore Tourism Board is targeting 12 to 13 million visitor arrivals and S$22 to 24 billion in tourism receipts this year, approximately an 8% and 22% increase over 2010, respectively. Singapore's strength as Asia's leading integrated convention and resorts centre should translate into stronger retail performance. Going forward, we expect the retail landscape to remain steady despite new malls and some refurbishments. Our forecasts indicate milder rental growth of 1% to 2% pa over the next three years while yields should edge up slightly over the same period due to the ongoing global uncertainty.
- The outlook for the residential sector is less clear with luxury properties continuing to draw steady leasing demand despite abundant new condominium completions and cautious sentiment. Healthy labor conditions, an increasing number of expatriate hires and tight short-term vacancy helped fuel rental growth in the second quarter. However, looking ahead, pronounced supply overhang should moderate rent growth in the coming years.
- We forecast luxury residential prices to rise modestly for the full year in 2011, before mildly correcting over the next two to three years with the softening growth outlook, tightened mortgage requirements and possible interest rate rises as global economic conditions normalize. Yields are likely to rise over this time and stifle medium-term returns. In the broader market, investment sentiment has weakened with developers submitting cautious bids at recent residential land tenders. The government policy to increase the income ceiling for first-time buyers of HDB homes (subsidized housing) may also shift some demand away from mass residential projects. Nevertheless, abundant liquidity and low mortgage rates are helping to buoy residential prices in the short-term.

Figures 38 — Supply, Take-Up and Vacancy Rate Outlook Across Sectors



Source: Invesco Real Estate Forecasts using historical data from Jones Lang LaSalle Research, Q2 2011
f = forecast

Thailand

Thailand's economy is expected to slow in Q4 2011 before picking up in 2012, with weakening global export demand mitigated by expanding intra-regional trade. The new government's property stimulus has boosted sentiment and helped support developers. We expect all property sectors to steadily improve from late 2012 onwards.

Opportunities: Selective with office and retail assets, cautious in the residential market

- We are selective in the office sector, which has shown signs of bottoming out and potentially catching a rental up-cycle as the economy grows and business confidence improves. Vacancy is beginning to ease as the supply pipeline moderates. We believe strategically located grade 'A' offices could be positioned to capture this growth momentum from 2012 to 2013.
- We are also selective in the retail market which is underpinned by solid demand fundamentals, but vulnerable to external shocks for Thai-exports. Assets in core CBD locations are likely to continue receiving strong interest from international and local food & beverage and fashion retailers. At the same time, boutique suburban malls have been rapidly developing and could be appealing for investors with persistent local demand underpinning more stable income performance.
- We are cautious with residential projects given the moderately abundant supply pipeline. Genuine end-user demand has turned selective and investors remain largely on the sidelines with rising interest rates. We forecast the supply overhang in the high-end market to be gradually taken up over the next two years and for the mass-market to take slightly longer.

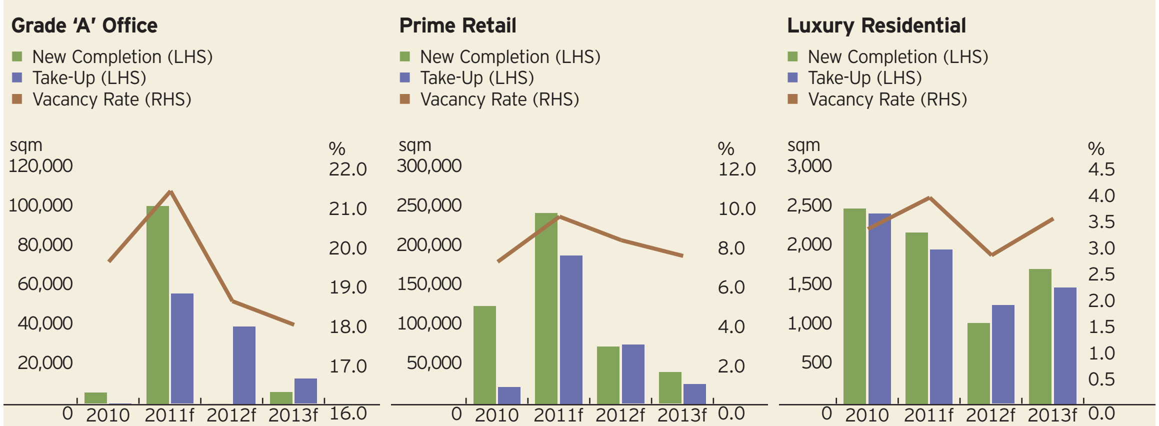
Macro Themes: Solid local economy susceptible to slowdown in external trade

- The Thai economy continues to perform solidly with steady private consumption and investment growth. While a slowdown in Western economies will dampen export demand, expanding intra-regional trade in tandem with continued domestic demand growth should help mitigate the impact. Local conditions are supported by healthy employment, improved consumer confidence and fiscal stimulus.
- The incoming Pheu Thai government party has helped provide political stability and boost sentiment with proposed stimulus measures including corporate tax reductions, an accelerated timeline of mass transit projects, a proposed five-year zero mortgage rate campaign, and increasing the tax allowance for interest on mortgage loans. While details on the implementation and timing are still to be determined, these measures are likely to target the lower-end/mass residential sector. Nevertheless, the measures have instilled positive influence on the overall purchasing sentiment, but may also be inflationary.
- The economic outlook is largely positive with inflation causing some concern. Recent interest rate increases combined with lower oil prices should provide relief. However, further interest rate hikes could dilute the impact of these stimulus policies and some policies may be inflationary such as the minimum purchase price of rice.

Real Estate Market Update: Property sectors subdued in the short term by supply before picking up in 2012 to 2013

- Bangkok's grade 'A' office market remains subdued, marked by soft occupier demand, new completions and high vacancy. Leasing activity continues to be focused on expansions and relocations by financial institutions, IT and pharmaceutical companies to better located, newly completed buildings. We are forecasting vacancy to peak during 2012 as historically high new supply has entered the market. Looking ahead, the office market is expected to bottom by late next year and gradually pick up momentum in 2013 with rent growth averaging 3% to 4% pa.
- Bangkok's prime retail sector remains underpinned by solid economic growth, improving consumer confidence, increasing household consumption and strong tourist arrival growth. The retail landscape should be enhanced by an abundance of new malls and quality, mixed-use developments completing this year. According to DTZ, strong pre-commitment rates of around 85% were recorded in a number of these projects. In response, landlords of older mid-town and suburban centers are undergoing renovation plans in order to stay competitive. With new supply peaking in 2011, rentals are forecast for mild growth.
- The residential market remains soft as inventory and new supply outpaces tenant demand. New leases have focused on recently completed projects which provide tenants with more facilities and modern fit-out. Improving political and market sentiment should boost investment and attract additional hiring of expatriates. Rent growth is forecast to be marginal while the supply pipeline moderately declines in the coming years. In addition, purchasing fundamentals remain supportive with relatively strong household balance sheets, improving consumer confidence, low unemployment and rising wages. Nevertheless, increasing interest rates are prolonging sales rates and weighing on speculative demand. Analysts at Macquarie and Citi estimate that each 100 basis points increase in the mortgage rate would reduce affordability by 7% to 9%. End-users and upgraders have been more active, selectively choosing higher quality projects and better locations near mass transport.

Figures 39 — Supply, Take-Up and Vacancy Rate Outlook Across Sectors



Source: Invesco Real Estate Forecasts using historical data from Jones Lang LaSalle Research, Q2 2011
f = forecast

- The investment market has been relatively active with a number of office buildings transacted at higher yields and lower prices. Available assets remain scarce for investors, particularly in the retail sector. On the whole, yields are forecast to marginally compress as the property markets gain traction from 2012 onwards.

Important Information

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