Quadrant Real Estate Advisors LLC

Australian Economic & Commercial Real Estate Market Commentary

3rd Quarter 2015
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About Quadrant Real Estate Advisors
Quadrant Real Estate Advisors LLC ("Quadrant") is a United States SEC registered investment adviser and Australian Securities and Investments Commission (ASIC) Foreign Registered Corporation (ABN 39 123 863 963). QREA Europe LLP ("QREA") is a subsidiary of Quadrant. QREA Europe LLP (registration number 610613) is authorized and regulated by the Financial Conduct Authority. Quadrant has approximately $6.0 billion of commercial and multifamily real estate investments under management on behalf of institutional investors. Clients include insurance companies, pension funds, sovereign wealth management funds, and high net worth investors.

Since 1993 Quadrant’s senior management has worked together as a team providing the firm’s clients with access to both privately placed and publicly traded U.S. commercial real estate debt and equity investments through commingled funds and single client accounts. In addition to experience, senior management controls 100% of the firm, thereby providing true alignment of interests and accountability.

The firm’s executive leadership includes Kurt Wright, Chief Executive Officer; Michael Wood, Executive Vice President; Thomas Mattinson, Executive Vice President; and Walter Huggins, Executive Vice President.
Executive Summary

- Quarterly Australian Gross Domestic Product ("GDP") fell to 0.2% in the final quarter of the 2014/2015 financial year, falling short of market expectations for the period. This represented a 0.7% drop from the previous quarter and provided a poor outlook for the remainder of 2015. The results were heavily affected by a decrease in net exports and continuing decline of the mining industry.

- Consumer confidence also declined during the month of September to reach 93.9 index points after regaining ground in August at 99.5. Increased global volatility, especially poor economic conditions in China have become a cause for concern for the Australian economy leading to a decline in consumer sentiment. Domestically, the low Australian dollar and declining GDP growth rates have damped consumer sentiment.

- Annual inflation figures improved slightly during the June 2015 quarter, rising from 1.3% to 1.5% from the previous quarter. This result continues a period of low inflation and maintains the rate outside the RBA’s target range of 2%-to-3%.

- Unemployment increased slightly in the first two months of the September 2015 quarter rising to 6.2% from 6.0% at the conclusion of the June quarter. Both full-time and part-time job seekers decreased during the period, falling by 14,400 in the month of August alone. Job ads in comparison proved strong, increasing substantially with internet ads providing the largest growth.

- The decline in the Australian dollar ("AUD") continued throughout the September quarter, falling from just below US$0.77 at the conclusion of June to its lowest point since the Global Financial Crisis to reach US$0.697 in early September. Concerns about the Australian economy, including lower exports and reduced mining and construction activity continue to play a role in the decrease in the AUD.

AUS Key Economic Data

Source: ABS, RBA
Retail sales also dropped, with the sector hit by the worst quarterly start in three years, falling by 0.1% to record $24.3 billion in July. Foreign brands continued to show interest in prime retail leasing opportunities, with a large contingent on new international stores expected to open over the next 12 months.

The Reserve Bank of Australia ("RBA") maintained the cash rate of 2.00% throughout the September quarter and into their meeting in October. The rate has now been kept at this historically low level for half a year, when the RBA first dropped it from 2.25% in May 2015.

Quadrant’s view is that margins are creeping up as tighter regulation and as credit/risk departments within the banks start to exert pressure. We expect spreads to widen further in coming months.

The A-REIT sector remained in good health during the September 2015 quarter, with the rating agency Moody’s Investors Service noting their strong liquidity and debt maturity profiles, particularly the eight A-REITs that Moody’s rates. The A-REIT reporting season during September saw retail trusts outperform their office and industrial counterparts, with higher average growth in net operating income and stronger prospects for the next year.

The commercial office markets of Perth and Brisbane remain dire as transactional volumes decline and vacancy rates are at all time highs. There is a concern relating to the amount of supply to be released in these markets over the next two years, with landlords already providing highly attractive incentives. Sydney and Melbourne are experiencing strong office and industrial markets with sales to foreign investors at record levels.

Global Economic Summary

**Chinese Economy**

The Chinese economy continued to slow during the September 2015 quarter, recording a slightly lower growth rate of 6.9%, down from 7.0% in the previous period. This figure however did beat market expectations, but was still the lowest rate experienced by the emerging market in the last six years. Their ageing industrial economy is facing problems, while the services sector is growing strongly. Gary Rieschel of Shanghai-based Qiming Venture Partners speculated about the current transition occurring in the Chinese economy, “it is diverging so you have the old traditional economy where industries such as aluminium, cement steel manufacturing are declining and you would expect that to happen...if you are in the new economy – healthcare or services – you’re probably seeing 10 to 12 per cent growth” (AFR, 19th Oct 2015). Aviva Investors’ Ian Pizer thinks that the transition is going smoothly with jobs being the main determinant of performance, “when you look at the rebalancing within the economy – and I think one of the key metrics here is the jobs numbers – basically job creation seems to be holding up relatively well” (AFR, 19th Oct 2015).

The Australian economy has remained steady on Chinese data, with most of the information released for the third quarter in line with expectations, with GDP and industrial figures beating market expectations for the quarter.
State of the Australian Economy

The Australian economy performed poorly during the September 2015 quarter, with Gross Domestic Product ("GDP") declining by 0.7% to reach 0.2% at the conclusion of the period. Alongside these figures consumer sentiment and outlook also declined substantially, nearing the 90-point mark, with global volatility playing a major part in a downgrade in confidence. Unemployment figures also eased up for the quarter, with the economy experiencing a decline in both part-time and full-time job seekers. Further to this the Prime Minister Leadership spill, which saw Malcolm Turnbull replace Tony Abbott as the nation’s leader did little to ease concerns surrounding economic stability as Australia goes into its final quarter for the year and the Christmas/New Year’s period.

Gross Domestic Product ("GDP")

- According to the Australian Bureau of Statistics (ABS), quarterly GDP growth declined significantly during the June 2015 quarter, falling from 0.9% in the previous quarter to 0.2% at the close of the financial year. The growth result was the weakest experienced by the Australian economy since early 2013, with the year-on-year growth also further declining to reach 2.0%, down from 2.3% in the previous quarter. (See Chart below).

- The ABS reported that the GDP growth was heavily impacted by a fall in net exports, which detracted 0.6% from the overall GDP growth figures. Final consumption expenditure and investment contributed positively by growing 0.9% over the quarter. This was not enough however to offset the weaker figures experienced by other sectors.

- On an industry perspective, mining performed poorly during the quarter, contracting by 3.0% after contributing 0.3% in the previous period. Construction also continued to decline, posting a negative growth of 0.6%, detracting further than the -0.1% experienced during the March quarter.

![Australian GDP Growth Rates - Seasonally Adjusted](chart.png)

Source: Australian Bureau of Statistics
Terms of Trade

- The June 2015 quarter saw the terms of trade remain relatively stagnant year-on-year at -11.6%, from -12.0% in the previous quarter. The June quarter saw a decrease of 0.5% from -29.5% to -3.4% from the March quarter. (See Chart below).
- The Australian trade gap widened by 11% during the month August 2015 to record a deficit of $3.10 billion, from an upwardly revised $2.79 billion in the previous month. The trade figures missed market expectations as imports rose and exports remained stagnant.
- The Australian trade gap widened by up to 10% during the month June 2015 to record a deficit of $2.93 billion, up from $2.68 billion in the previous month, as imports grew more than exports during the period. Exports of goods and services rose $830 million (3%), while non-rural goods and monetary gold rose $590 million (4%) and $231 million (28%) respectively.
- Between July and August 2015, imports rose $173 million (1%) to reach $29.60 billion. Consumption goods rose $139 million (2%) while intermediate and other merchandise goods rose $67 million (1%). In contrast capital goods fell by $30 million (1%) and services debt fell by $29 million.
- The latest figures by the ABS in seasonally adjusted terms show the current account deficit increased by nearly 41% to reach $19.03 billion during the June 2015 quarter. This represents an increase of over $5.53 billion since the March quarter.

![Australian Terms of Trade - Seasonally Adjusted](chart.png)

Source: Australian Bureau of Statistics

Consumer and Business Confidence

- The Westpac Melbourne Institute Index of Consumer Sentiment jumped in the month of August, increasing by 7.8% to reach 99.5 points. However the final month of the September quarter saw the index decrease once again, falling to 93.9. This represents the 17th out of the last 19 months that the index has been below 100 points, which indicates a continuing pessimistic sentiment in the Australian economy. A recent spike in disturbing news including "violent gyrations in both Australian and overseas equity markets; poor economic data from China; a disappointing report on Australia’s growth rate and the weakness in the Australian..."
dollar” (Bill Evans, Westpac), are all factors that have led to a decline in consumer sentiment. (See Chart below).

- The Westpac Melbourne Institute Index of Unemployment Expectations for September 2015 rose sharply by 5.8%, which is the highest the index has been since December 2014. Sitting at 156.3 to finish the quarter, expectations in the jobs market remain concerning for Australian households. The index noted that almost all respondents who recalled news items about the labour market stated that the news was mostly unfavourable.

- Confidence around the housing market continues to deteriorate, with the “Time to Buy a Dwelling” index falling by 0.9%, to reach 101.7, which is 8.6% down from the same time last year and 30% lower than two years ago. The NSW markets sentiment towards buying property is of major concern, falling by 14% during the month, while Sydney in particular is experiencing a 46% reduction since last year, the lowest the Sydney index has been since 1975.

![Westpac/Melbourne Inst. Consumer Sentiment Chart](chart.png)

- The NAB Business Survey saw a drop during the September quarter in business confidence throughout the Australian economy. Falling from 10 index points at the conclusion of the financial year to 5 points in September. The month of August also performed poorly falling to 1 point, attributed mainly to Government leadership uncertainties. The partial recovery in September came about as leadership issues were resolved and volatility in financial and emerging markets continued to moderate. (See chart below).

- Business conditions fell slightly during the third quarter, falling from 11 points in June to 9 points in September. Trading conditions and profitability eased during the quarter, however in contrast, employment saw huge improvements recording its highest level since mid-2011. (See chart below).
**Inflation**

- The Consumer Price Index (CPI) increased slightly from an annualized percentage change of 1.3% in the March 2015 quarter to reach 1.5% for the June quarter. The figure remains below the RBA’s target range of 2-3% with the growth in inflation lower than the market forecasts. It is the lowest the rate has recorded since June 2012. (See Chart below).
- Costs declined once again in areas such as transport (-2.4%), communication (-4.5%) and clothing and footwear (-0.9%). Costs did however increase year-on-year for a number of areas including food and alcoholic beverage (1.3%), alcohol and tobacco (4.8%), housing (2.5%) and health (4.3%).
**Employment**

- The unemployment rate increased slightly over the first two months of the September 2015 quarter, increasing from 6.0% at the conclusion of June to 6.2% in August, after rising to 6.3% in July. These figures matched market consensus, with the economy adding a further 17,400 jobs and the number of jobs declining by 14,400 in the month of August alone. The number of unemployed persons looking for full-time work decreased by 3,500 to 561,400 and the number of unemployed only looking for part-time work decreased by 11,000 to 219,700. (See chart below).

- The source of these labour figures is based on a multi-stage area sample of private dwellings and a list sample of non-private dwellings, which covers 0.32% of the Australian population aged 15 years or over. The households selected are contacted each month over 8 months, with one-eighth of the sample being replaced each month. Due to the small sample size statistical anomalies can occur and in the view of the author are likely.

- The participation rate remained steady, fluctuating around the 65% mark during the first two months of the September 2015 quarter. The continued steadiness of the participation rate dating back from September 2013 is a sign of plateauing economic activity and stabilization in the labour market. (See chart below).

- A word of caution. The erratic nature of the ABS data series on unemployment/employment bring into question the data collection process outlined in bullet 2 above. Unlike other Western countries that collect statistical employment data from “payrolls”, the collection process used in Australia is to our mind highly questionable. This aside it is further interesting to note that Australia’s unemployment rate is now higher than the U.S for the first time since 2007.

![Australian Unemployment Statistics](chart)

- The ANZ Jobs Ad Index grew substantially in the September 2015 quarter, increasing by over 5,000 new ads to reach 153,778 ads during the month of September. This represents a 3.9% increase during the month and is a positive indicator for the Australian economy as it seeks to adjust to a changing landscape. Warren Hogan, Chief Economist at ANZ stated, “the positive trend in job advertising is a sign that the economy is so far adjusting relatively well to
significant headwinds from falling commodity prices and mining investment” (ANZ Media Release, 5th October 2015). (See chart below).

- Newspaper ads increased slightly in the first two months of the third quarter prior to falling by 2.7% during the month of September. Newspaper ads now only account for 2% of the total job ads market. Internet ads continue to grow as websites such as seek.com.au and careerone.com.au increase their reach, increasing by 4% over the month of September. Internet ads are now 13.7% greater than experienced at this time last year, which points to the growing trend of employers utilising online platforms to recruit staff. (see chart below).

![ANZ Job Ads Index]

Source: ANZ

**Exchange Rate**

- The Australian dollar continued to decline during the September 2015 quarter after closing out the previous financial year at US$0.769. The month of July saw the currency drop significantly to US$0.729 before finishing at US$0.701 at the conclusion of the quarter. The quarter also saw the dollar drop to its lowest amount in six years in early September when it produced a result of US$0.697. This is the first time since the Global Financial Crisis that the dollar has dropped below the US$0.70 mark. The month of October has seen the currency move slightly upwards as data from China looks a little more favourable than expected, including the release of above market expectations GDP growth. The Australian export market has been suffering lately, and continual strong growth and demand in China may be the answer to rejuvenate the sector. (See chart below).

- The chart below shows the Australian dollar reacting similarly to various global currencies during the September 2015 quarter. The only comparison currency that showed signs of stabilization with the Australian dollar was the UK Pound, which fell from £0.467 in July to £0.461 by the end of September. (See chart below).
**Interest Rates**

- The Reserve Bank of Australia (RBA) maintained the cash rate at the historical low of 2.00% throughout the September quarter and into their first meeting of the fourth quarter. The drop in commodity prices continue to be of concern to the Australian economy, especially as net exports also decline. The RBA is attempting to promote capital investment and increased borrowing through their low cash rate, while also intending to keep the Australian dollar low in order to encourage overseas investment.

- Westpac are the first major bank to increase the interest rate on their owner occupier variable rate home loans, with the other banks expected to follow suit. Speculation is also mounting that due to this decision the RBA will seek to drop the official cash rate prior to the end of the year in order to assure that there is not a slowdown in housing. Macquarie Securities analyst James McIntyre commented that “the announcement by a major bank of an out-of-cycle 20 basis point rate hike – for investor and owner-occupier loans – all but seals the deal for a November rate cut from the RBA” (SMH, 15th Oct 2015).
Australian Real Estate Capital Outlook

**Equity Transactions**

The September 2015 quarter saw a large amount of transactional activity occur in the Australian commercial property market. The quarter saw $8.6 billion worth of assets change hands, which is a substantial increase from the $5.5 billion experienced in the previous quarter. The recent level of activity puts the Australian commercial property market on track to outpace the record $29.6 billion worth of transactions experienced in 2014. Foreign investment continued to be a major factor in investment during the quarter, with 56% of all transactions coming from overseas, especially from China. Australia proved to be an attractive investment market for Chinese capital during the quarter, with up to 25% of the US$6.5 billion Chinese investors transacted throughout the world in the first of the year ending up on Australian shores. The profile of foreign investment is also changing from private investors and developers to major institutional firms. CBRE Capital Markets Managing Director, Mark Granter stated that, “we are starting to see the larger Chinese life insurers target opportunities here as they look at geographic diversification to balance their portfolios” (CBRE, 1st Sept 2015). Two large foreign transactions to occur during the September quarter were the $2.5 billion purchase of the Investa portfolio by Chinese Investment Corporation (CIC) and the $1.01 billion deal by Singapore’s Ascendas Real Estate Investment Trust for a portfolio of 26 logistics properties from GIC.

- The table below highlights some of the major transactions (> $50million) for the September 2015 quarter:

<table>
<thead>
<tr>
<th>Property</th>
<th>Sector</th>
<th>Sale Price</th>
<th>Vendor</th>
<th>Purchaser</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portfolio Sale</td>
<td>Off</td>
<td>$2.45 b</td>
<td>Investa Property Trust (Morgan Stanley)</td>
<td>China Investment Corporation (CIC)</td>
</tr>
<tr>
<td>T1 Barangaroo</td>
<td>Off</td>
<td>$2.00 b</td>
<td>Lend Lease</td>
<td>LLOneITST</td>
</tr>
<tr>
<td>155 Clarence Street, Sydney</td>
<td>Off</td>
<td>$140 m</td>
<td>St Hilliers</td>
<td>Eureka Funds Management</td>
</tr>
<tr>
<td>222 Exhibition Street, Melbourne</td>
<td>Off</td>
<td>$231</td>
<td>AMP Capital Wholesale Office Fund</td>
<td>LaSalle Investment Management</td>
</tr>
<tr>
<td>114 William Street, Melbourne</td>
<td>Off</td>
<td>$125 m</td>
<td>Kyko Group</td>
<td>CorVal (Straits Trading)</td>
</tr>
<tr>
<td>45 Francis Street, Perth</td>
<td>Off</td>
<td>$101 m</td>
<td>Deka Immobilien</td>
<td>Warrington Property</td>
</tr>
<tr>
<td>1 Eagle Street &amp; Eagle Street Pier, Brisbane</td>
<td>Off</td>
<td>$635 m</td>
<td>Stockland Group &amp; Future Fund</td>
<td>Dexus Property Group &amp; DWPF</td>
</tr>
<tr>
<td>215 Adelaide Street, Brisbane</td>
<td>Off</td>
<td>$224 m</td>
<td>Pramerica</td>
<td>Challenger Life</td>
</tr>
<tr>
<td>Jam Factory, South Yarra</td>
<td>Ret</td>
<td>$165 m</td>
<td>Challenger</td>
<td>Asia-based Investor</td>
</tr>
<tr>
<td>Westfield Strathpine, Queensland</td>
<td>Ret</td>
<td>$209 m</td>
<td>Scentre Group</td>
<td>Blackstone Real Estate Asia</td>
</tr>
<tr>
<td>Portfolio Sale</td>
<td>Ind</td>
<td>$1.01 b</td>
<td>GIC</td>
<td>Ascendas Property Group</td>
</tr>
<tr>
<td>Four Points Sheraton, Perth</td>
<td>Hot</td>
<td>$91.5 m</td>
<td>GIC &amp; Host Hotels</td>
<td>Bonvest Holdings</td>
</tr>
</tbody>
</table>

Source: Knight Frank & CBRE
Debt
The Australian domestic bond market remained flat throughout the September 2015 quarter following the release of Chinese economic data and US inflation figures. Australian debt capital markets year-to-date bond issuance fell to $US109.4 billion, which reflected a four-year low for volumes leading up to September 16th. Dealogic noted that the transport sector was the busiest for merger and acquisition deals, with the mining and oil-and-gas sectors followed with the second largest amount by industry group.

- BHP Billiton announced during the third quarter that it would plan to sell approximately US$3 billion worth of hybrid bonds. As per statements filed with the Australian Securities Exchange during the month of September the instruments would be treated as half-debt, half-equity, which due to the low-interest rate environment would be considered an “opportune moment” (The Australian, 14th Oct 2015) to issue these securities. The funds would be used for purposes such as refinancing near-term debt when it becomes due.
- Host Hotels and Resorts, which along with GIC sold the Four Points Sheraton in Perth for $91.5 million during the September quarter, repurchased close to 11 million shares for a total price of $US198.5 million. The sale of the Four Points, which represented the largest hotel transaction in Australia for the third quarter, is part of a strategic plan by the company to exit the Asia-Pacific region through a number of asset sales and re-position the company in the US market.
- Merger and acquisition activity provided a strong outlook for the remainder of 2015, with foreign investment amounts anticipated to grow following Malcolm Turnbull replacing Tony Abbott as the Australian Prime Minister. In a report by Allen & Overy titled M&A Insights notes that sentiment has improved since the leadership spill, with Turnbull’s background and leadership style pointing towards a focus on restoring growth in the economy by loosening foreign investor controls.

<table>
<thead>
<tr>
<th></th>
<th>Sydney</th>
<th>Melbourne</th>
<th>Queensland</th>
<th>Perth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>Good</td>
<td>Good</td>
<td>Fair</td>
<td>Fair</td>
</tr>
<tr>
<td>Commercial</td>
<td>Fair</td>
<td>Fair</td>
<td>Weak</td>
<td>Weak</td>
</tr>
<tr>
<td>Retail</td>
<td>Fair</td>
<td>Fair</td>
<td>Weak</td>
<td>Fair</td>
</tr>
<tr>
<td>Industrial</td>
<td>Good</td>
<td>Good</td>
<td>Fair</td>
<td>Good</td>
</tr>
<tr>
<td>CBD Hotels</td>
<td>Good</td>
<td>Good</td>
<td>Weak</td>
<td>Fair</td>
</tr>
</tbody>
</table>

Source: Quadrant Real Estate Advisors, LLC

- Technology heavy-weight Apple Inc readied itself during the September quarter to issue its first ever Australian bond, which is looking to target large domestic institutions and superannuation funds. The bond issuance is a signifies a mark of confidence by the global
firm in the domestic Australian bond market, which was also proved strong for global brewer SABMiller which recently sold $700 million worth of bonds in the local market.

- We anticipate that prudent borrowers will avail themselves of the long dated non-bank capital presently available in the market. While pricing for this capital is also edging higher it is still below the long-run average for real estate debt.
- Quadrant’s view is that margins are creeping up as tighter regulation and as credit/risk departments within the banks start to exert pressure. We expect spreads to widen further in coming months.

**Listed Property Trusts**

The Australian Real Estate Investment Trust market is expected to remain stable over the next 12 – 18 months as net operating income increases at an average rate of 2%. This forecast is mainly in line with the growth witnessed in the previous 12 months up to the conclusion of the September 2015 quarter. The retail sector performed well, producing higher returns than both the office and industrial and are forecast to keep improving in the short-term. Moody’s Investor Services have flagged a number of strong performing retail firms, including Charter Hall Retail REIT, Shopping Centres Australasia Group and Scentre Group. The A-REIT sector as a whole is proving attractive to investors with an expected 5.4% forward dividend yield, which provides relative stability compared to the uncertainty present elsewhere in the Asian market region. London-based Managing Director of Principal Real Estate Investors, Simon Hedger believes that there are some “alternative real estate sub-sectors which look attractive both from the perspective of yield compression, as well as having potential for sector consolidation such as childcare and self-storage” (AFR, 21st Oct 2015).

- The office sector is currently undertaking a balancing act, with strong supply and demand fundamentals existent in the Sydney and Melbourne markets, which are seemingly outweighing the weaknesses evident in the resource-driven cities of Perth and Brisbane. The sale of the Investa portfolio to Chinese Investment Corporation during the September quarter provided a boost to the office market, with a number of large potential sales in the pipeline including a $250 million Charter Hall portfolio and the $700 million office and retail area at 420 George Street.

- Dexus Property Group looks to benefit from its industrial portfolio, especially in the Sydney market which is expected to see a boost in income due to a favourable supply-demand balance.
in the sector. Industrial properties are also attracting a large amount of interest from Asian buyers in Singapore and China, especially with the low Australian dollar. The $1.07 billion purchase of GIC and Frasers Property Group’s Australian logistics portfolio, which includes 26 properties and was the largest offering ever made in Australia signifies the interest in the market.

- The retail sector is expected to grow from renewed strength in specialty store sales and increased occupancy rates, at nearly 99% for some of the larger retail REITs, such as GPT Group and Scentre Group. This is also leading to growth in rental income for existing leases, with the net operating income of the segment expected to increase by 2.0% – 2.5% over the next 12 – 18 months.

**Australian Property Markets**

**Residential**

Melbourne was the surprise in the residential asset class during the first month of the Spring season, overtaking Sydney with the largest amount of dwelling rates. Melbourne posted a 7.4% quarterly increase, while Sydney came second with a modest 4.6% increase. Both Hobart and Adelaide experienced lacklustre performance recording negative figures of 2.0% and 1.6% respectively. Auction numbers have been almost a third up on the previous quarter across the nation, however this has led to lower clearance rates, with Sydney and Melbourne still producing solid figures. Foreign investment, especially in the apartment sector, has been strong throughout the quarter, with a large amount of new supply about to be brought to market.

- Approvals for the construction of new private houses decreased slightly over the quarter leading to August 2015, with 9,562 houses approved in August compared to 9,625 in May. Apartment approvals declined slightly over the same period after peaking during the month of April at 9,499. The disparity between new houses and apartments continues to be relatively small compared to the latter stages of 2014, which indicates the changing of the Australian residential landscape to higher density living. (See chart below).
The number of loans advanced during the month of August 2015 fell slightly by 0.4%, while the loans issued over the previous quarter and the year grew substantially, with growth rates of 4.1% and 17.5% respectively.

The number of owner occupiers housing utilising finance increased by 2.9% during the month of August 2015. The quarter outperformed the year by increasing 10.5% in comparison to 7.2% on a year-on-year basis.

### Housing Finance Commitments

<table>
<thead>
<tr>
<th>Period</th>
<th>% Change</th>
<th>Seasonally Adjusted</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Aug-15</td>
<td>Quarterly</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Year on Year</td>
</tr>
<tr>
<td>Total Owner Occupier No.</td>
<td>2.9%</td>
<td>10.5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>7.2%</td>
</tr>
<tr>
<td>Owner Occupied Housing $</td>
<td>6.1%</td>
<td>14.9%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>24.7%</td>
</tr>
<tr>
<td>Investment Loans $</td>
<td>-0.4%</td>
<td>4.1%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>17.5%</td>
</tr>
<tr>
<td>Total Owner Occupier $</td>
<td>3.5%</td>
<td>10.3%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>21.8%</td>
</tr>
</tbody>
</table>

Source: ABS

### Value and No. Of Dwelling Commitments

Sources: Australian Bureau of Statistics

**Office**

The Australian office market provided a stark distinction between capital cities as investment and demand grew strongly in Sydney and Melbourne, while remaining subdued in resources prevalent cities such as Brisbane and Perth. Foreign investment has been concentrated predominantly on the east coast, with a number of large transactions from Chinese and Singaporean investors occurring during the September quarter. The low Australian dollar and an attractive investment environment coupled with limited stock are creating a heightened sense of interest in the CBD office market.
Sydney

- The Sydney CBD office market saw its vacancy drop from 8.4% to 6.3% coming into the September 2015 quarter. As the Australian economy transitions from large scale mining investment into the services sector, the Sydney market experienced a lot of growth from new jobs in the professions such as administration, technology or professional services.
- Prime face rents have increased over the past year to $961/sqm gross, which equates to an annual growth of 2.8%, which was predominantly extended from A-grade assets. Prime incentives have also seen a slight decrease from the beginning of 2015, falling from 30% - 32% to between 29% - 20% in the third quarter.
- Investment activity during 2015 has been strong with a large amount of capital seeking opportunities in the market. Deal volumes have equated to $4.93 billion for the year so far, which has already exceeded 2014’s total of $4.64 billion. Two large sales have been the predominant factor for the high volume amount, the CIC purchase of the Investa Property Portfolio and the sale of Tower 1 at Barangaroo into a new wholesale fund, both accounting for over $4 billion in transaction activity.
- The result of capital inflow and limited buying opportunities has seen downward pressure on yields for both prime and secondary assets. Prime core yields ranged from 5.25% - 6.5% in the third quarter, which represents a firming of 30 bps in 2015.

Melbourne

- Melbourne CBD office supply grew by 80,755 sqm in the first half of 2015, mainly contributed by the completions of 313 Spencer Street (27,500 sqm), 699 Bourke Street (18,644 sqm) and 570 Bourke Street (27,000 sqm). Investa’s 567 Collins Street was also completed during the September quarter, but will not be available until early 2016. There are no more large-scale buildings ready for completion until late 2016.
- White collar employment in the CBD is expected to continue to grow, having grown by 3.3% over the 12 months coming into the September 2015 quarter. The sectors pushing this growth are Finance, Professional Services and Government, with a decline in vacancy occurring due to the large amount of required office space.
- Investment activity within the Melbourne CBD in 2015 to date recorded $1.58 billion across 21 properties. Foreign investors have purchased a majority of these assets, amounting to $1.23 billion or 78% of total sales, which surpasses the level of transaction activity for the whole of 2014.
- Prime office yields continued to compress into the September 2015 quarter, declining by 55 bps over the year to range between 5.50% - 6.5%. Average secondary yields also tightened by 44 bps to range between 6.50% - 7.50%.

Brisbane

- After a 6 month period up to June 2015 where the Brisbane CBD did not add any new supply of stock and lost 35,000 sqm, a number of buildings are poised to be completed in the latter half of the year and through 2016 that should see an additional 188,000 sqm delivered to the market. The pipeline of development is not substantive, with most developers concentrating on the hotel and residential markets in Brisbane.
- The vacancy rate is expected to increase over the next 18 months as new supply additions are added to the market, which will outweigh the current and forecasted demand for Brisbane CBD office space. Vacancy is then expected to decrease coming into 2019 as no substantial supply
has been earmarked for the area and residential conversions continue to play a part in the CBD landscape.

- In comparison to the commercial markets of Sydney and Melbourne, Brisbane has not seen substantial growth in CBD commercial sales, achieving $1.302 billion in sale for the 12 months to August 2015, which is slightly higher than the $1.282 billion experienced in the prior 12 month period. Purchasing activity has been dominated by domestic funds such as Super Funds (33%), Unlisted/Syndicate (30%) and AREITs (24%).
- Prime yields firmed slightly in the Brisbane CBD, reducing by 25 bps to average between 6.15% - 7.35%. Yields in the secondary markets also firmed slightly during the year, averaging between 7.85% - 9.60%, with assets like well leased B grade buildings experiencing greater investment demand.

**Perth**

- The Western Australian economy and its capital, Perth continue to suffer from the drop in mining and resources investment which has led to a drop in business investment and market confidence throughout the region. Negative effects on the commercial CBD market have seen high vacancy rates, rising incentives and negative net absorption.
- There was relatively low new supply delivered to the market in the six months leading to July 2015, with just over 15,000 sqm added. Due to a lack of demand the added stock has put further downward pressure on vacancy, which is expected to increase as a large amount of stock is added to the market in the second half of 2015. Only 68% of the 134,556 sqm of new stock has been pre-committed to companies such as Ashurst, Brookfield Multiplex, Corrs, Deloitte and Wesfarmers.
- The first half of 2015 saw relatively little transactional activity, however the September quarter saw the sale of 45 Francis Street for $101 million. There are a number of office buildings for sale including Brookfield Place, 363 Wellington Street and 50% of Exchange Tower located at 2 The Esplanade.
- The outlook for the next 18 months indicates weak net absorption levels, however with decreasing rents and ever more attractive incentives, there will be option for tenants to gain more favourable leasing options in higher rated buildings. Knight Frank expects that little to no improvement will occur in the market until 2017 as new supply continues to be added throughout 2016.

**Retail**

Retail sales grew at a slow pace during the third quarter of 2015, with growth among the different states remaining consistent, with NSW and VIC generating the largest amount of growth, while QLD, WA and ACT performed well, they began from a much lower base. The last two years have proven healthy for the Australian retail trade environment, with income growth for retailers and in turn rental growth for landlords proving strong. The landscape is seeing an influx of new foreign entrants looking for prime retail space, especially in Sydney and Melbourne. Other types of retailers are also beginning to make an impression in the market, with many gymnasiums looking to expand into other locations, while pet and automobile retailers are witnessing strong growth in their products.

- The ABS retail trade figures for the September 2015 quarter saw total sales improve slightly from the previous quarter, recording a 0.3% increase during the first two months of the quarter. Retail sales performed well going into the winter months, however began to plateau
in the third quarter. These figures are expected to improve as we reach the Christmas/New Year period. Movements can be seen in the chart below.

- Foreign brands continue to snap up stores in the Australian market, with Sydney and Melbourne becoming a hotspot for international retailers. During the year 2015, over 35 stores were leased by a foreign brand with more than 30 already opened. The reason for the influx in brands relate to the consumption per capita, with Australians being one of the highest spending developed nations, doubling the rate of the US. The lack of penetration by foreign retailers compared to other Asia Pacific nations is another reason retailers see Australian shores as an attractive destination, as minimal competition means they can create strong brand presence before the market becomes flooded.
The best performers by sector for retail sales as recorded by the ABS were Department Stores and Cafes, both recording a growth of 0.4% over the month of August 2015. Clothing, which recorded the strongest result in the month of May at 0.8% growth, fell dramatically to record only 0.1% in the first two months of the third quarter. (See chart above).

**Industrial**

The industrial sector grew by 0.5% during the last financial year and growth has continued throughout the September 2015 quarter. A structural shift in the retail sector is driving demand for new industrial properties, especially with the escalating growth of online retail. Traditional users of industrial space are generally being replaced by retailers utilising operating models which target online sales. Investment in the industrial sector also saw strong gains during the September quarter with large amounts of offshore investors looking for income generating assets to add to their portfolios.

**Sydney**

- The Sydney industrial market continued to perform well during the September 2015 quarter, with Government infrastructure spending on a number of major projects, such as the WestConnex and M4 widening lending themselves to improved access to more remote industrial parcels.
- Transaction activity in the New South Wales Industrial sector for sales over $5 million totaled $712 million for the September 2015 quarter. Nine sales were part of the GIC portfolio sale to Ascendas, with foreign investment playing a major role in transactions for the quarter. Other examples of major transactions include Charter Hall’s purchase of the old Fairfax printing facility in Chullora for $45 million and Stockland’s purchase of 23 Wonderland Drive for $34 million.
- Leasing enquiries for industrial properties remained strong in the third quarter which has supported an uplift in rents coming in from the first half of the year. Super prime face rents increased by 0.25% to $150/sqm, while prime face rents increased by 0.2% to $117/sqm. Incentives also contracted during the quarter, with super prime and prime declining by 11% and 11.5% respectively.
- Supply in the Sydney market has been below the long-term average of approximately 30%, which has also helped to drive up rental return and minimize the need for incentives. Residential conversions are also playing a part in the low stock available for potential tenants. A large amount of supply is expected to be released to the market, with 463,000 sqm currently under construction, with most of it ready throughout 2016.

**Melbourne**

- Sales volumes in the Melbourne industrial market continued to rise during the September 2015 quarter, with $670 million worth of transactions occurring, up from $303 million in the previous quarter. The majority of sales was taken up by the purchase of $370 million of Victorian industrial property by Singaporean-based Ascendas from GIC. Other large transactions include the sale of Scoresby Industry Park by Perfection Private Group for $73 million to ISPT and the $36 million sale of 706 Lorimer Street, Port Melbourne by Centinniel to AMP.
- The September quarter saw GMH commence an expression of interest for the sale of over 37 hectares in Port Melbourne, which represents nearly 30% of the total industrial space in the
region. The proximity to the CBD could also attract a number of residential developers, with interest expected to be high from a number of property sectors.

- Infrastructure investment remains an important aspect of the Victorian Government’s long-term plans for the state, with the newly-created Infrastructure Victoria (InVic) concentrating on the further need for new and expanded projects allowing improved connections to areas such as Port Melbourne.

- Supply in the Melbourne industrial market has seen strong growth over the last two years with approximately 800,000 sqm expected to be added by the conclusion of 2015, with the West precinct contributing the most new space. Two major developments completed during the September 2015 quarter include a 70,000 sqm distribution facility on Boundary Road, Truganina and a 41,000 sqm freight facility at Melbourne Airport.

### Economic Data

- The Australian Industry Group – PwC, Performance of Manufacturing Index (PMI) rebounded during the September 2015 quarter to reach 52.1, up from 44.2 at the conclusion of June. This was the strongest reading for the index since May 2015 and the first time the index has grown for three consecutive months since July 2010. Increased residential construction leading to higher demand for building materials and housing related products are driving the continued expansion in manufacturing. (See chart below).

- The Westpac – Australian Chamber of Commerce Survey of Industrial Trends Actual Composite continued to rise during the third quarter of 2015, increasing by 1.7 index points to reach 52.7. The expected index rose significantly after a large drop during the June quarter, finishing up at 59.2 from 49.6. The increase in the index is an indication of improving sentiment in the Australian economy. (See chart below).
Hotels & Tourism

- As the Australian dollar continues to fall, Australian hotel assets are becoming increasingly attractive to overseas buyers. Sydney and Melbourne have a number of upscale and luxury hotels which are expected to transact over the next 12 months, with competition for these assets particularly strong.

- Savills recorded a total of $325.6 million hotel transactions over 14 properties during the September 2015 quarter. The largest of these transactions was the sale of the Four Points Sheraton in Perth to Bonvests Holdings from GIC and Host hotels. The hotel boasts 277 rooms and represents a transaction where both buyers are from overseas, in this case from Singapore. Another major transaction was the purchase of the Oaks Elan in Darwin for $41.6 million by Thailand’s Minor International from Australian firm Gwelo.

- As reflected in the sale of the Oaks Elan in Darwin, the Australian Government’s continued promotion and infrastructure upgrade in the Northern Territory is gaining traction. The location is crucial due to its geographic location to Asia and has been heavily marketed as an entry point into Australia, serving as a great destination for inbound Asian travelers. Investors, while still heavily focusing on the major markets of Sydney and Melbourne and begun to shift their attention to up-and-coming regional centres, such as Cairns.

- International visitor numbers continues to grow with approximately 7.18 million visitor arrivals for the year leading up to August 2015, which is an increase of 6.5% from the previous year. The main purpose for visits was for leisure and holidays, which saw a 4.7% growth over the previous 12 month period, while business travel continued to soften, showing a decline of 10.4% during the month of August 2015.
Quadrant – Market Focus

The third quarter of 2015 saw promising signs emerge from China, with GDP growth above market expectations, with industrial and manufacturing figures also providing some relief. The Chinese market, alongside Australia is attempting to shift its focus to its services sector as production steadily declines in what is considered an ageing industrial economy. The transition for China is a momentous task and it will have broader implications for Australia as our largest trading partner, especially in regards to our resources sector and global exports. China seems to be handling the divergence well, with employment figures and job creation numbers appearing positive. The Australian economy also held relatively steady after the Chinese data dump following the September quarter.

The third quarter saw the RBA maintain the cash rate at the historically low levels of 2.00%, with expectations that they will most likely have to drop further prior to the conclusion of the year in a balancing act as Westpac became the first of the major commercial banks to increase their owner occupier variable home loan interest rate. The Governor of the RBA, Glenn Stevens is looking to promote capital investment and maintain a low Australian dollar in order to increase foreign investment. The latest Australian GDP figures show the economy grew at 0.2%, which was 0.7% lower than the previous quarter, with the result heavily influenced by a decline in net exports. Australia will need to explore a number of other short-term opportunities to justify continued growth and maintain a positively growing economy.

The Australian property market experienced a strong third quarter with the sale of a number of large portfolios to overseas investors. These include the sale of the Investa Property Group office portfolio and the GIC industrial portfolio to China Investment Corporation and Singaporean-based Ascendas Group respectively. The disparity in city performance is evident however, with Brisbane and Perth still struggling from the effects of the mining sector decline, while Sydney and Melbourne continue to grow with demand high and a strong services sector creating further opportunities. The A-REIT market remained steady throughout the quarter, with indications that the retail sector will perform well in the short-term buoyed by a low Australian dollar and an influx of new international operators.

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