

Market Perspective

Executive Summary

- Asia's 2007 GDP growth is projected to be 8.3%, comparable to the 8.5% in 2006. Inflation this year is expected to be moderately higher than last year.
- The grade-A office markets continued to see strong demand and rental increases in 3Q, supported by corporate expansions. Business prospects remain positive, and the office space absorption rate should be sustainable.
- Retailers' expansion plans, which were fueled by rising consumer spending and more visitors, buoyed regional demand for retail space in 3Q.
- Asia's industrial market remained stable in 3Q, supported by robust intraregional trade. Warehouses continued to attract institutional investors, as long as they were yield-accretive to existing portfolios.

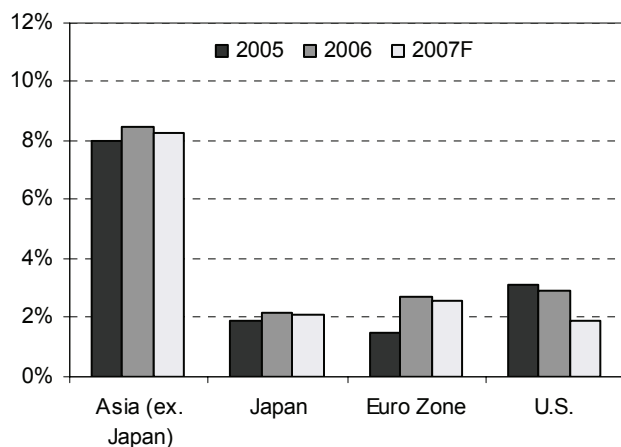
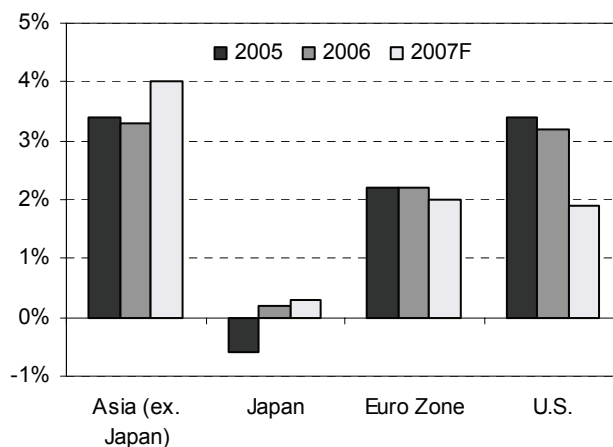
Asian Economies

China's GDP growth in 3Q is estimated to be 11.7%, comparable to the 11.5% achieved in the first half of 2007. Strong investment, exports and consumption supported this robust growth. Inflation rose to an 11-year high of 6.5% y-o-y in August, mainly driven by rising food prices. To curb inflation and to cool the economy, the government raised the lending interest rate three times in 3Q, or five times this year, to reach a nine-year high of 7.29% at the end of September, from 6.12% at the start of the year.

Japan's economy contracted unexpectedly by 1.2% y-o-y in 2Q, reversing the 0.5% growth estimated earlier. The strong currency (versus the U.S. dollar) also sparked concern over exports. Despite this, the government is still optimistic that the economy will continue to recover, as consumption and corporate earnings are growing, albeit moderately. Household spending and retail sales in August rose by 1.6% and 0.5% y-o-y, respectively, supported by a robust labor market. The Bank of Japan held the interest rate at 0.5% in 3Q, although the Federal Reserve reduced its federal-funds rate by 50 bps in September.

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Exhibit 1a: Annual GDP growth**Exhibit 1b: Annual Inflation**

Sources: Asian Development Bank; IMF; Prudential Real Estate Investors

India's GDP grew by 9.3% y-o-y in 2Q, supported by stronger-than-expected growth in the manufacturing sector. The nation's fiscal 2008 GDP is expected to be 8.5%-9.0%. Like China, India imposed several measures to check inflation and to prevent the economy from overheating. Since March, it kept the interest rate high, at 7.75%. Thus, inflation fell to a five-year low of 3.3% in early September, from 4.1% in August and 5.2% in the same period last year.

Hong Kong's economy expanded by 6.9% y-o-y in the first half of 2007, and the unemployment rate remained low at 4.2% in the three months to August. In the same month, government officials raised Hong Kong's 2007 GDP forecast to 5%-6%, higher than the previous prediction of 4.5%-5.5%. Inflation rose at a faster pace in July, by 1.5% y-o-y, due to escalating food prices and strong domestic consumption driven by rising wages. In September, banks lowered the prime lending rate by 25 bps, after the 50-bp reduction of the U.S. federal-funds rate.

South Korea's central bank raised the interest rate by 25 bps in both July and August to 5% to moderate private banks' aggressive lending and inflation. It kept the rate unchanged in September, as inflationary pressures appeared contained. **South Korea's economy grew by 5% y-o-y in 2Q. It continued to show strong growth in 3Q due to robust exports and the accelerating recovery in consumption and production.** The consumer survey index in 3Q rose to a five-year high of 112 from 108 last quarter, as South Koreans became more optimistic about the prospects for the local economy.

In Singapore, the higher-than-expected economic growth of 7.6% y-o-y in the first half has prompted the government to raise its 2007 GDP forecast to 7%-8%. Reflecting its positive sentiment about the nation's economy, the government has targeted long-term economic growth of 4%-6% for the next five to 10 years, up from 3%-5% estimated previously.

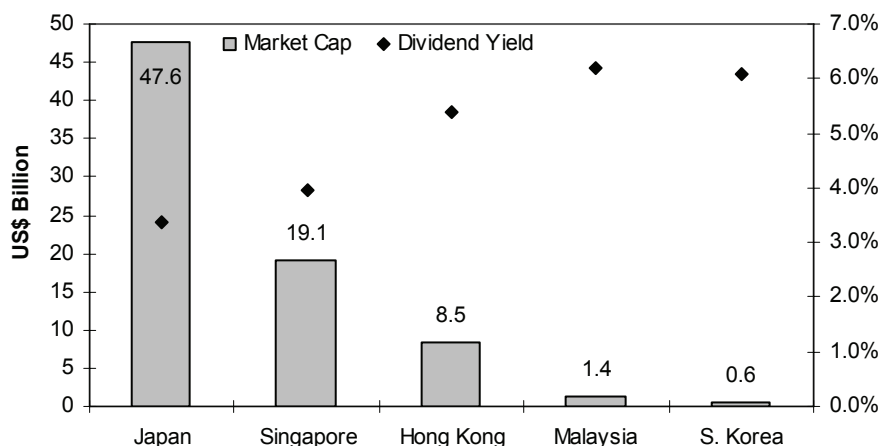
Malaysia's GDP grew by 5.7% y-o-y in 2Q, stronger than the expected 5.5%, driven by domestic demand, public spending, and the services and mining sectors. **Malaysia's central bank maintained the 2007 GDP forecast at 6%, supported by public spending and regional trade.** In September, the government unveiled the budget for fiscal 2008. One of the highlights was the

reduction of the corporate tax rate by another 100 bps to 25% in 2009. (In the previous budget, the government announced that the corporate tax rate in 2008 would be reduced by 100 bps to 26%.)

Capital Markets

Two new listings in the Asian REIT market brought the number of Asian REITs to 83. Total market cap at the end of 3Q was about US\$77.2 billion (see Exhibit 2).

Exhibit 2: Market Cap and Dividend Yields of Asian REITs, as of 3Q07



Sources: Various Exchanges; IPO Prospectuses; Prudential Real Estate Investors

The new REITs, both listed in Singapore, are Ascendas India Trust (a-iTrust) and Parkway Life REIT. The a-iTrust, Singapore's first listed Indian property trust, has an initial portfolio of IT parks and business space in India's major cities. Its forecast dividend yield is 4.75% for 2008. Parkway Life is a healthcare trust with three hospitals in Singapore. Its dividend yield is projected to be 4.88% for 2008. The total market cap of S-REITs was US\$19.1 billion, with an average dividend yield of 4.0%, 124 bps above the 10-year government bond yield. In September, the Monetary Authority of Singapore revised its REIT guidelines to safeguard retail investors. Key changes include disallowing discounts to institutional investors at IPOs and requiring REITs to invest at least 75% of their assets in income-producing real estate (up from 35%).

At the end of 3Q, Japan had 41 listed J-REITs, with a total market cap of US\$47.6 billion and an average dividend yield of 3.37%, 164 bps above the 10-year government bond yield of 1.73%. Hong Kong's seven REITs had a total market cap of US\$8.5 billion and an average dividend yield of 5.4%, about 100 bps above the 10-year Exchange Funds bond yield of 4.4%.

At the end of September, Malaysia had 11 REITs, with a total market cap of US\$1.4 billion. The average dividend yield was 6.2%, 280 bps above the 10-year government bond yield of 3.4%. In its budget for fiscal 2008, Malaysia raised the allowable share of foreign ownership in fund and REIT management companies to 70% from 49%. The move is expected to set new benchmarks for the industry in terms of management and to encourage more cross-border REITs.

In South Korea, the market cap for its six K-REITs totaled US\$634 million. The average dividend yield of 6.1% was only 58 bps above the five-year Treasury bond yield of 5.52%.

In contrast to the regional trend in 2Q, the spread between dividend yields and government bond yields widened significantly, as the former rose while the latter fell. The only exception was in South Korea.

Office

Tokyo's grade-A office market sentiment remained positive in 3Q, despite the unexpected softening of the economy in 2Q. Both corporate expansions and relocations drove demand for office space. Grade-A office effective rents improved by 5.3% q-o-q in 3Q, supported by low vacancy (0.8%). This was slightly higher than the 0.6% in the preceding quarter but still nowhere near the frictional rate of 5%. More than 95% of 2007's new supply is already committed. Tokyo's office market prospects remain positive, as demand will likely outstrip supply.

In Hong Kong and Singapore, corporate expansions drove leasing activity in the grade-A office market in 3Q, although requirements were smaller. Expansions came from a broader base, rather than just from the banking and finance sector. In August, the vacancy rate in Central fell to almost a 20-year low of 2.8% from 3.4% in June. Other areas also saw the vacancy rate falling via expansions and relocations from Central by tenants who were cost-conscious and did not need a Central address. In Singapore, grade-A office space saw almost full occupancy. Temporary supply shrinkage due to redevelopment and renovation led to significant increases in grade-A office rents by 8.7% q-o-q. Expansions are likely to continue as the employment outlook for 4Q is positive, and we expect the leasing markets in both cities to remain robust.

Demand for grade-A office space in Beijing continued to be strong in 3Q, with net absorption already surpassing all of 2006. Expansions were mainly from the IT, professional service and finance sectors. However, surplus office supply means that Beijing will remain a tenants' market going forward. Vacancy may see some upward pressure, and landlords will need to offer more competitive lease terms to retain tenants.

In Shanghai, the lack of grade-A office supply led to brisk take-up in new buildings. Meanwhile, non-grade-A buildings and business parks continued to benefit from spillover demand. Vacancy will decline further, as demand is expected to absorb most new supply. Rents are poised to see more upside by the end of the year. That said, new, stricter rules on commercial mortgages are likely to moderate investment market sentiment. These changes include raising the minimum required down payment to 50% from 30%, shortening mortgage terms to 10 years from 20 years and raising the mortgage interest rate to 1.1 times the benchmark one-year lending rate.

In Seoul, business volume in the financial and insurance industry rose by 22% y-o-y in July, better than the 20.8% growth in June, based on the Service Activity Index. **The average grade-A office vacancy rate was below 2% in August, supporting small rent increases.** Going forward, tight supply and strong tenant demand will put upward pressure on rents in the next 12 to 18 months.

Grade-A office rents in Kuala Lumpur City Center (KLCC) remained firm in 3Q, as healthy tenant demand continued. The vacancy rate stood at 9.5% for the quarter and is likely to remain stable until the end of the year, as new supply is expected to be readily absorbed.

Residential

In Tokyo, housing starts in July and August fell 42.6% y-o-y. On the other hand, the contract ratio of new condominium units in Tokyo (units contracted versus units marketed) rose to 81.0% in July from 78.7% in June. The number of unsold units declined slightly to 1,525 units in July from 1,570 units in June. For the first seven months of the year, new condominium prices in Tokyo rose by 42% on average, more than the 28% increase for the same period last year.

China's residential market showed no signs of slowing in 3Q due to the booming economy, rising household income and strong buying interest. The average home price in 70 cities rose by 8.2% y-o-y in August, up from 7.5% in July. Major cities such as Beijing and Shenzhen saw price increases of more than 10%. Because of this, the central bank tightened mortgage-lending rules for second homes. The minimum down payment for a second home was raised to 40% from 30%, the mortgage rate was increased to 1.1 times the benchmark one-year lending rate, and the installment to income ratio was limited to 50%. The tighter rules and other government measures are expected to moderate demand and to slow price increases.

Residential property transactions in Hong Kong hit a two-year high in August, totaling 13,664, 22.9% higher than in July and a 58.3% increase y-o-y. Total sales in August amounted to HK\$44.2 billion (US\$5.7 billion), representing a huge 76.3% y-o-y increase, signaling renewed interest in home purchases. The upward price momentum should be sustainable for the rest of the year, supported by a robust economy and improved confidence among potential buyers.

In Seoul, housing prices for the first eight months rose by only 3.7% y-o-y, much lower than the 7.2% growth for the same period last year. Heavier property taxes, stricter rules on mortgage loans and a high mortgage loan rate were the main factors causing the slowdown. Starting in September, the government placed a price cap on new apartment supply, which means it will set the profit margin for developers according to the book costs of new apartment projects. In August, the government announced a revised tax bill (to take effect by January 2008), which included tax cuts (by raising the tax deduction scope) on capital gains from sales of homes, land or buildings costing KRW600 million (US\$650,000) or more for owners who hold their homes for a longer time. (The exact timeframe was not specified.)

In Singapore, housing transactions saw a seasonal slowdown in 3Q. Despite this, the total number of transactions for the first nine months of 2007 has already exceeded that of 2006. The collective sale market saw some moderation in volume in 3Q, partly because land prices rose significantly in the first half and partly because of the rise in the government's development charge (a tax on projects that increase their gross floor area or change land use). However, the upward momentum of prices in prime areas is likely to be sustainable, given the buying interest from local and foreign investors. Prices in suburban areas will likely rebound further, given the high land prices achieved in recent government sales.

Retail

China's retail sales in July and August reached 1.41 trillion yuan (US\$188.4 billion), 16.7% higher than the same period last year. The large increase in tourist arrivals compared with 2006 also

contributed positively to the retailing industry. Demand for retail space in Beijing and Shanghai came from new entrants and expansions, mostly from the luxury and fast-fashion industry.

Hong Kong's retail sales remained strong in 3Q, thanks to the robust economy and the falling unemployment rate. In July, retail sales rose by 14.2% y-o-y, similar to June. Visitor arrivals swelled by 6.8% y-o-y to more than 13 million in the first half of 2007. Supported by growing income and wealth, sales of luxury and big-ticket items remained the top-performing categories. Several high-end international brands expanded beyond the core retail areas of Central, Causeway Bay and Tsimshatsui. Food and beverage retailers also opened new outlets. **Looking ahead, retailer expansions are likely to continue in 4Q, and rents are poised to see more upside.**

In Seoul, the retail market showed signs of improvement in 3Q. The Bank of Korea's consumer sentiment index rose to 112 in September from 108 in 2Q. Total department store sales in July rose by 0.75% y-o-y, or 0.5% m-o-m. The nationwide unemployment rate fell to 3.1% in August from 3.2% in June. At the same time, monthly wages increased by 6.9% y-o-y in July, higher than the 6.0% for the same period a year ago. **That said, retailers are likely to take a cautious approach in terms of expansion plans, given the rise in interest rates. Retail rents will likely move sideways going forward.**

Singapore's retail market remained buoyant in 3Q, despite the increase in the goods and services tax from 5% to 7% in July. Total retail sales (excluding motor vehicles) rose by 7.9% in July y-o-y. In July and August, Singapore saw record tourist arrivals of 1.86 million, representing a 4.4% y-o-y increase. **Rents in the prime Orchard Road area rose in the quarter due to limited quality space and strong tenant demand.** For the rest of the year, retailers will likely focus more on retail sales in view of the upcoming year-end holiday season rather than on expansion plans. Retail rents will therefore stay firm in the fourth quarter.

In Malaysia, total retail sales are likely to grow by 8% this year, versus 8.4% last year, supported by strong consumer spending and tourist arrivals. The government plans to spend RM858 million (US\$252 million) for the construction and upgrading of tourist facilities. **The average vacancy of prime retail space in Kuala Lumpur stayed firm at about 11% in 3Q. Rents were firm in the first nine months of 2007, and the outlook remains positive for the last quarter.**

Industrial

Business sentiment among large manufacturers in Japan remained positive in 3Q, according to the Bank of Japan's *tankan* survey. **In the quarter, institutional funds continued to actively acquire industrial properties, mainly logistics, distribution centers and development sites.** Acquisitions were less active in the latter part of 3Q, as global financial market uncertainty moderated sentiment. Sales and leasing activities are expected to be modest in the final quarter due to growing concerns about slowing manufacturing outputs and exports, as reflected in the *tankan* survey, which shows a four-index-point decline in the forecast for the December index.

China's industrial sales rose by about 27% y-o-y each in July and August, similar to the same period last year. **Industrial land prices in Beijing rose steadily after the government set a minimum price last quarter. Despite this, investors continue to buy industrial properties, particularly those related to the manufacturing sector. In Shanghai, industrial land prices in**

some districts have doubled since the start of the year. To ease tight supply conditions, the government released eight industrial plots totaling 3.88 million square feet. On the other hand, as industrial rents and land prices grew rapidly, investors and developers were eager to develop their own industrial facilities in Shanghai's fringe areas, where costs are relatively cheaper.

Hong Kong's total exports rose by 8.6% and 7.5% y-o-y in July and August, respectively. **In 3Q, demand for warehouse and other industrial space catering to transportation, logistics and distribution services remained firm.** The opening of the Hong Kong-Shenzhen Western Corridor in July has further enhanced logistics activities between Hong Kong and the Pearl River Delta. Areas in the northwestern New Territories, such as Yuen Long and Tuen Mun, have seen strong investment interest in the industrial sector due to the direct link between these areas and the mainland's highway network.

In Singapore, rental increases for the high-tech sector and business parks continued in 3Q. For other building types, such as conventional multistory factories, some owners have refurbished, done major additions and alterations, or even redeveloped them to secure higher rents. Investment interest from institutional funds and REITs remained strong in the quarter. These yield-driven investors typically look for sale-leasebacks, especially properties near major transportation nodes. Rents of high-tech space rose by 8.5% q-o-q in 3Q, while rents for warehouses remained firm in the quarter.

Conclusion

The upward economic momentum in Asia continued robustly in 3Q. Leading the pack are China and India. On average, Asia is expected to see 2007 GDP growth of 8.3%, up from the previous projection of 7.6%.

The region's grade-A office markets continued to benefit from strong economic growth in 3Q. Corporate expansions remained active, although the tight supply of quality space has somewhat constrained expansions. Vacancy rates remained low, and rents rose or remained firm. Going forward, demand for grade-A office space in Asia should remain healthy in the final quarter, supported by the region's positive economic growth prospects and business sentiment.

The region's retail markets remained firm in 3Q, buoyed by the growing number of visitors and rising household income. International luxury brands stayed active in expanding their businesses to capitalize on growing demand in Asia, especially in China. The Asian retail market will continue to favor landlords, given the limited supply of prime retail space and strong demand.

The housing markets in China, Hong Kong and Singapore continued to see rising prices in 3Q, but tightening measures in China might cause the market to slow. In Hong Kong, market confidence improved, and sales volume rose robustly in 3Q. In Singapore, the upward price momentum is spreading from prime areas to the suburbs; thus, the current market upturn will likely continue.

The region's industrial market remained stable in 3Q, supported by healthy export growth. While the industrial leasing market in Japan may moderate in the short term due to concerns over slowing exports, the markets in Beijing, Shanghai, Hong Kong and Singapore will likely see more activity in the medium term. Industrial land prices in China remained on an uptrend, reflecting the importance of China's status in the global industrial marketplace.

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