

Letter to Shareholders

Overview

Net income for the second quarter was \$1.2 billion or \$0.62 per share and Funds from Operations (FFO) was \$520 million or \$0.50 per share. The results reflect continued earnings and cash flow growth across our operations and the contribution from recently completed acquisitions and developments, although offset somewhat by the results in our renewable energy and private equity businesses, which tend to have more variable earnings.

Fundraising continued to be very active, with more than \$10 billion committed to various strategies through the first six months of this year. This brings total assets under management to \$218 billion and fee-bearing capital to nearly \$100 billion, up 18% over the last twelve months. This also increases our annualized fee revenues and target carried interests to \$1.4 billion.

We expect our current private fundraising efforts to achieve or exceed the original fund expectations, with several final closes by the end of this year. Based on our pace of investing, we also expect to be in a position to begin marketing a further \$10 to \$15 billion of funds later this year.

We committed or deployed \$4 billion of capital on new investments during the quarter and \$16 billion over the past twelve months as we continue to invest the capital raised in our private and listed funds. We are looking at a number of high quality investment opportunities across our operating businesses and regions, in addition to building out over \$10 billion of property, infrastructure and renewable energy projects.

We generated substantial disposition proceeds across our franchise, including \$3 billion from sales of mature assets such as an electrical transmission network in the northeastern U.S., a California wind farm, and interests in commercial properties. This capital, along with the over \$2 billion we raised from a corporate share issue and issuance at our infrastructure partnership, as well as over \$9 billion of uncalled client capital commitments, ensures we have ample liquidity to pursue additional growth opportunities.

Market Environment

News in the second quarter was dominated by Greece, the Chinese market “sell-off,” and continued anxiety over interest rates as the U.S. Fed continued to give indications it would increase interest rates for the first time since it dropped them to zero (amazingly, it has been seven years). This caused virtually all securities perceived to have some linkage to interest rates to trade lower.

None of these events has given us any pause about the continued recovery of the U.S. economy. Despite this, we have been net sellers of assets in the U.S., given the robust amounts of capital available to investors.

Oil and commodity prices have hurt economies like Australia and Canada, although we’re still seeing very good employment levels across most affected regions. We continue to pursue value investments in and around these markets.

Brazil is undergoing extreme pressure, and this has been exacerbated by scandals that have affected many of the global champions in the country. Despite this, and a recession, the country has a strong democracy with an emerging middle class, and we continue to believe in the long-term emergence of Brazil. As a result, we are investing large sums of capital there.

In India, government reform continues and we are pleased with the investments we have made over the last few years. Capital is starting to migrate back to the country but India is still recovering in many sectors. We hope to selectively put money to work in further value-based opportunities there.

With the Euro trading closer to par to the U.S. dollar and oil imports costing the continent less, Europe is now becoming much more competitive and despite few fiscal reforms, looks a lot better than a few years ago. With Eurozone interest rates near zero and looking to stay that way, our investments are focused on operating businesses where we can achieve growing cash flows, while locking in extremely attractive borrowing costs.

Investment Strategy

Investment success requires a combination of skill, patience and luck. Over time, with hard work most investors can acquire the skills; patience comes with experience; and often you have to be positioned to be lucky.

Two important items that can enable positioning for luck are finding a business where the pie for everyone is expanding, and investing in countries or companies that are well run. In short, it is easier to ride the wave than fight the tide.

Over the longer term, it is very difficult to generate strong returns in an industry, or in a currency, that is declining. With a publicly traded company, one can sometimes work to shrink the float of shares at big enough discounts to tangible value that one can earn good returns, but it is hard work. Examples of these types of businesses over the last 20 years include paper mills, textiles, and newspaper businesses – and more recently, businesses disrupted by new technologies. The only other way investors have done well in these declining businesses is to have acquired the business cheaply enough, milked the cash flow, and reinvested it into new businesses. These are anomalies, as the returns were unrelated to the old business and were, in fact, dependent on an individual who was a good capital allocator redirecting cash flow to new investments.

This brings us to our business of alternative asset management. Thirty years ago, bonds dominated pension portfolios; 20 years ago equities became very large components of institutional portfolios. Since then, equities have proven to be volatile and fixed income returns are now almost non-existent. As a result, we have seen continuously expanding allocations to alternatives – including real estate, infrastructure, private equity and hedge funds. All indications are that the growth of alternatives will continue to be positive for a long time.

Furthermore, since the financial crisis in 2008 we have seen consolidation starting to occur amongst alternative managers. This is creating a number of super-brands which are separating from the rest, as they have global reach, resources to achieve best-in-class governance standards, size to attract attention, and investment track records to assemble large sums of capital in multiple funds for institutional clients. The ability to provide a wide range of solutions to clients is an attractive alternative to having to otherwise vet possibly hundreds of managers, and enables managers to put large sums of money to work efficiently. As a result, institutional clients are increasingly allocating their capital to a smaller number of larger funds. We are among the fortunate few who possess this type of franchise.

Overall, we continue to believe that by simply compounding existing capital, we are heading to a +\$50 trillion industry. As important, allocations to real assets have grown from virtually nil years ago to 10% on average today, and we estimate they will increase to 20% or more. As a result, in excess of \$10 trillion of incremental capital will be available for the sector, a five-fold increase from today. Of course, institutions will range in allocations based on many factors, but as an example we expect that select institutions will have over 50% allocations to alternatives in the short term.

We believe that we continue to be in a very robust industry, and therefore our focus is not on major strategy change, but instead on relentless execution of our plans. Our goal is to generate strong returns by investing wisely, and to ensure we take care of our clients. As long as we do this, we believe we can grow at a strong pace for decades to come.

Interest Rates

We have been running our business with the expectation that interest rates will increase, particularly in the United States; in fact, we welcome this. Interest rates will rise because the economy is improving and that is positive for business.

Rates have been virtually at zero in the United States for seven years, the economy is doing well and a 1% or 2% increase in interest rates on the short or long end of the treasury yield curve means almost nothing to a long-term investment. We have assumed for six years that a 10-year treasury would have a 4% to 5% yield – not 2%, and we have based all our decisions on this. There are very few sophisticated acquirers of real estate or infrastructure that have had a different view. Returns may be slightly less going forward, but cap rates (the inverse of the return) have been stubbornly high relative to interest rates for one specific reason...that everyone knew interest rates were going up and people have not been willing to reduce the cap rates to levels that were unduly low, acknowledging that rates were going to go up.

Our business is positioned to thrive in a higher interest rate environment; there are four simple reasons for this. First, and most important, we own “real return” assets that increase their cash flow generating capacity over time either through contractual rights, our ability to operate them better, or an expansion of the operation. These enhancements should far outpace any extra interest costs, in particular in a more inflationary environment. Second, we generally earn total returns on equity of 10% to 20%. This is much greater than treasury yields and therefore a 1% increase does not really matter. Third, we finance approximately 50% of our investments with debt. Moving interest rates up by 1% impacts our returns by 1% to 2%, which is not meaningful. And fourth, most prudent property and infrastructure investors have fixed rate debt, therefore cash flows until maturity of that debt will not change at all, period. Nothing at all.

The broader point is that interest rate increases really do not have a major adverse impact on us, with the exception of one circumstance. That exception would be an increase to 7% to 8% in the shorter term, in which case there would be significant disruption to many businesses, including real estate and infrastructure. We have planned to be able to sustain this type of shock, although there is no doubt it would not be fun for any of us. And it might even lead to some tremendous opportunities for us. But, for the record, we believe the chance of this occurring in the next five years is very low, although you should make your own assessment and act accordingly if you believe this is a likely scenario.

Brookfield Listed Affiliates

Our listed affiliates, Brookfield Property Partners, Infrastructure Partners, and Renewable Energy Partners are very important to our overall long-term franchise. In order to continue to ensure the long-term success of these companies, we will use our resources to support them where required. That is one of the reasons we maintain substantial liquidity at Brookfield Asset Management, as we want to always be in a position to enable our companies to achieve transactions and build their businesses in a way that will create value for all unitholders. Sometimes this assistance relates to capital, often to business relationships, sometimes to execution, and at times to other resources that we possess.

At Brookfield Property Partners since spin-off, we have been supporting their plans with lending to ensure they could grow their business, complete the major developments they have in the pipeline and reorganize the company to create an optimal asset ownership structure. BPY is well into achieving their goals and is also coming close to completing their asset sale program and repaying bridge loans taken on to do this. The sales values being achieved today are substantially higher than when they started, and therefore the NAV growth has been far greater for all unitholders due to this support. In addition, given that private markets have very robust pricing for assets, and that public markets have sold off for any stock associated with interest rates, there is a great arbitrage for BPY to continue to sell interests in assets and repurchase its own units. Furthermore, as the major BPY leasing and development projects start to contribute to bottom line FFO, the growth in FFO will be between 15% and 20% for the next few years; far greater than almost any other property company. Together, this should contribute to substantial value creation for all BPY unitholders. We are thrilled that BPY will soon begin to show the results of these efforts.

At Brookfield Infrastructure, we recently were required for regulatory purposes to announce that we are in negotiations to acquire Asciano, a major rail and port operator in Australia. This transaction requires significant capital to complete, and since the disclosure, the unit price of BIP has traded off from where it was prior to that announcement. Given our positive outlook for BIP and its strong results, we believe this dip in the unit price relates to concerns regarding the issuance of units to complete the transaction. We don't know at this stage if this transaction will proceed, but if it does, we are confident that this will be a solid long-term investment for BIP. Fortunately, due to the scale of capital available from BIP, our clients, and our own financial resources, we have the flexibility to negotiate and structure a transaction of this scale to maximize value for all BIP unitholders.

We believe that as manager of these entities one of our roles is to enable these companies, and our other funds, to be in a position to complete transactions that they might not otherwise be able to do on their own. We believe that this is key to our success as an asset manager, and we intend to continue using this advantage to support our companies.

Operations

Our total assets under management increased to \$218 billion, with fee bearing assets increasing by approximately \$15 billion year over year, to nearly \$100 billion. This growth reflects new commitments to our private funds, strong growth in the funds managed by our public markets group, and increased capitalization of our flagship listed entities. Our fee-related income increased by more than 44% to \$127 million in the quarter, as the business continues to mature.

Brookfield Property Group

Our property business generated total FFO of \$394 million. Our share was \$324 million, a 20% year-over-year increase. During the first half we signed 4.3 million square feet of retail and office leases, at rents that were 9% above expiring leases in our retail portfolio and 34% above expiring rents for our office buildings.

We continue to recycle capital in our property business, as there continues to be very strong demand from institutions for mature assets that generate predictable returns. We sold interests in office buildings in Boston, London and Washington, D.C. as well as in a retail centre in Hawaii. The majority of this capital was used to repay our acquisition loans taken on to acquire the balance of our office company, as well as to fund the build-out of our office, retail and residential rental apartment pipeline.

We committed \$2.4 billion of capital to property acquisitions, including the acquisition of a \$3.5 billion resort property operator in the UK, the Bloomberg headquarters office building in London, and a \$1.0 billion portfolio of office properties in São Paulo and Rio de Janeiro. We also advanced all of our developments across the portfolio, including breaking ground on the first office tower and a 900-unit residential rental apartment building at our Manhattan West project in New York, and launching the first sales of residential condominiums, and construction of both these condominiums and rental properties at Canary Wharf in London.

Brookfield Renewable Energy Group

Our renewable energy business generated total FFO of \$146 million. Our share was \$66 million, in line with expectations, but below historic levels as our generation during the quarter was approximately 11% below long-term averages. Part of the decline in FFO was offset by acquisitions and because our wind facilities performed well.

In Europe, we experienced strong fleet availability at our wind facilities, as well as strong wind conditions. In North America, we are starting to see long-term contracts at good power rates come back into the market. In Brazil, prices are high due to the low water levels. We believe these conditions will recover and are therefore using this environment to add to the portfolio with recent acquisitions of both hydroelectric and wind assets at attractive valuations.

We agreed to acquire 1,200 megawatts of early stage wind development projects in Scotland during the quarter, adding these to our European project development pipeline. We also continue to pursue numerous other opportunities in Europe where the renewable build-out has caused significant disruption in the power markets.

Brookfield Infrastructure Group

Our infrastructure business generated total FFO of \$213 million. Our share was up 15% to \$61 million, reflecting strong results across our global portfolio. The increase was due to contributions from our newly acquired Brazilian transportation assets, as well as our telecom tower portfolio in France. We continue to see significant scale growth opportunities with the decline in commodity prices and the scarcity of capital in some markets.

We recently agreed to provide a \$250 million loan to a construction company in Brazil, secured against a 25% stake in a subsidiary that owns a number of world class assets. The portfolio includes three critical toll roads in Rio de Janeiro and São Paulo, the subway system in Rio de Janeiro, and the international airport in São Paulo. We hope this will lead to longer term involvement in these premier assets. In Australia, we are in negotiations to acquire a rail and port company, which has an equity capitalization of approximately \$7 billion. This will unfold over the coming months.

Part of our growth strategy in all our businesses is to focus on tuck-in acquisitions, where we purchase assets that are easily integrated into our existing operations. This approach lowers our risks as we are buying assets that we know well while also achieving scale. In line with that, we recently added or committed to acquire further natural gas storage businesses for our platform, which now includes storage facilities in California, Texas, Oklahoma and Alberta. We also continue to add district energy systems in a number of cities in the United States, and have started pursuing opportunities in the UK and Australia.

Brookfield Private Equity Group

Our private equity operations generated total FFO of \$53 million. Our share was \$12 million. Our housing-related investments continued to benefit from the slow but steady recovery of the U.S. home market, offset by a slowdown in western Canada and in our Brazilian operations. Results of our private equity operations were also impacted by the performance of our oil related investments due to the impact of oil prices.

We continue to expand our private equity operations in both scale and geography. During the quarter, we closed on a \$2.1 billion acquisition of a mid-tier Australian oil and gas company. We tendered to acquire a \$900 million U.S. based graphite electrodes producer, which manufactures components for steel mini-mills, acquired a Canadian infrastructure products manufacturer, and purchased a palladium mine.

We are devoting significant corporate resources to building out our private equity businesses with equivalent scale as our other operations.

Summary

We remain committed to being a world-class alternative asset manager, and investing capital for you and our investment partners in high quality assets which earn a solid cash return on equity, while emphasizing downside protection for the capital employed.

Our primary objective continues to be generating increased cash flows on a per share basis, and as a result, higher intrinsic value per share over the longer term.

And while I personally sign this letter, it is done so on behalf of all of the members of the Brookfield team, who collectively generate the results for you. Please do not hesitate to contact any of us, should you have suggestions, questions, comments, or ideas you wish to share.

J. Bruce Flatt
Chief Executive Officer

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