Q2 2017

Letter to Shareholders

Overview

The second quarter of 2017 was strong. Our asset management fees continue to grow at a rapid pace and most of our operations achieved plan. The market for selling mature property and infrastructure assets continues to be very positive, and we are using this environment to monetize assets and recycle capital where it makes sense. Recently, we sold a New York office property for $2.21 billion, a London office building for £410 million, and various other assets at attractive prices.

At the same time, we continue to put capital to work in markets that are out of favor and in businesses that require our operating expertise to grow revenues or to rework their cost structure in order to enhance returns. In total, we invested $9 billion across the business during the quarter. This included a regulated gas transmission business, a road fuel distribution company, a water distribution business and various real estate properties globally.

Funding in both the public and private market for real assets remains strong, as institutional funds continue to allocate greater amounts of capital to our sectors. With interest rates still low, this should continue for the foreseeable future.

Global Infrastructure

We are often asked our views about the infrastructure focus of governments around the world and what this means for us. To date we have focused more on the private market; however, we have participated to a limited extent in government privatizations, with some very successful results. For example, we acquired a wind business from the government of Ireland, are building transmission lines and toll roads in Brazil under government bid concessions, acquired a district energy business from the City of Toronto, and acquired a hydro-power company from the government of Colombia.

We support government efforts to privatize infrastructure, including the “Infrastructure Banks” being set up globally to facilitate these activities. This is good for both taxpayers and governments, as service levels will improve and government debt levels will be reduced. This also means that a greater number of opportunities will be available for institutional investors to put capital to work on behalf of their pensioners, policyholders, union members and other stakeholders.

The “Infrastructure Banks” are excellent concepts as they have an opportunity to become the knowledge centers that municipal and state governments rely on for advice, as well as a source of capital to provide “gap” financing to bridge revenue shortfalls in some projects’ early years of operation. We firmly believe that these organizations can be effective in assisting governments and investors focus their resources, and that this will enable more private infrastructure investment.

Over the next 25 years, it is inevitable that a much greater number of infrastructure assets will find their way into private hands. The process will neither be quick nor simple, but we believe there will be a strong tailwind for those with the skills and capital resources able to participate effectively.

Fund Growth

As the global investment market in alternative assets grows and matures, we continue to adapt our investment products to meet client needs. We primarily offer two types of products: opportunistic return and core products. The former is an alternative for traditional equity investments; the latter for traditional fixed income investments.

In each of our business sectors, we are growing our funds and expect to have large scale opportunistic funds of $10 to $20 billion for each sector. Our clients consider these to be substitutes for equities in their portfolios, and the returns we earn for them are a welcome respite from low return or more volatile liquid investments.

Increasingly, institutional investors are also looking for alternatives to supplement the return on their fixed income portfolios, since with a 2.5% – 3.5% long U.S. rate they also need to earn higher returns with this capital, while taking modest risk.

In response to this, we have been growing our credit businesses and have started to create private perpetual long-term entities to enable clients to own assets. In particular, we recently established a private perpetual core plus fund focused on real estate opportunities in the United States. Within the last 12 months, we have grown this fund to over $2 billion of gross assets and $1 billion of equity investment. Given the current size and scale of our operations, we are well suited to be a leader in this space and believe that over time our core real estate products could exceed $50 billion.

We have also been considering this core product for long-duration renewable energy and infrastructure assets, which are ideal for clients wishing to match their liabilities. Infrastructure and renewable power assets are particularly suited for perpetual capital investors and we are well positioned to offer these products. Longer term, each business should also be able to grow to over $50 billion and be highly complementary to our operations.

North American Residential

We own a number of residential housing businesses globally. We build both high rise in-city and suburban multifamily apartments for rent, develop residential condominiums for sale, and own a large master-planned residential lot development business across North America. The residential lot development business is held privately, and therefore receives less visibility than our publicly held businesses; accordingly, we thought an update might be of interest to you.

The North American lot development business is 100% owned by our Brookfield balance sheet capital, with a book equity investment value of $1.5 billion and an intrinsic value of much more. This business generates $2 billion of revenues and ±$400 million of cash flow annually. The value of the lots we currently own is about $8 billion at today's prices on an undiscounted basis, and these lots will be converted to cash over the next 15 years.

The business of entitlement, land development and master planning is time consuming and requires very specialized skills. As a result, few do it and still a smaller number have the capital required to do it well. It necessitates detailed knowledge of the technical entitlement process, product knowledge that maximizes value in the land, a capital management plan to invest and absorb land uses appropriately, as well as the operational skills to bring communities to life. When done well, it can generate excellent risk adjusted returns and significant cash flows over very long periods of time.

We have been in this business for over 30 years and it has been one of our most profitable. Despite this, because of the long-dated nature of the cash flows and value creation of land often being far into the future, it is a tough one for most public market investors to value. Irrespective – and partly because – of this lack of public

market capital, the cash and wealth it generates over the longer term has made it an incredibly valuable business for us.

We are among the top five largest owners of residential lots in North America, with ±100,000 lots in 12 supply-constrained markets. Approximately 60,000 of these lots are entitled, with the balance in the process of being entitled. Post entitlement, we develop lots (install roads, sewers, electricity, etc.) in preparation for home construction. Then we either sell these lots to third party builders or build homes on the lots ourselves (we currently average about 50% of each).

The U.S. housing market has had a long, slow recovery since the recession almost 10 years ago that caused a drop in home ownership rates. Recently we have seen a return of first-time buyers in many markets. In addition, with the used home market supply at only four months, the new home market has seen significant demand growth year over year. We are optimistic that this trend, together with the move to reduce burdensome regulations affecting the housing sector, will give rise to increased housing starts, thereby addressing the significant pent-up demand that exists. In addition, because lot supply in the U.S. market has not kept pace with the changes in homebuyer demand, we anticipate that builder demand for lots to construct homes will continue to result in value increases for the land we control.

In Canada, the Greater Toronto Area housing market has been at record levels, with home prices increasing at double-digit levels. Recently introduced legislation intended to slow this pace of increase has had some impact, with sales prices flattening and listings increasing. However, these are short-term measures and the only permanent solution is to increase supply to better match the demand, but this takes time. In Alberta, the housing market is performing reasonably well considering the slowdown in oil and gas. Longer term, we are highly confident in our positioning given our dominant land positions in Calgary and Edmonton.

United Kingdom

The United Kingdom has continued to capture the news of the day with their Brexit negotiations. Despite the headlines, virtually all of our businesses are doing well.

We have a number of office buildings under construction in the City of London and leasing continues to be strong. Since Brexit, we signed a major law firm to over 200,000 sq. ft. of space at our 100 Bishopsgate project and we are progressing construction of a number of major residential rental projects, and other office projects which are substantially fully leased.

Our electricity, gas and fiber connections business in the U.K. is robust. Sales volumes are up 16% over last year, as housing sales across the U.K. continue to be strong. Our Center Parcs hospitality business is effectively 100% occupied and cash flows continue to grow. Our port on the east coast is seeing solid volumes, our industrial warehouse property business is very strong with internet deliveries driving growth, and valuations on industrial properties are at all-time highs.

Real estate prices in London for major high-quality office properties are at least 30% higher than pre-Brexit. This is exemplified by two major properties we have just sold: one in the City of London and the other at Canary Wharf. Fully let properties in the City of London with strong rent rolls are closing in on £2,000 per sq. ft. In local currency, this is the highest price ever. In U.S. dollar (global) terms, it is still close to the highest.

The full impact of Brexit on the U.K. is still unknown, but our view continues to be that the effect will be moderate, and that London will remain one of the global centers of commerce for a long while. We see no other competitive center in Europe – and globally, few cities rival it as a welcoming market for global business. New York remains the center of the United States and in many ways, a global one. Shanghai is the center for business in Asia, but nothing comes close to London as a result of its rule of law, English language, taxation rules for global investors, and a welcoming environment for all.

We have not seen any major distress opportunities as a result of Brexit, and we do not know if we will. If business weakness appears, we will use it as an opportunity to continue to expand our operations, as we have in the past.

Performance in the Quarter

Fee bearing capital grew 8% to $117 billion over the last twelve months while fee related earnings increased by 15% to $732 million over the same period. These increases were driven primarily by growth in our listed issuer fee bearing capital as a result of strong market performance and capital deployment. We have also been busy putting capital to work across our private funds and, as a result, have started raising our next flagship opportunistic real estate fund. We expect this fund to be larger than its predecessor fund and to hold its first close later this year.

AS AT AND FOR THE TWELVE MONTHS ENDED JUNE 30 (MILLIONS)	2013	2014	2015	2016	2017	CAGR
Total assets under management	$ 183,498	$ 191,803	$ 217,948	$ 243,479	$ 257,538	9%
Fee bearing capital	78,270	81,233	93,955	108,312	117,254	11%
Annual run rate of fees plus target carry	997	1,119	1,430	1,950	2,150	21%
Fee related earnings (LTM)	240	341	436	639	732	32%

During the second quarter we continued to execute on our business plan, closing several large transactions, which deployed over $9 billion of capital, primarily in our infrastructure and private equity funds. At this stage in the business cycle we are also very focused on enhancing and de-risking cash flows in all of our businesses through operational improvements. For example, our renewables team has been focusing on locking in longer-term, higher-priced contracts at our hydro facilities. In Colombia, we recently signed our first 10-year contract with a local utility. This is significant in a market where typical contract lengths traditionally were for two to three years. At our 5 Manhattan West office building, following a complete renovation of the property we are in the midst of completing upwards of 750,000 sq. ft. of leases to bring occupancy to close to 100%, at rates double where they were prior to renovation.

Growth in our listed issuers has been strong, with capitalization of these entities increasing by $11 billion over the last twelve months. We benefit from this in two primary ways. First, as an investor in these businesses we benefit from capital appreciation and growth in distributions. Each has a solid track record of distribution growth and currently delivers in excess of $1.2 billion of cash dividends to us annually. Second, we earn fees from these entities as an asset manager. Annualized base fees from the listed partnerships are $515 million, an increase of 21% year over year, which will continue to grow as the capitalization of these entities grows. We also earn performance based incentives, in the form or incentive distribution rights (“IDRs”) and performance fees, based on our ability to deliver robust returns while further aligning our interests with investors. These IDRs and performance fees have nearly doubled over the last twelve months and now stand at $203 million on an annualized basis.

We continue to evolve our product offering to meet changing market demands. In particular, we see a growth opportunity in the wealth channel where we can expand our distribution network to access new sources of capital for our products. As an example of this, in June we launched our first feeder fund to facilitate investments from high net-worth investors into certain of our private funds. We believe these funds will enable us to reach new investors where there is demand for our products, and we expect to expand this type of offering more broadly across other products in time. We also continue to raise capital in our real estate and infrastructure debt funds, and expect our credit strategies to be an area of growth.

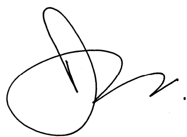
Each of our major business groups report separate detailed information (press release, quarterly letter and supplemental information) on their businesses, which are all on our website. Rather than repeat that information here, we encourage you to read them if you have time.

Closing

We remain committed to being a leading, world-class alternative investment manager, by investing capital for you and our investment partners in high-quality, simple to understand assets which earn a solid cash return on equity, while emphasizing downside protection for the capital employed. The primary objective of the company 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.

Please do not hesitate to contact any of us should you have suggestions, questions, comments, or ideas you wish to share with us.

Sincerely,



J. Bruce Flatt
Chief Executive Officer

August 10, 2017