

# Letter to Shareholders

## Overview

Results in the quarter were strong. Fee related earnings grew by 37% and most of our businesses benefitted from improved operating performance and growth in their operations. We reported FFO of \$883 million and net income of \$2 billion during the quarter.

We have committed \$20 billion of capital over the last twelve months, including \$10 billion in the last quarter. We currently have \$19 billion of client commitments available to invest over the next three years which, combined with our \$7 billion of core liquidity, provides us substantial capital to execute transactions.

Assets under management were approximately \$250 billion at quarter end. Fee bearing capital grew to \$111 billion by quarter end, representing a 23% increase over the last twelve months. Our flagship property fund is well on its way to being fully invested, and we expect to begin raising our next fund early in 2017.

## Investor Meetings 2016

We recently held our 12<sup>th</sup> Annual Investor Meeting in New York. Thank you to those who attended in person or by webcast. We hope the information provided was informative and valuable in your analysis of the firm. We try to make this event as beneficial to you as possible. If you have any feedback, please let us know. For those of you who were not able to attend, the presentation material and transcripts are available on our website, and we encourage you to have a look at them. We also held our client event for investors in our private funds this quarter and had record attendance for all of our sessions.

Over the years, our business has grown but our strategy has remained consistent. We are building a premier global manager of real assets. Several years ago, we laid out our five-year objectives for the business and with the foundation now built, we believe we are well on our way to achieving our goals.

Three things are critical to our organization. The first is investment performance: we have to perform for all of our investors. Second is our product offering: we continually evolve our products to match the needs of our investors. And finally, service: serving our investors extremely well will always be our priority. We are focused on these three items every day.

We have been building our franchise for more than 115 years, although it seems like we are just getting started. Our operations enable us to execute on many transactions in multiple locations with scale that sets us apart. At the foundation of this is our deep and extensive knowledge of our operating businesses, our global presence and our ability to access large scale capital through multiple sources. All these continue to position us well as the partner of choice for real asset strategies.

## Global Expansion of Money and the Environment for Real Assets

The U.S. Federal Reserve is attempting to increase short rates to, among other things, ensure that they have room to cut them should the U.S. economy need extra stimulus in the future. If they accomplish this, that will be positive for the global economy. It is, however, very important to note that real asset values are affected by long rates, not short rates. While real assets are tangentially affected by short rates, they are virtually always compared to what can be earned on a long bond. So while we believe that both short rates and long rates will rise (under this new U.S. Administration, maybe even a little more, and faster, than was previously expected), we believe that long rates will stay relatively muted during this cycle due to a number of factors. As a result, we are not concerned about real asset values during this cycle.

As everyone knows, the backdrop to all of this is that the world is currently in the midst of an unprecedented monetary policy experiment being carried out by the major central banks. After reducing rates to (and even through) zero, the central banks of the U.S., Japan, Europe and UK have been printing money in an attempt to revive economic activity. As a result of these programs, also known as quantitative easing (or QE), the combined balance sheets of these four central banks have increased from approximately \$4 trillion in 2008, to over \$12 trillion recently. For context, an \$8 trillion increase is about half of the U.S. treasury market. This has caused yield curves to flatten globally; it has also created unprecedented opportunities for real asset investors to earn large spreads over treasuries.

QE sounds complicated, but the mechanics are actually pretty simple. The central banks, based on their ability to issue money, create equity on their balance sheet (“a reserve”). They use this reserve to buy assets (treasuries, bonds, mortgage-backed securities) off the balance sheets of banks. In exchange for these assets, the central bank credits the reserve accounts of the banks that sit with the central bank. This is intended to increase the liquidity available to the banks to lend into the economy, thereby generating activity to support the labour market, wages and consumption. The purchase of these securities, as well as the higher stock of liquidity in the system, drives down long-term yields, which in theory creates a more attractive borrowing and investing environment as valuations become more attractive and financing costs are reduced.

As a result of changes in financial sector regulation, the commodity price shock and lower global demand, the productive use of these reserves has been limited and the impact they were designed to have on growth has not occurred. The world also continues to de-lever from an excess of credit that built up over the last few decades and, as a result, disinflationary pressures persist and global economic activity remains below trend.

It is unclear how and when these asset purchase programs will end. Recently, markets have begun to debate the limits of QE and there is now a growing focus on the need for fiscal policies to generate growth. However, it is unlikely these QE programs will end soon. Japan has adopted more unconventional monetary policy tools to control yields, in addition to their QE program and negative interest rates. QE is also likely to remain a primary policy tool in Europe and the UK. While the U.S. Fed is attempting to normalize policy by increasing short rates, it looks like they will do so gradually. Thus, as the world continues to de-lever, expansionary monetary policies are likely to be a feature of the global economy for a while, and as a result long end bond yields will remain low.

Despite the uncertainty these programs have caused for markets, what remains clear is that this dynamic is creating an unprecedented environment for investments in real assets. With long bond yields being low around the world, real assets continue to offer investors the most attractive, risk-adjusted yields, particularly for those seeking safe, long-duration exposures. As such, we believe we will continue to see substantial capital flow into real assets, and our business remains well positioned to support our investors in achieving these returns. We are close to being in a “Goldilocks” world for real asset investing: the environment is not too hot or too cold, but just right.

In summary, there is significant capital to be invested in real assets, comparable returns are anemic and business conditions are good, therefore offering revenue growth—and with low inflation, enabling margin expansion. It appears that the odds are currently stacked heavily in favour of lower-than-usual interest rates for the medium term, if not longer. With close to \$50 trillion of savings in the world that need to earn a return, these savings are increasingly targetted at the returns and dependability that come from investment in real assets.

## **The Utility of Cash**

In a world where cash and most liquid assets that are easily convertible to cash earn a zero return, the utility of cash would seem to be zero. But we would argue that cash is becoming increasingly valuable, given that we are nearly eight years into a bull market, and the fixed income markets are near highs.

This is because cash becomes extremely valuable in one circumstance in particular: when financial accidents happen. It certainly feels like we are closer to the place where cash will be more valuable than

we have been for eight years. Because of all this, we have continued to liquify our balance sheets, sell assets, pay down bank lines and start to accumulate cash.

As a result, at the margin, we will experience lower growth in our operating results in the short term than if we were putting this cash to work productively. But over the longer term, we believe the advantage of having liquid assets when the market turns will far outweigh any drag on short-term cash flows that may otherwise occur. It is during market downturns that very special assets can be acquired. That we are now one of the largest asset managers globally is largely the result of our patience and staying power. Having liquidity at the right times is a big part of this.

During periods of illiquidity in the past, we did two things: we protected our franchise, and we acquired many of our greatest initial stakes in assets. Most of these assets would never have otherwise been available at reasonable prices. Our Olympia & York New York office portfolio, our General Growth U.S. mall portfolio, our Canary Wharf London property portfolio, our Babcock & Brown Australian infrastructure portfolio, our Reliant Energy northeast U.S. power portfolio and more recently, investments in emerging markets, namely Brazil, India, Colombia, Peru and China, are all examples of this in action.

This does not mean that we have stopped investing. It merely means that around the edges we are becoming more conservative today than we have been over the past eight years. In 2009/2010, we had many attractive opportunities to invest the capital at hand because there were so many deep value opportunities generated by the financial crisis. Today we are being much more selective. And, while we have deployed \$20 billion in the last 12 months, our cash resources have also been building over this period of time.

Bottom line: cash only matters when it matters. And when it matters, it really, really matters.

### **Brazilian Natural Gas Pipeline**

We try to invest using our competitive advantages to earn attractive returns. These include our size, our global presence and our operating capabilities. As an example of these at work, in September we agreed to acquire 90% of Nova Transportadora do Sudeste S.A. (“NTS”), from Petrobras for total consideration of \$5.2 billion.

NTS owns the backbone natural gas pipeline system that serves the core economic regions in the highly populated states of São Paulo, Rio de Janeiro and Minas Gerais in South Central Brazil. These are well positioned long-life assets that earn revenues that are 100% contracted under long-term ship-or-pay agreements indexed to inflation, and have no volume risk. This is a large-scale franchise that should position us to be a key participant in the country’s growing natural gas industry, with the potential to generate strong risk-adjusted investment returns for a very long time.

This transaction highlights the three most important advantages that we believe enable us to earn strong returns over the longer term, and they were all critical in enabling us to execute on this opportunity.

First, our size and scale provides access to multiple sources of capital, which allowed us to form a substantial consortium in a very short period of time. We were able to access capital from our publicly listed infrastructure entity, our newly raised \$14 billion private infrastructure fund, and from a number of highly valued co-investment and joint venture partners.

Second, our global presence provides us with a unique perspective in many markets around the world in which we operate. In this case, having been investors in Brazil for over 100 years provided us with a perspective built up over many decades. This gave us an advantage to better assess and value this opportunity. Being a local—and global—business makes all the difference.

Third, our significant operating capabilities established us as a credible partner, capable of operating a large scale business on a standalone basis and adding value over the long term. Without this, the owner would never have sold this asset to us.

## Premier Retail Real Estate

Within our property group we have been building one of the premier retail portfolios in the world. We continue to both add to and rework it, and contrary to common belief, performance continues to be strong operationally and financially. As an example, we recently wound up the last part of our original partnership that acquired GGP out of bankruptcy with an aggregate \$10 billion profit for our consortium, making it one of our most successful property investments in recent times.

We continue to focus our retail business on best-in-class retail projects globally. We have been selling lower quality and non-core retail from our portfolios and focusing on our best. We own and manage one of the largest premier quality retail portfolios in the world, and continue to add to it selectively. The portfolio currently includes interests in 156 million square feet of retail space globally, ranging from the retail at our Brookfield Places in New York, Toronto and Perth, the retail on all of the Canary Wharf Estate in London, the world-class Ala Moana Mall in Hawaii, other luxury malls in the U.S., our New York Fifth Avenue street retail portfolio and the premier retail portfolios that we own in Rio de Janeiro, São Paulo, Shanghai and Berlin.

Our core retail portfolio finished the quarter with 95% occupancy, and we continue to see further growth in the business. The revamped retail and restaurant tenants at Brookfield Place New York have been operational for a year and have become extremely popular with the increasingly diverse clientele in Lower Manhattan. Saks recently opened their second store in New York at our centre and all of this should enhance traffic for our retailers.

We continue to expand our retail holdings selectively, with the belief that by focusing on best-in-class retail, we will be able to integrate our retail centres with online retail. Our centres are becoming destination fashion entertainment complexes, and our tenants are continuing to develop innovative ways to use the internet to augment their business offerings. As this happens, we believe that our centres will continue to thrive.

## Performance Across Our Business

### *Asset Management*

Our asset management operations generated \$173 million of fee related earnings in the quarter, a 37% increase from the same period in the prior year. Fee bearing capital increased by 23% compared to the prior year to \$111 billion. Combined, the annualized run-rate of base fees and target carry of \$2 billion. Along with the larger scale of our operations, our profitability as a manager continues to increase due to our relatively fixed cost base.

AS AT AND FOR THE TWELVE MONTHS ENDED SEPT. 30 (MILLIONS)	Q3'12	Q3'13	Q3'14	Q3'15	Q3'16	CAGR
Total assets under management	\$168,503	\$183,954	\$192,863	\$220,383	\$238,015	9%
Fee bearing capital	54,749	77,179	81,738	90,018	110,747	19%
Annual run rate of fees plus target carry	700	1,007	1,143	1,399	1,992	30%
Fee related earnings (LTM)	129	288	346	464	707	53%

Our reported earnings benefit from the compounding of steady base fees. The growth of these fee streams should continue for some time, as the capital is predominately permanent or long-term in nature, and we have been adding assets and larger funds at a substantial growth rate.

In addition to base fees, we earn carried interest, which will be an equally valuable fee stream to the business as we realize investments in our funds. In our private fund business, investors pay us a portion of the returns out of the funds for our efforts on their behalf. The assets we buy in these funds are office buildings, malls, toll roads, renewable power facilities and pipelines. We finance these assets conservatively and hold them for long durations, generally earning  $\pm 15\%$  returns on a leveraged basis. If we achieve this, we are compensated  $\sim 20\%$  of the total return through carried interest, and as a result of

the type of assets we own, our carried interests are much more recurring than some might otherwise think.

We account for carried interest in a very conservative manner. It is only recognized in FFO and net income for Brookfield's shareholders at realization, which generally occurs in the last few years of a ten year fund. This method of recognition differs from many other investment managers. As a result, the growth in carried interest is largely excluded from our earnings. However, as our fund profile matures and we wind up funds on a recurring basis, carried interest will quite possibly be our largest, recurring stream of cash flow.

If we were to liquidate all of the assets in our funds today, we would earn \$1 billion of carried interest. However, as we invest our fund capital, and the cash flows and asset values of our businesses increase, we should generate over \$800 million annually of carried interest from only the current capital we have; and this should accumulate to over \$8 billion over the next decade.

### *Brookfield Property Group*

Our property group generated FFO of \$624 million, of which our share was \$545 million. This included disposition gains of \$367 million. Our property business continues to realize quarter-over-quarter earnings growth attributable to incremental capital invested in our opportunistic real estate strategies and operational improvements.

Real estate fundamentals and overall activity in our major markets continue to be positive. Rents in our largest office market, Lower Manhattan, are approaching the highest ever. Vacancy in Toronto is at a three-year low. Energy-dependent markets remain sluggish but our assets are largely insulated with above-market occupancy and significant terms remaining on leases in place. Capital markets activity also remains healthy and we continue to recycle capital out of stabilized assets into higher yielding opportunities. During the third quarter we sold a fully leased class A office asset in Sydney, along with two additional assets in Australia, for total net proceeds of nearly \$300 million. We sold three U.S. malls and have begun harvesting capital in our multifamily residential and industrial portfolios. This included sales of 11 suburban multifamily assets in the U.S. and 30 industrial facilities, for gross proceeds of approximately \$1.3 billion.

We recently entered into a binding contract to sell Moor Place, a fully leased 227,000-square-foot office building in the City of London after receiving bids consistent with our pre-Brexit expectations. The sale, which occurred two years after we acquired the property, generated a profit of approximately £60 million and is a good example of our ability to acquire at a discount and execute a leasing strategy to enhance value.

We are under contract to acquire a premier 4.2-million-square-foot office portfolio in Mumbai—the largest consolidated office portfolio of its kind in India's financial capital. This, combined with our current assets, makes us one of the largest foreign-owned office property landlords in India today. We are also in advanced negotiations to acquire a premier, mixed-use commercial campus in Seoul, South Korea, further expanding our global footprint. This premier 5.4-million-square-foot complex comprises three premium-grade office towers, a high-end retail mall and a five-star hotel.

### *Brookfield Infrastructure Group*

Our infrastructure group generated FFO of \$261 million in the quarter, of which our share was \$89 million. Our results have benefitted from solid organic growth across the business and contribution from new investments acquired over the past year. Our increased interest in our U.S. pipeline operations was partially offset by the impact of foreign exchange. Our infrastructure business is entering a period of significant growth from three main sources: organic growth projects that are underway; recently completed transactions that will soon contribute; and, substantial investments being made in the gas and electricity transmission utility sectors in Brazil.

We continue to grow our businesses through organic growth in each of our business lines, with \$2 billion of approved projects currently underway. We expect to complete \$1.5 billion of our current backlog within the next 12 to 18 months. For future growth, we have high visibility on approximately \$2 billion of additional projects that may be added to our backlog in the next 12-24 months.

During the third quarter, we invested \$2.2 billion of equity in three transactions, including an Australian ports business, a North American gas storage business and a Peruvian toll road business. These transactions have meaningfully expanded our transport and energy businesses, and will contribute to a full quarter of operating results beginning in the fourth quarter of this year.

We expect to deploy a significant amount of capital in the build-out of our utility business in Brazil. Over \$5 billion will be invested in the recently announced large-scale gas transmission business and approximately \$1 billion will be invested over the next five years to construct 4,200 km of new electricity transmission lines, including lines awarded within the last two weeks. These assets are attractive, long-life, regulated assets that earn revenues under contractual or availability-based frameworks. We expect to close these transactions either at the end of the year or in early 2017.

### *Brookfield Renewable Group*

Our renewable business generated FFO of \$80 million, of which our share was \$49 million. We continued to experience improved hydrology in Brazil and strong wind conditions at our European wind farms. In North America, new assets, improved inflows at Canadian facilities and higher capacity sales helped to partially offset lower water levels in the U.S. Our assets continue to deliver very high levels of availability and efficiency, and our reservoir levels look good going into the fourth quarter.

We completed the take-private of our 3,000 megawatt Colombian hydroelectric portfolio during the quarter. We also continue to integrate a 296 megawatt hydroelectric portfolio in Pennsylvania, the latest of our acquisitions in the northeastern United States. This portfolio combines high-quality hydro assets, strong cash-on-cash returns in today's low price environment, and significant upside potential as pricing in the U.S. recovers.

In Ireland, we commissioned a 14 megawatt wind farm, and continue to advance two other wind projects totalling 43 megawatts. We acquired a 19 megawatt build-ready project close to one of our existing wind farms and expect to commence construction next year, for completion in early 2018. In Brazil, we continue to advance the construction of 70 megawatts of hydro facilities whose output is fully contracted for 30 years at attractive prices. The first of these is expected to come online in the first quarter of 2017. Several other hydro projects in South America are moving forward through the approvals processes, providing the basis for further organic growth in the coming years.

Low wholesale energy prices in the northeastern U.S. continue to deter large scale investment in the power sector. We remain very well positioned to continue to acquire assets for good value while preserving cash flow upside for eventual increases in power prices. We are also making progress with our energy marketing strategy, pursuing contracting opportunities with various state-level procurements, load-serving entities and corporate buyers.

### *Brookfield Private Equity Group*

Our private equity operations generated FFO of \$117 million in the quarter, of which our share was \$107 million. Our housing-related investments continued to benefit from a strong North American housing market and higher OSB pricing. Within our residential development operations, our U.S. business was positively impacted by increased consumer confidence, job growth and limited supply, while unfavourable market conditions persisted in Alberta as a result of depressed energy prices. In Brazil, we continue to right-size our operations and position them for a recovery in the markets.

Our business services operations showed strong performance as our facilities management business benefitted from continued global expansion, both organic and through acquisition activity. Our

construction services backlog is strong and we expect this backlog to grow over the balance of the year given advanced negotiations on several new projects. Geographic and sector diversification across our workbook is one of our primary goals and our focus remains on our key clients.

Notwithstanding the impact of the current low commodity pricing environment on our energy operations, we have seen gradual pricing improvement through the quarter and were able to favorably monetize a portion of securities acquired in several energy and industrial operations that had been acquired earlier this year. Our energy business in Western Australia remains largely insulated from commodity price volatility due to its large hedge position for oil and customer contracts for gas.

We recently entered into a definitive agreement to acquire a 70% controlling stake in Odebrecht Ambiental, Brazil's largest private water distribution, collection and treatment company (it delivers clean water and removes sewage from homes and business customers) for approximately \$900 million. This represents an exciting opportunity to invest in a water services platform in an emerging market with leading scale and strong growth potential. We continue to focus on targeting high quality businesses for acquisition, and Brookfield Business Partners provides us with enhanced flexibility to invest in multiple industries in a variety of forms, further strengthening our private equity operations.

## **Closing**

We remain committed to being a world-class alternative asset manager, and investing capital for you and our investment partners in high-quality, simple to understand assets that 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.



J. Bruce Flatt  
*Chief Executive Officer*

November 11, 2016