AEW RESEARCH

2018 EUROPEAN PROPERTY MARKET OUTLOOK

FUNDAMENTALS DRIVING FEARS AWAY

FOCUSED ON THE FUTURE OF REAL ESTATE

AEW EUROPEAN PROPERTY OUTLOOK

Rob Wilkinson,

European Chief Executive Officer

"We are delighted to share with you our first European Property Market Outlook for 2018. At AEW we are supported by a global in-house research capability which is fully integrated at every level of the decision making process. The role of the research team is critical in designing and implementing the right strategies and ultimately delivering performance for our investors in these uncertain times and challenging market conditions.

In this report we have provided an overview of current market conditions and have updated our market scoring analysis using our in-house forecasts. We highlight the strategies that we believe will deliver outperformance over the medium term based on this market scoring. We have also considered the likely impact of market changes such as the growth of on-line retail as well as analyzing the current state of the debt markets in Europe.

I hope that you will find this European Property Market Outlook interesting and we look forward to continuing to identify new investment opportunities for our investors. We wish you all a successful 2018."

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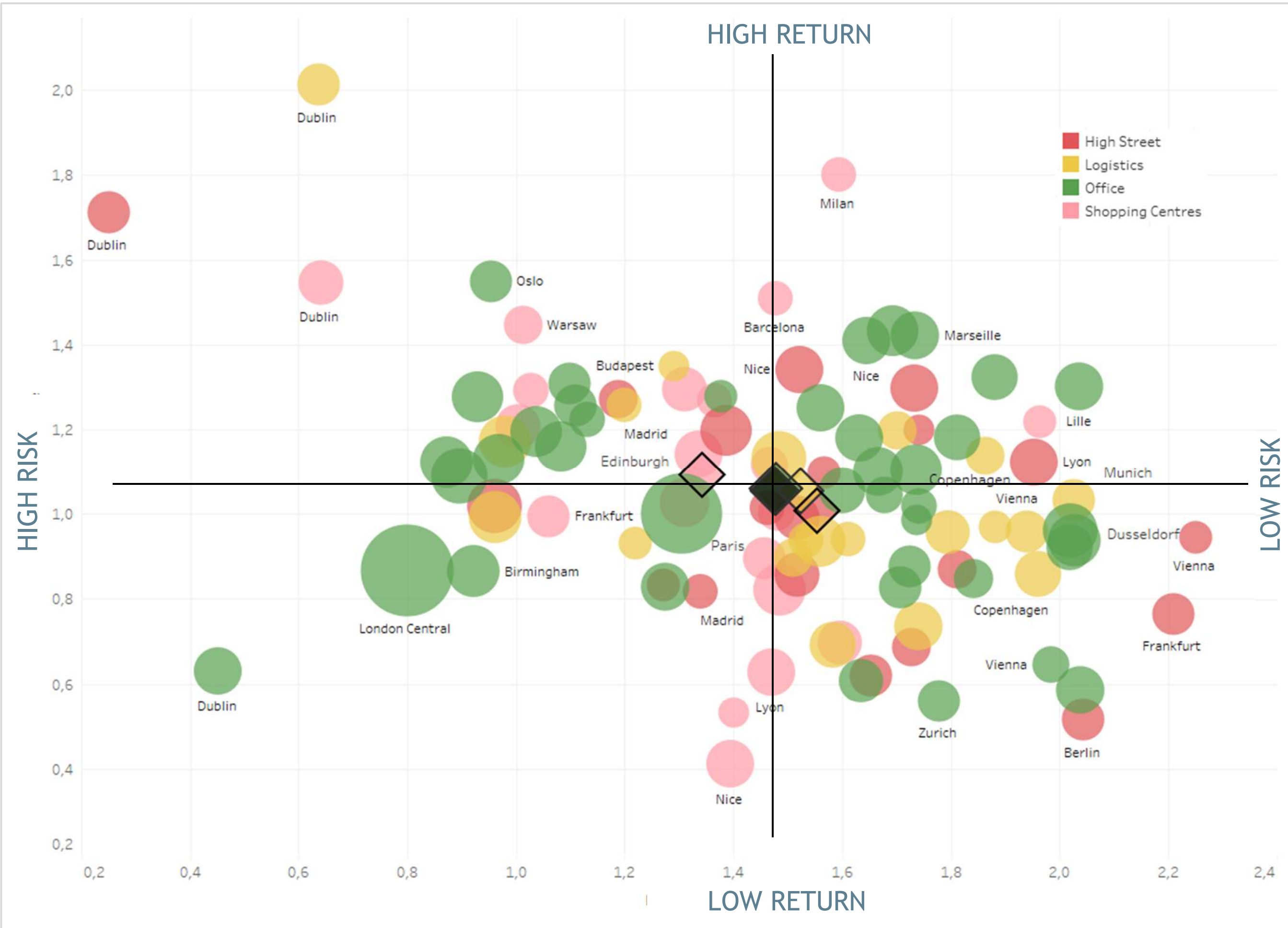
EXECUTIVE SUMMARY: FUNDAMENTALS DRIVING FEARS AWAY

- With recent political uncertainty and the prolonged unwind of the GFC, focus remains on downside risks
- Our outlook shows robust economic fundamentals are driving occupier and investment markets in a positive direction over the next 2-5 years, with little risk on new supply, rising interest rates and leverage
- Occupier markets are showing better market rental growth as new supply remains modest and net absorption steps up with improving consumer spending and employment growth. E-commerce is a key driver for both the bifurcation in the retail markets and the new record take-up across logistics.
- With the recovery in capital values and tightening of yields across the most liquid core investment markets, investors should consider adjusting their focus for the medium term to:
    - Consider a broader range of European markets, as implied by our market scoring
    - Focus on income returns, as marginal yield widening and limited upside in capital value is projected
    - Given the low systematic market risks at the moment, expand into value creation assets

RISK & RETURN SCORE (BUBBLE SIZE REPRESENTS LIQUIDITY SCORE)



Source: AEW

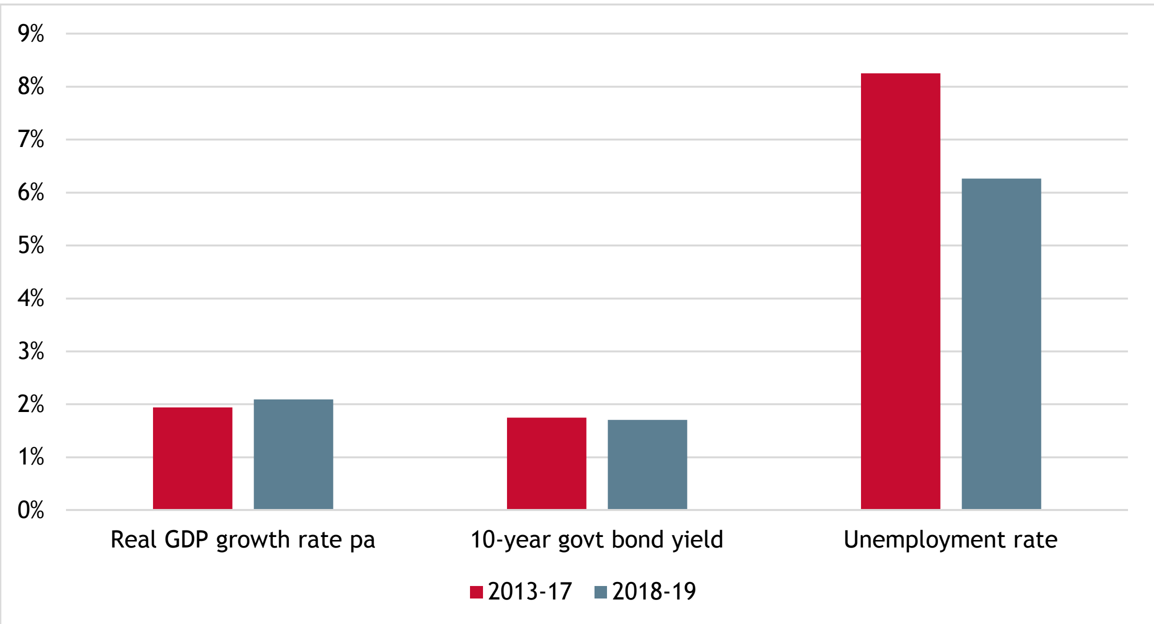
MARKET SCORING BASED ON IN-HOUSE AEW FORECASTS

- Our market scoring is re-launched based on our new AEW in-house forecasts. Our coverage universe includes 40 office, 20 high street retail, 20 shopping centre and 20 logistics markets across 18 countries. Each market is scored on four equal-weighted key criteria.
- Both sector-specific and common economic demand drivers are used, as illustrated in the Economic Criteria table. For high street retail and shopping centres the same drivers apply.
- In the medium term, GDP, bond yields and unemployment all show a positive trend over the next two years across the 18 countries making up our market universe.
- This ongoing economic recovery together with low bond yields and declining unemployment should take away most of the remaining concerns of real estate investors.

SCORING KEY CRITERIA	WEIGHT
Economics -- Each property type different city-level economic drivers	25%
Liquidity -- Last 5 years volume per market & JLL Transparency Index	25%
Risk -- Standard deviation, maximum drawdown and Sharpe ratio	25%
Return -- Forecast rental growth, income & capital return for next 5 years	25%

ECONOMIC CRITERIA	OFFICE	RETAIL	LOGISTICS
10y bond yield	3%	3%	3%
National real GDP growth	2%	2%	2%
GVA - Manufacturing	-	-	3%
GVA - Trade	-	8%	5%
GVA - Transportation & storage	-	-	5%
Employment - ITC	4%	-	-
Employment - Finance & Insurance	4%	-	-
Employment - Real Estate	4%	-	-
Employment - Admin & support	4%	-	-
Unemployment	4%	4%	4%
Retail Spending	-	8%	3%

KEY ECONOMIC DRIVERS ACROSS 18 COUNTRY UNIVERSE (2013-17 VS 2018-19)

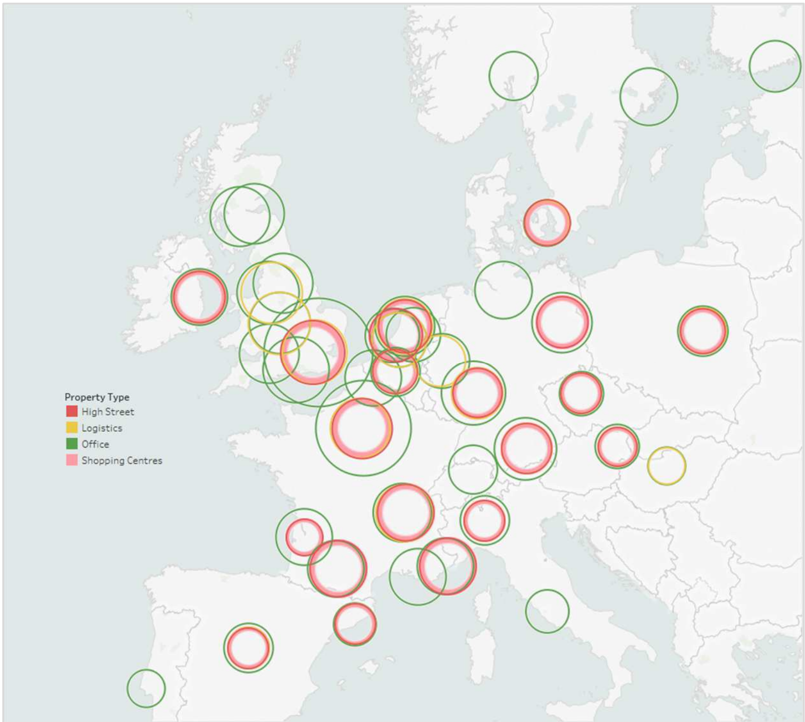


Source: AEW & Oxford Economics

MARKET SCORING

- Liquidity scores (like return and risk scores) are mapped in concentric rings per market per property type with high street retail in red, logistics in yellow, office in green and shopping centres in pink.
- London and Paris offices are the most liquid across our European universe.
- Retail and logistics lead in regards of the economics scores. Prague retail and Warsaw logistics scores stand out. Warsaw's transportation & storage share is near double the European average.
- Office markets with strong economic drivers include some secondary markets in the UK and France as well as larger markets in the Nordics, Ireland and CEE.

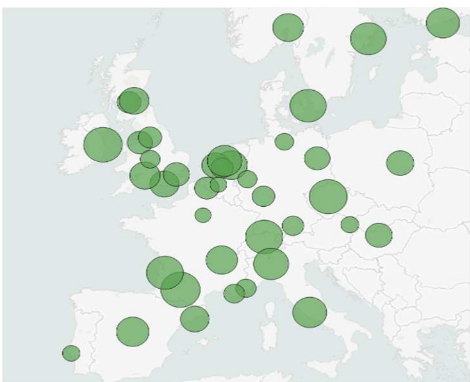
LIQUIDITY SCORE



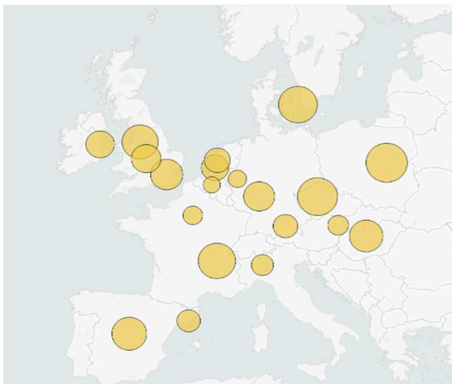
Source: AEW, JLL & RCA

RETAIL MARKET ECONOMIC SCORES

OFFICE MARKET ECONOMIC SCORES



LOGISTICS MARKET ECONOMIC SCORES

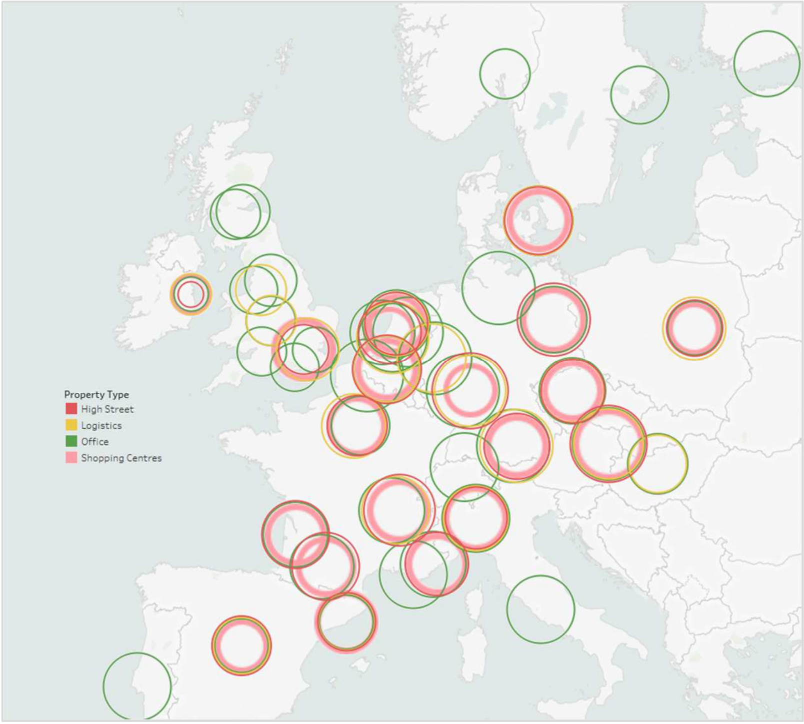


Source: AEW & Oxford Economics

MARKET SCORING

- In reviewing these results, please note: The bigger the ring, the better the risk score (i.e. the lower the risk).
- Most secondary markets in Germany, France, Benelux and even CEE score well on risk due to lower volatility.
- Dublin, Spain and most UK markets have worse risk scores, due to their deep downturns in the previous cycle.
- In most locations, the shopping centre ring is inside the others implying a lower risk score.

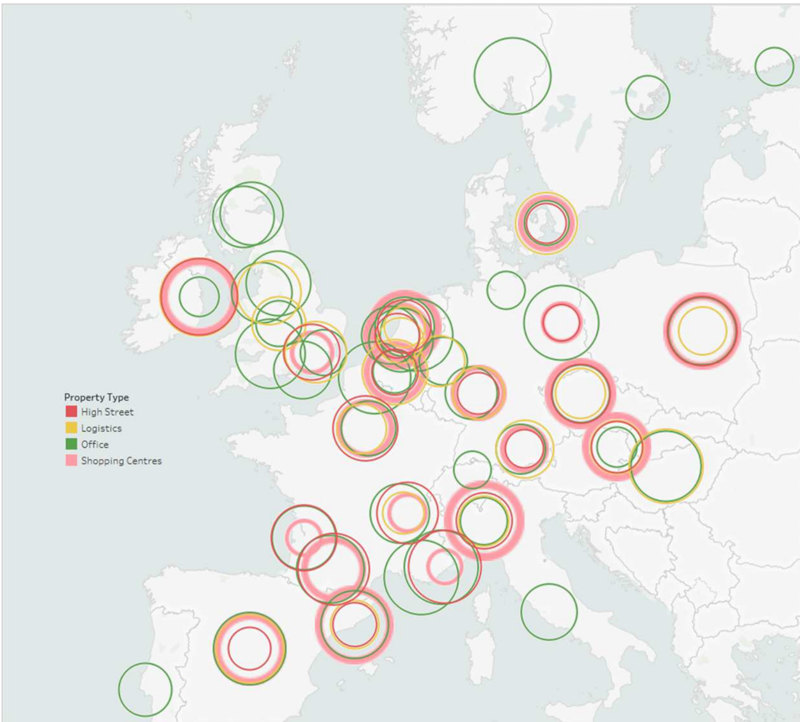
RISK SCORE



Sources: AEW & CBRE

- Returns results are more mixed, with less clear patterns. Return scores are driven not only by economic driven demand but also by existing and new supply.
- In offices, Spain, the Netherlands, Hungary and secondary French markets have above average return scores.
- In retail, Prague, Dublin, Nice and Warsaw are benefitting from a robust economic environment.
- In logistics, Madrid, Dublin and Budapest show great growth potential for the next five years.

RETURN SCORE



Sources: AEW & CBRE

22 MARKET SEGMENTS SHOW ABOVE AVERAGE RISK & RETURN PROFILE

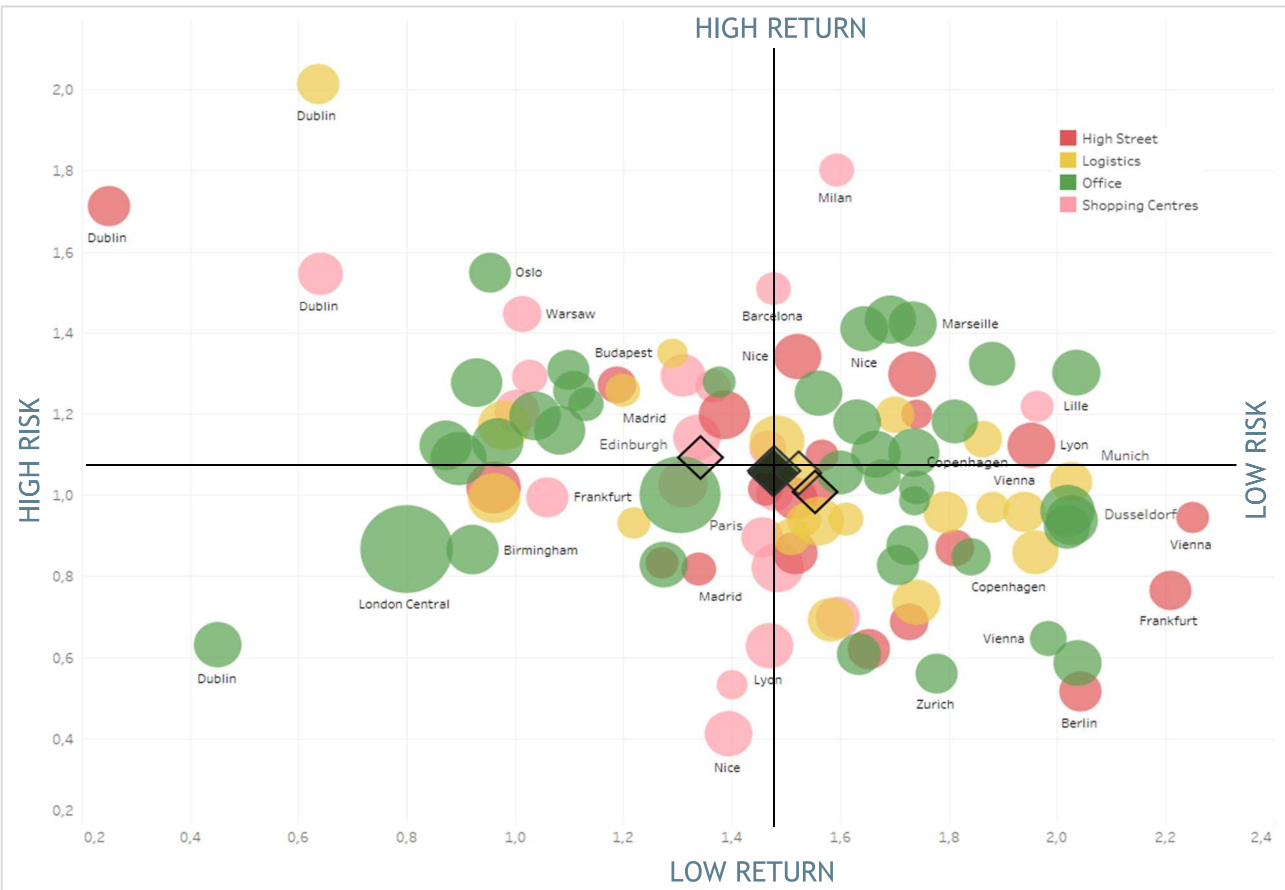
We focus on the upper right quadrant (low risk – high return) to identify the most attractive markets.

- Offices show a marginally better average risk-return profile than the average for logistics and high street retail. Shopping centres have a better return score, but a lower average risk score.
- 11 of 40 office markets have a better risk and return profile than the overall universe average.
- 3 of 20 logistics markets are in the same attractive quadrant.
- 8 of 40 combined high street retail (20) and shopping centre markets (20) meet the same criteria.
- 9 of 19 French markets are in the attractive upper right quadrant, but Paris offices are not.
- 1 of 14 German markets have this distinction, although 12 of 14 have above average risk scores.
- 1 of the 13 UK markets covered (including London offices) show both above average risk and return scores, but 8 of 13 UK markets do have above average return scores despite Brexit.

These results are generally consistent with those from previous quarters, which also showed smaller regional markets as more attractive given that pricing for some of the major gateway markets has moved up. In our new methodology, we incorporate market rental growth explicitly in the return score, which favours lower yielding but higher rental growth markets. High yielding logistics with more modest rental growth are coming out less positive than before.

However, we should bear in mind that an optimal portfolio allocation is not only determined by risk and return. The correlation between different markets also plays a major role. In this respect, we point out the below average correlation of retail markets compared to other property types. Finally, the performance of individual assets inside these markets is very likely to differ more widely than the market averages between these markets. This makes careful stock selection essential to producing benchmark beating performance.

RISK & RETURN SCORE (BUBBLE SIZE REPRESENTS LIQUIDITY SCORE)

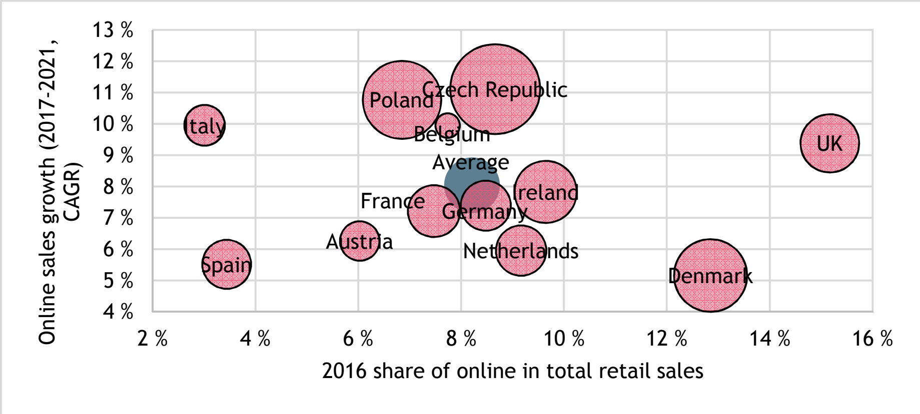


Source: AEW & RCA

OCCUPIER MARKET OVERVIEW: HIGH STREET RETAIL & SHOPPING CENTRES

- E-commerce (i.e. on-line retail) is one of the most significant changes in consumer behaviour.
- Near double-digit growth in on-line sales is projected in Europe, with Poland and Czech Republic lead by strong economic scores.
- UK's high share and above average growth should keep it in the lead. We also note that Italy is expected to beat Spain going forward.

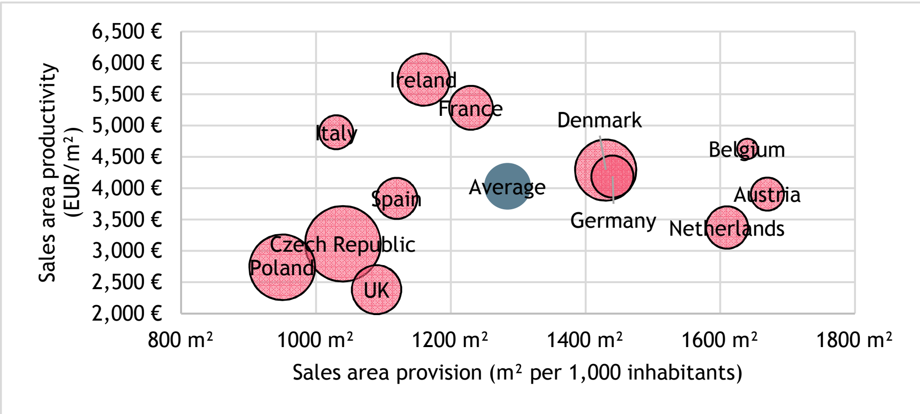
STRONG GROWTH IN ON-LINE SALES FORECAST



Sources: AEW and CBRE

- CEE and to a lesser extent the UK show good potential for in-store retail prospects, as they have below average existing retail space per capita and sales per sqm.
- More modest upside potential is seen for Benelux, Austria, Germany and Denmark.
- However, compared to the U.S. the impact of on-line sales on in-store sales should be more limited.

IN-STORE RETAIL SALES RELATIVE TO STOCK



Sources: AEW, GfK and Oxford Economics

- Retail rental growth at 2% p.a. for next five years on average.
- Dublin high street rents stand out at 6% p.a., while Spanish and Italian shopping centres are forecast at 4-5% p.a.
- Some regional French shopping centre market rents are showing no rental growth.

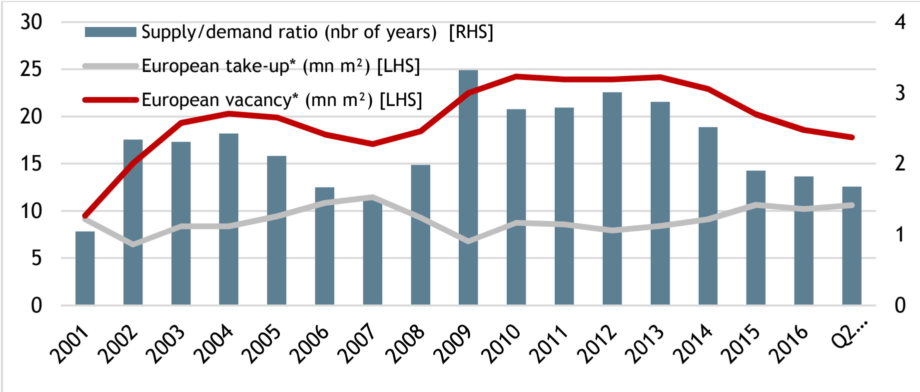
RENTAL FORECAST ACROSS RETAIL MARKETS (2018-2022, p.a.)

Source: AEW and CBRE

OCCUPIER MARKET OVERVIEW: OFFICE

- The ratio of available space over annual take-up has nearly halved from 3.3 to 1.7 years between 2009 and mid-year 2017.
- Even as tech replaces finance as the main driver for take-up, it has stepped up only slowly. Change is coming more from a decline in supply. This can be linked to the lack of debt finance for speculative development.

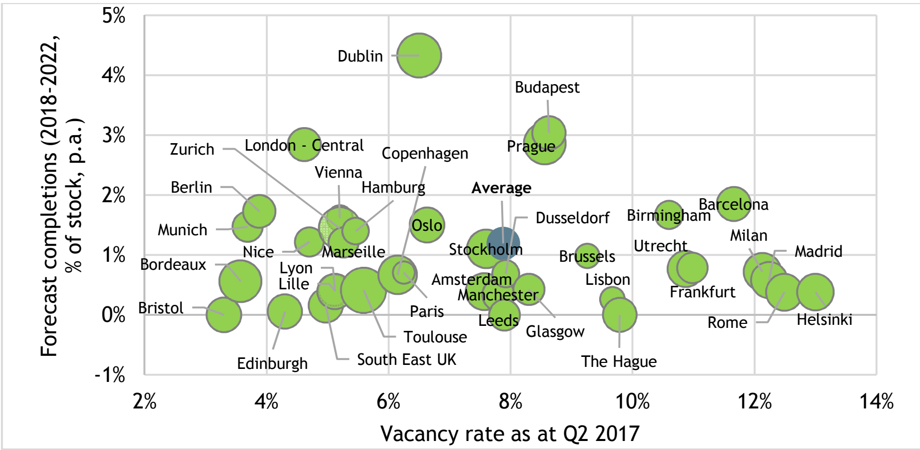
TAKE-UP, VACANCY AND SUPPLY VS DEMAND RATIO



Sources: AEW & CBRE

- Across our office market universe, we project new annual supply equal to just 1.2% of existing stock over the next three years.
- CEE markets, like Warsaw, have high new supply.
- Most French and German markets are forecasted at below average new supply in the next 3 years.

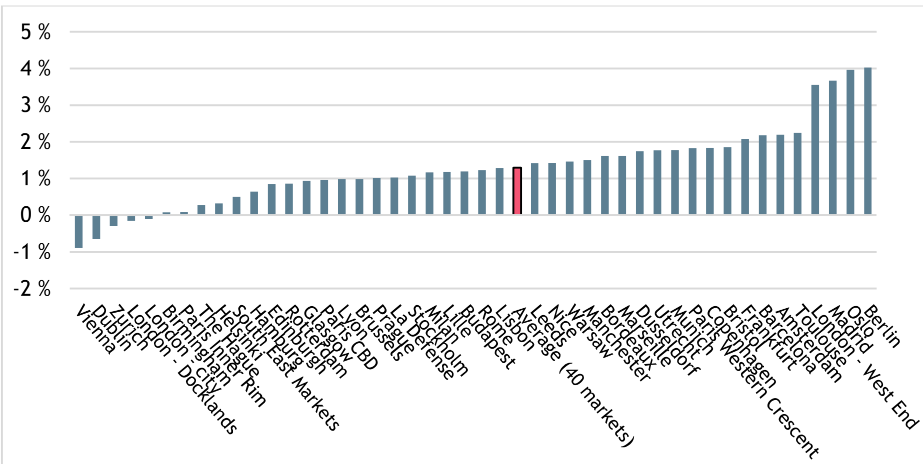
NEW SUPPLY AS % OF STOCK (2018-20)



Sources: AEW & CBRE

- Prime office rental growth is forecasted at 1.3% p.a. for next five years on average.
- Berlin, Oslo, Madrid and London West End rents to be at 3.5-4% p.a. level.
- Vienna, Dublin, Zurich, London Docklands and London City are forecasted to have flat or small declines in prime office rents over the 2018-22 period.

RENTAL FORECAST ACROSS OFFICE MARKETS (2018-2022, p.a.)

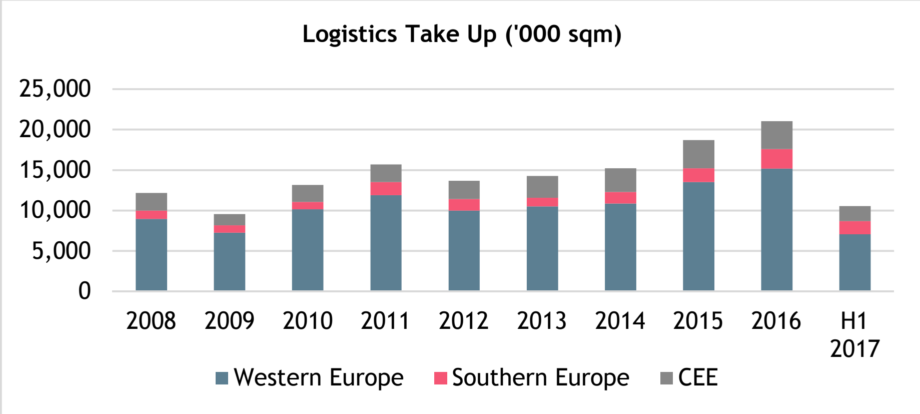


Sources: AEW & CBRE

OCCUPIER MARKET OVERVIEW: LOGISTICS

- The structural shift from in-store to on-line consumer spending has driven up take up by e-commerce and third party logistics providers.
- Based on year-to-date figures, we expect 2017 to be another record year in logistics take up.
- CEE and Southern Europe are making up a larger share of this.

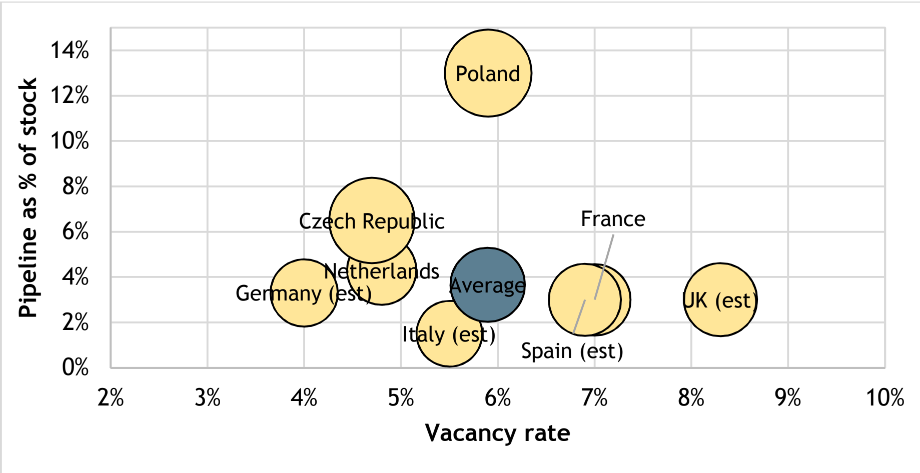
GROSS TAKE-UP 2008-17



Sources: AEW & CBRE

- Apart from Poland and Czech Republic, pipelines of new supply are modest.
- Germany has the lowest logistics vacancy rate combined with a modest pipeline of new space.
- The high vacancy in UK will be offset by above average economic growth, which should boost demand.

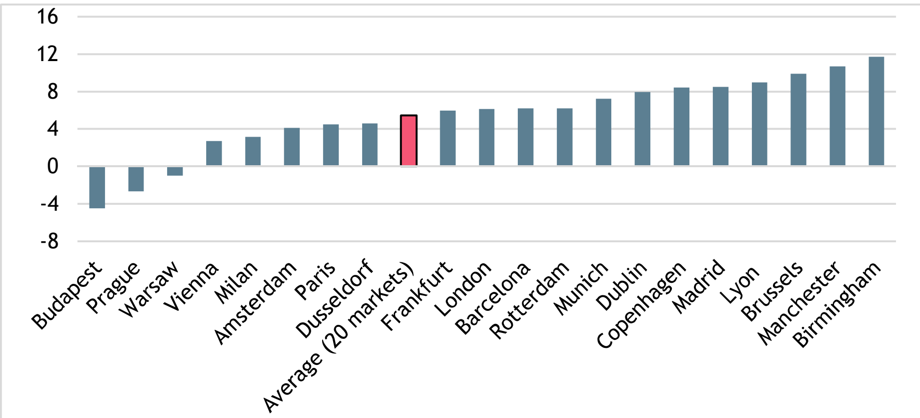
NEW SUPPLY AS % OF STOCK



Sources: AEW & CBRE

- Prime logistics rental growth is forecast at 1.1% p.a. for the next five years on average.
- Timing of these increases is crucial as the UK markets show strong growth only later in the forecast period. Dublin is showing strong growth in 2018.
- Most CEE markets are forecasted to have small declines in logistics rents over the 2018-22 period.

RENTAL FORECAST ACROSS LOGISTICS MARKETS (2018-22, cum)

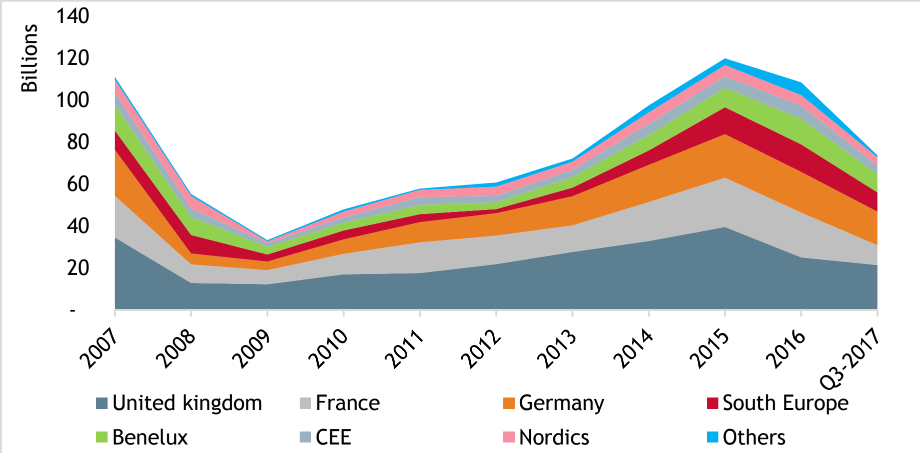


Sources: AEW & CBRE

INVESTMENT MARKET OVERVIEW: TRANSACTION VOLUMES

- As we consider liquidity in our scoring, we look at historical real estate investment volumes.
- The 2016 decline in volumes was mostly driven by political uncertainties related to Brexit and the French elections. Ex-UK volumes were up from 2015.
- Based on pending deals, we expect 2017 to be on par with 2016, with UK and logistics volumes driven by a small number of very large deals (i.e. Logicor deal).

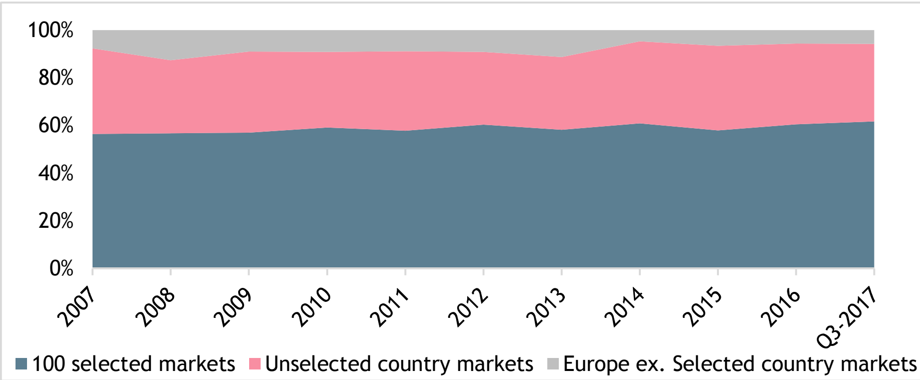
TRANSACTION VOLUMES PER COUNTRY & SUB-REGION



Sources: AEW & RCA

- The 100 market segments included in our universe makes up near 60% of the total investment transaction in Europe.
- Transactions outside our market universe but inside the 18 countries make up close to 35% of the entire European transaction volumes.
- This data confirms the relevance of our universe selection!

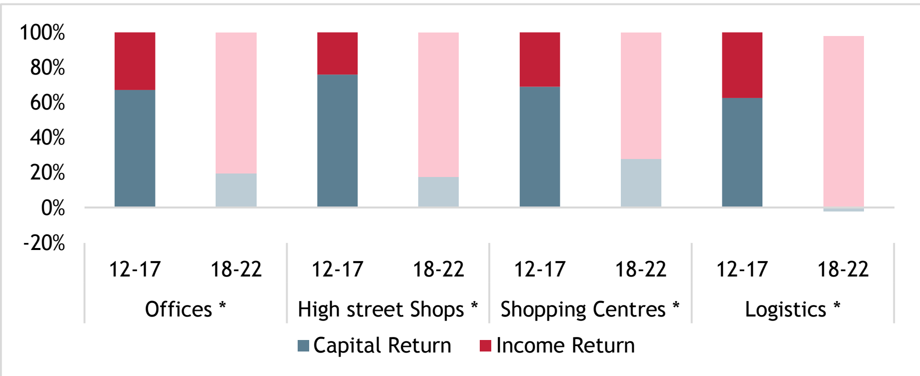
100 MARKET UNIVERSE COVERS NEAR 60% OF VOLUME



Sources: AEW & RCA

- Given the strong recovery of capital values since the onset of the GFC, we expect a shift in returns. Over the past five years, investors realised more than half of their total return from capital growth.
- Given the current yield levels and outlook, we expect that income will make up the majority of total returns in the next five years.

RETURNS DRIVEN BY BOTH CAPITAL VALUES & INCOME

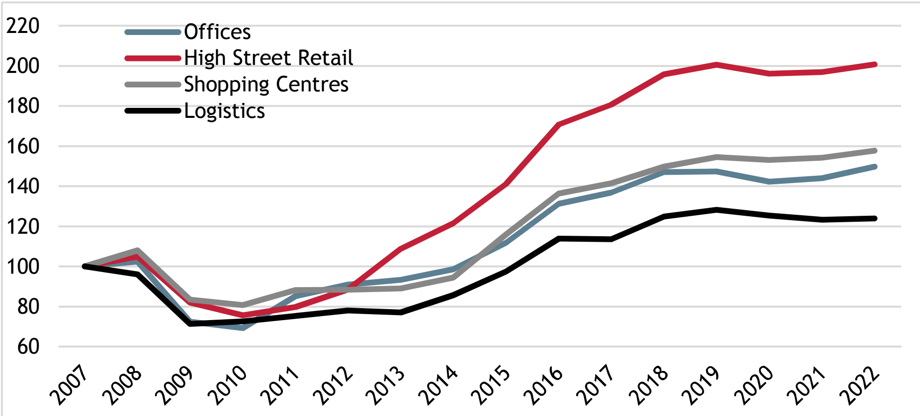


Sources: AEW & RCA

INVESTMENT MARKET OVERVIEW: CAPITAL VALUES

- E-commerce forces a bifurcation or polarisation with prime high street retail showing the strongest recovery in capital values.
- Shopping centre capital values have recovered quicker than office and logistics.
- For the next five years, we project a near 3% cumulative capital value increase on average.

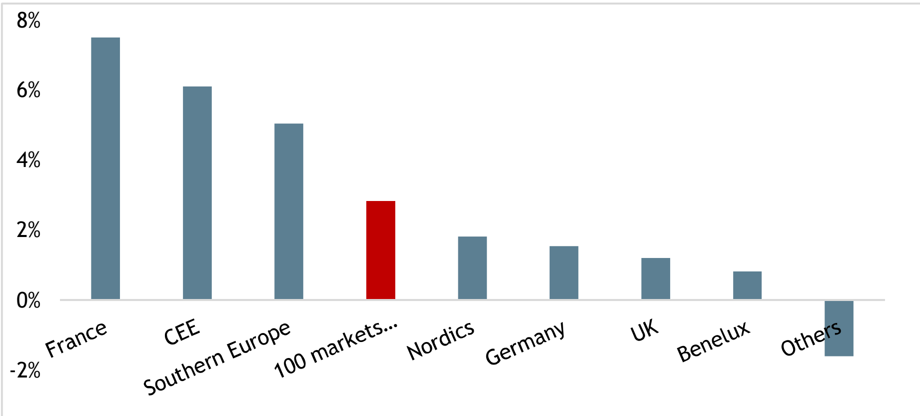
CAPITAL GROWTH PER PROPERTY TYPE (INDEX 2007=100)



Sources: AEW & CBRE

- The French markets are predicted to show the strongest increase in capital values to 2022.
- CEE and Southern European markets also show above average capital value growth.
- In fact, only a few markets are forecast to see a decline in capital values in the next five years.

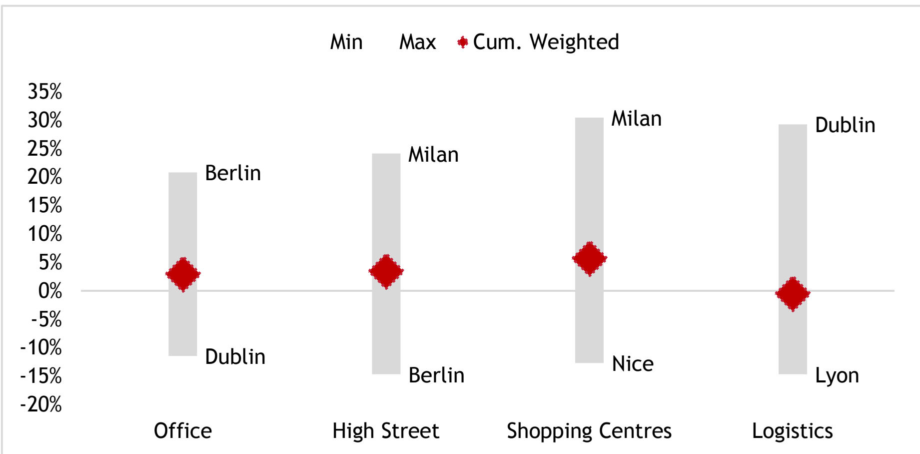
CUMULATIVE CAPITAL VALUE PER COUNTRY 2018-22



Sources: AEW & CBRE

- Shopping centres surprise with Milan as the highest single market and the broadest range in values.
- Across the 40 office markets we see the narrowest range of capital value changes and worst decliner (Dublin)
- This is offset by Dublin being the best logistics market. Lyon suffers from a sharper outward shift in yields in the forecast period.

CUMULATIVE CAPITAL GROWTH ACROSS MARKETS 2018-22

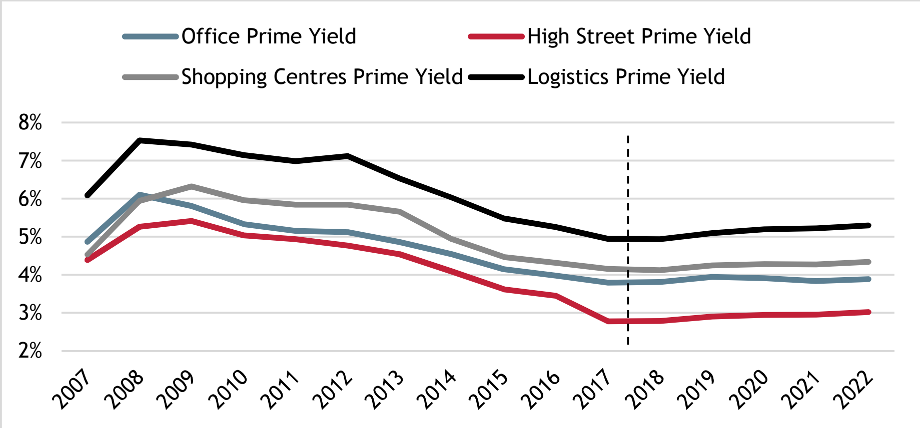


Sources: AEW & CBRE

INVESTMENT MARKET OVERVIEW: PROPERTY YIELDS

- Investors have seen a long period of consistently tightening property yields across property types.
- In 2017, some initial widening in Central London office and other select markets was noted.
- Over the next five years, we project a 25-50 bp widening in average prime yields across all sectors.

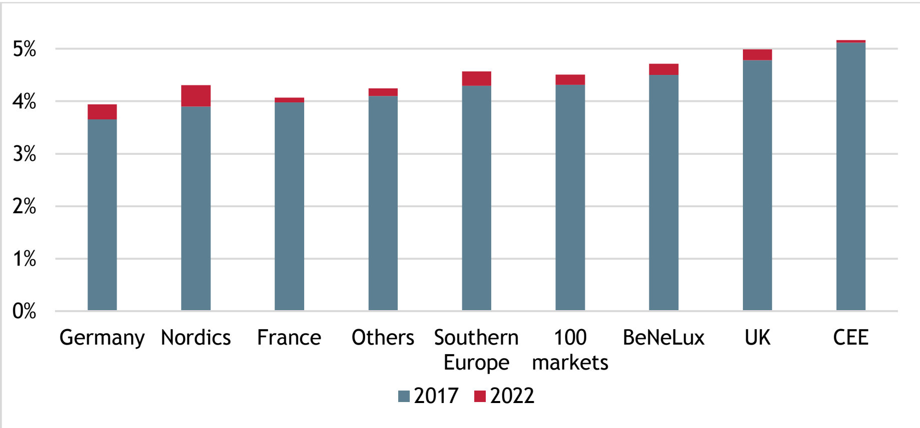
INITIAL PRIME YIELDS PER PROPERTY TYPE



Sources: AEW & CBRE

- Given where government bond yields are heading over the next five years, we project consistent yield widening across all property markets and countries.
- But, the extent of the property yield widening is limited as cross-asset investors continue to see relative value. We will expand on this in the final section.

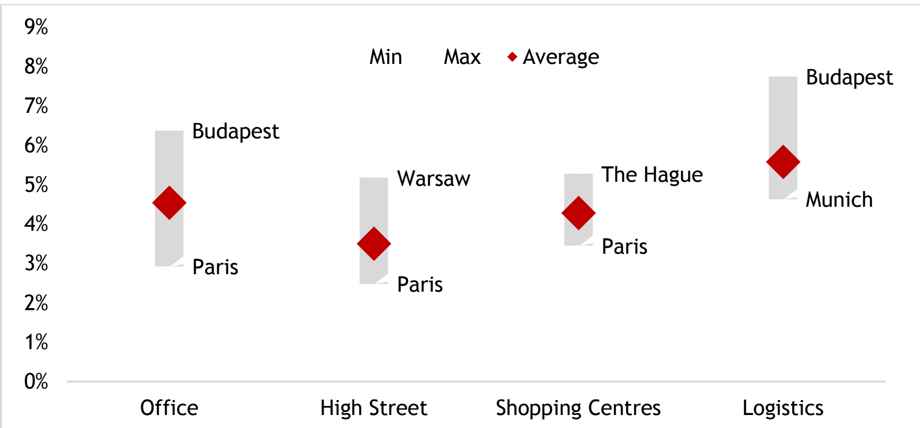
INITIAL PRIME YIELDS PER COUNTRY (2Q17 vs 2022)



Sources: AEW & CBRE

- Paris is projected to have the tightest 2022 yields across all property types, except logistics.
- Budapest and Warsaw are expected to retain the highest yields across our 100 market universe by 2022 in office and logistics, and high street retail respectively.

HIGHEST AND LOWEST INITIAL YIELDS MARKETS (2022)

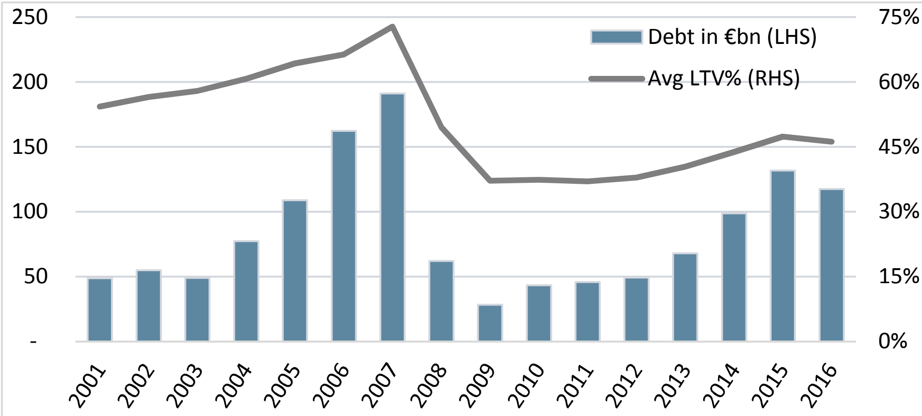


Source: AEW

DEBT MARKET OVERVIEW

- European banks reduced new CRE lending origination in 2016 by 11%.
- Eurozone banks continue to reduce their CRE exposure as they sell non-core loans to meet stricter capital & risk regulations.
- Insurers and non-bank lenders have picked up market share, but cannot replace banks entirely.
- Below 50% market-wide LTVs limit the systematic risk of leverage.

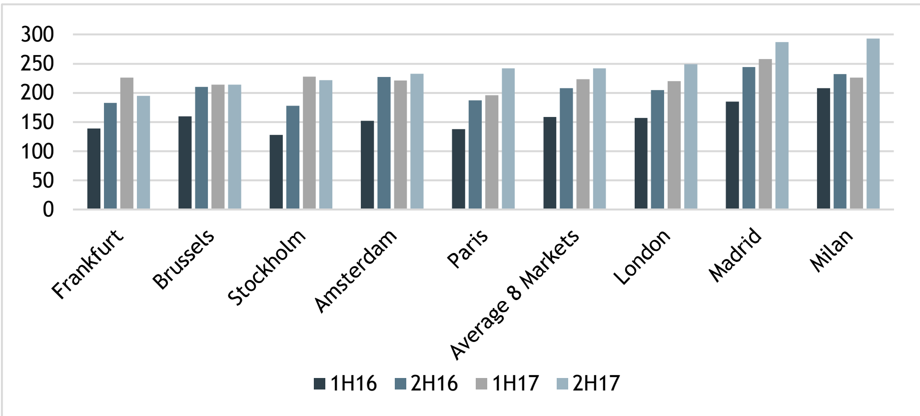
LENDING VOLUME AND AVERAGE LTVs ACROSS EUROPE



Sources: AEW & CBRE

- Average loan margin across eight key markets has increased by 35% over the last 18 months.
- Due to high degree of non-core loan exposure in the Italian and Spanish banks, margins remain highest there.
- Due to Brexit, London margins were up by nearly 40%.
- Frankfurt and Stockholm showed a small margin decline in the most recent period.

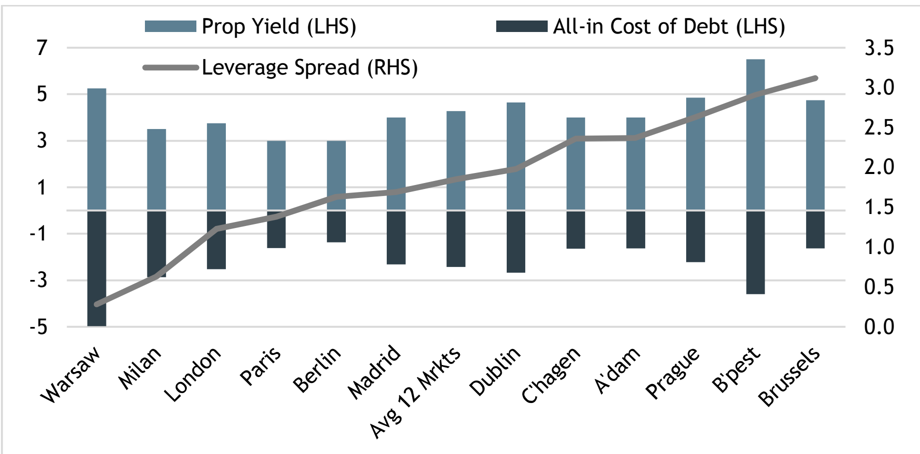
LOAN MARGINS WIDEN 35% OVER LAST TWO YEARS



Sources: AEW and C&W

- Investors achieve a positive 185bp spread between the all-in cost of debt and the property yields.
- As 5-year swap rates remain low, they offset wider margins.
- Range of available leverage yield spreads varies from 28bp in Warsaw to Brussels' 312bp.
- Even at moderate LTV levels, investors can enhance their equity returns in the current rate environment.

POSITIVE SPREAD OF YIELDS OVER ALL-IN DEBT COSTS

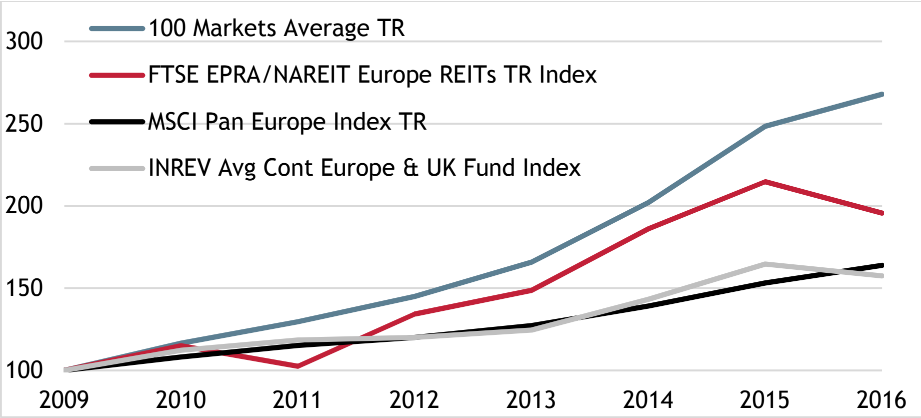


Sources: AEW, Bloomberg & CBRE

RELATIVE VALUE ANALYSIS

- If we step back from local market and sector detail, we look at the most widely used property indices.
- The gross return on our universe beats all other indices. But, this is before transaction costs, fees or taxes are taken into account.
- The upward trend from 2013-15, did consistently come down in 2016 across all indices, except MSCI.

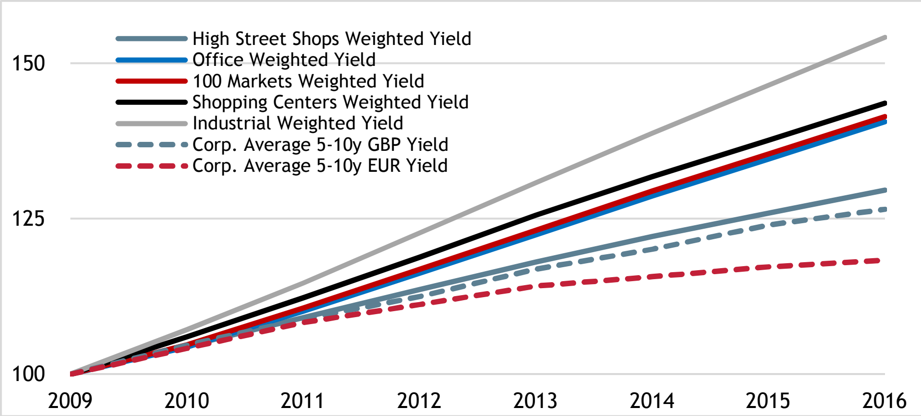
EUROPEAN REAL ESTATE INDICES COMPARED



Sources: AEW, FTSE, INREV & MSCI

- For fixed-income investors, we show the historical yields for BBB corporate bonds and each of the main property types indexed from 2009.
- Logistics yields in particular have become more attractive over the period.
- Based on our property sector yield forecasts, we do not expect a change in the yield ranking across sectors.

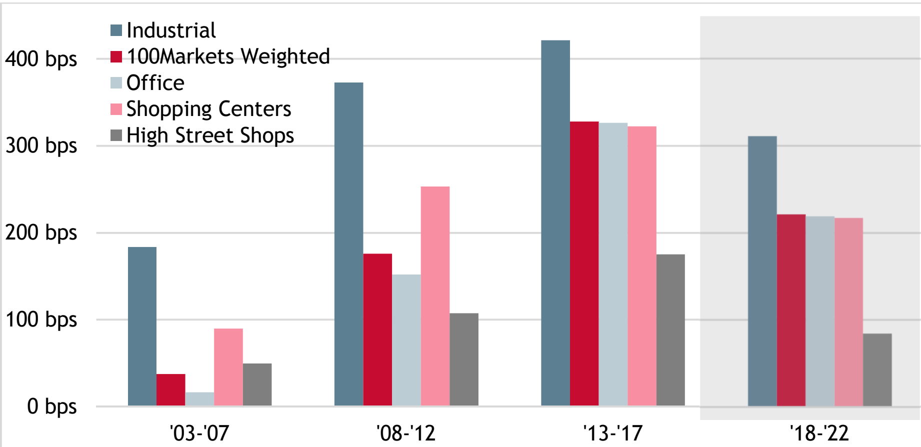
PROPERTY TYPE AND CORPORATE BOND YIELDS COMPARED



Sources: AEW & Bloomberg

- The relative value outlook for European real estate for the next five years is positive.
- This is based on the yield premiums available across our property sectors over government bond yield forecasts.
- Even though not quite as strong as the last five years, this yield premium still beats the previous 5-year periods before and after the global financial crisis.

PROPERTY TYPE YIELD PREMIUM OVER GOVERNMENT BONDS



Sources: AEW & Oxford Economics

ABOUT AEW

AEW is one of the world's largest real estate asset managers, with €57.7bn of assets under management as at 30 September 2017. AEW has over 600 employees, with its main offices located in Boston, London, Paris and Hong Kong and offers a wide range of real estate investment products including comingled funds, separate accounts and securities mandates across the full spectrum of investment strategies. AEW represents the real estate asset management platform of Natixis Global Asset Management, one of the largest asset managers in the world.

As at 30 September 2017, AEW managed €26.6bn of real estate assets in Europe on behalf of a number of funds and separate accounts. AEW has close to 400 employees based in 10 offices across Europe and has a long track record of successfully implementing core, value-add and opportunistic investment strategies on behalf of its clients. In the last six years, AEW has invested and divested a total volume of over €17.5bn of real estate across European markets.

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