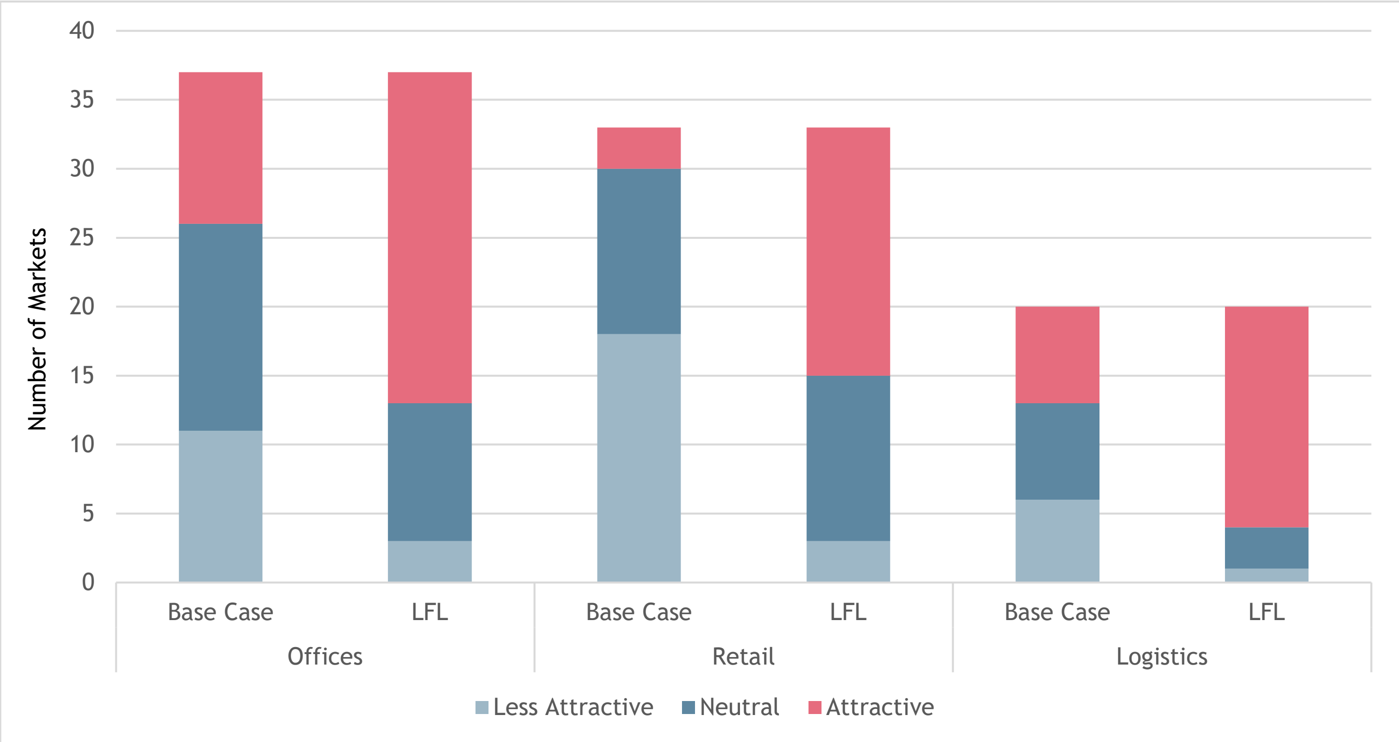
EUROPEAN RESEARCH MONTHLY UPDATE

JANUARY 2019

LOWER-FOR-LONGER SCENARIO POSITIVE FOR PROPERTY INVESTORS

- Over the last six months Eurozone macro-economic growth has slowed and GDP growth forecasts for 2020 and 2021 are also trending downwards.
- On the back of this changing macro-economic outlook, continued political uncertainty around Brexit and disappointing corporate earnings, most European government bond yields have come down over the last six months.
- In addition, current swap market pricing implies that government bond yields will stay lower for longer and not widen as much over the next five years compared to our base case forecasts.
- Based on these recent economic and market trends, we consider a lower-for-longer (LFL) scenario, where we assume that property yields widen in-line with current swap pricing, albeit 41% less quickly than our base case.
- There are two main results. First, with lower spot bond yields, the required rate of returns have come down for both the base case and LFL scenario, using our required and expected rate of return framework as outlined in our Annual Outlook 2019.
- Second, in our LFL scenario 58 of 90 markets are now rated attractive compared to 21 in our base case. This is due to the fact that in the LFL scenario rental growth more easily offsets slower property yield widening compared to the base case.

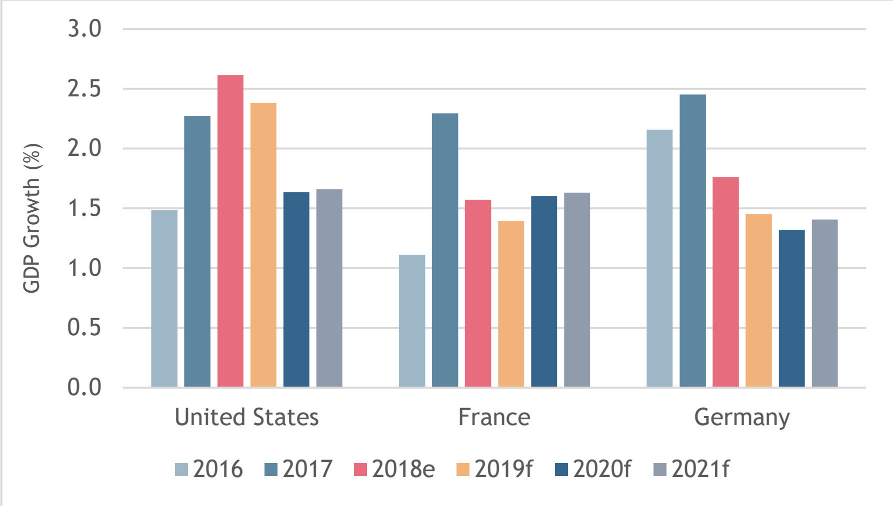
LOWER FOR LONGER SCENARIO SHIFTS MANY MARKETS INTO ATTRACTIVE CATEGORY



Sources: CBRE, RCA, MSCI, Natixis & AEW

BOTH EURO AREA AND US GDP GROWTH PROJECTIONS TO SLOW IN THE NEXT YEARS

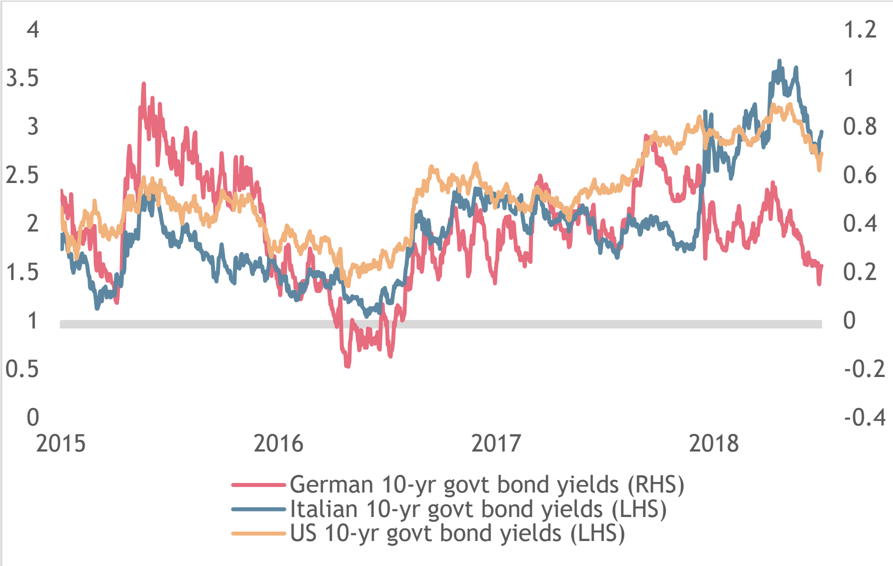
- Since mid-year 2018, actual GDP growth in the leading economies of the US, Germany and France has come in below expectations as the slowdown has been more pronounced with continuing political uncertainty on many levels.
- The long term GDP growth forecasts for 2021 show a modest recovery.
- The silver lining for the two leading Eurozone economies growth forecasts coming down to around 1.5% for 2021, is that it reduces inflationary pressures.



Sources: Natixis & AEW

GOVERNMENT BOND YIELDS HAVE TIGHTENED ACROSS EUROPE SINCE Q3 2018

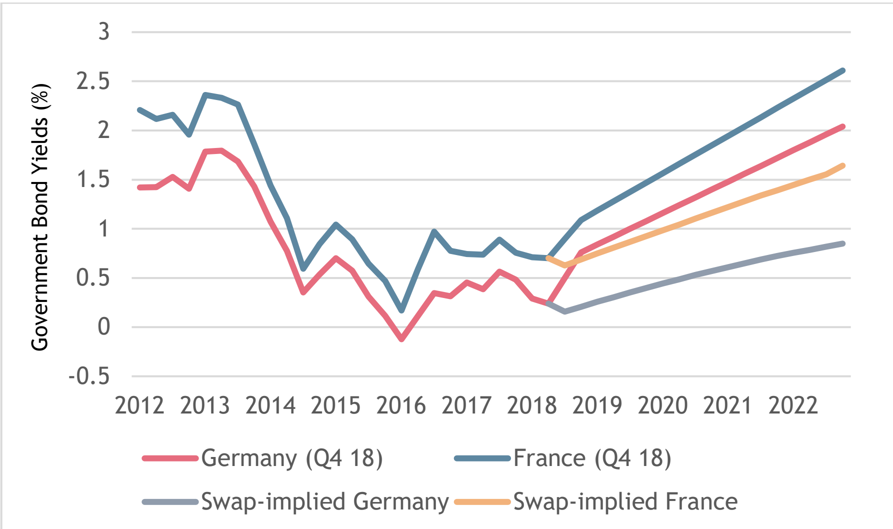
- In response to the macro-economic slowdown and continued political uncertainties, bond yields have come down as investors increased allocations to low risk investments.
- Despite the long term upward trend since 2015, we note a decline over the last six months in both US and Italian yields.
- German bond yields have also come down after normalising in early 2018.
- With central banks now less concerned about inflation, they are focused more on maintaining the growth momentum.
- Rate hikes are expected to be less likely in the short term.



Sources: Bloomberg & AEW

SWAP MARKETS ALSO PRICE GOVERNMENT BOND YIELDS TO STAY LOWER FOR LONGER

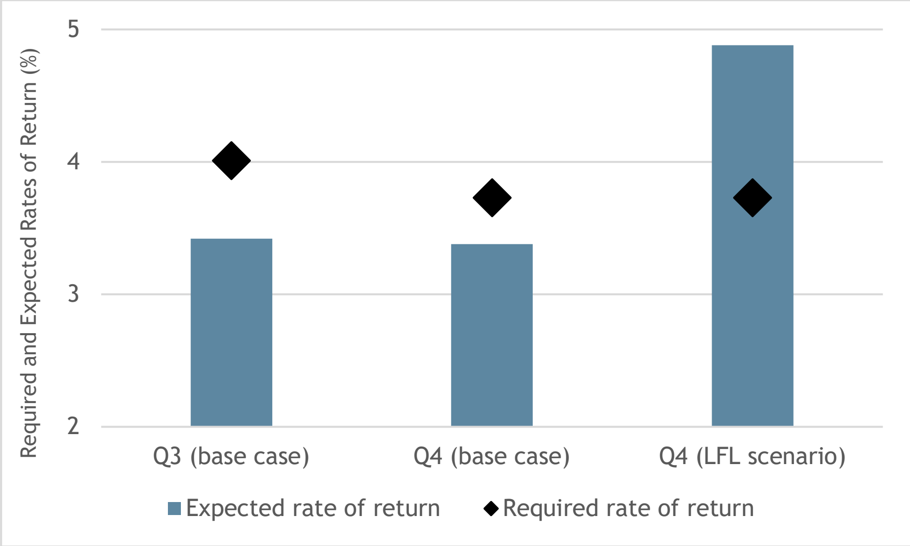
- The swap market is showing a strong price signal of expecting 10-year bond yields to stay lower-for-longer (LFL).
- JCRA calculations based on swap prices show French bond yield widening by 95 bps compared to Natixis forecast of 190 bps to Q2 2023 (Germany 60bps vs 180bps).
- This provides justification to consider a scenario where not only government bond yields, but also property yields remain lower for longer.
- For this LFL scenario, we apply the same (41%) differential between implied-swap pricing and Natixis 10-year government bond yield forecasts to our base case property yields.



Sources: Bloomberg, JCRA & AEW

LOWER FOR LONGER YIELD SCENARIO LEADS TO HIGHER EXPECTED RATE OF RETURNS

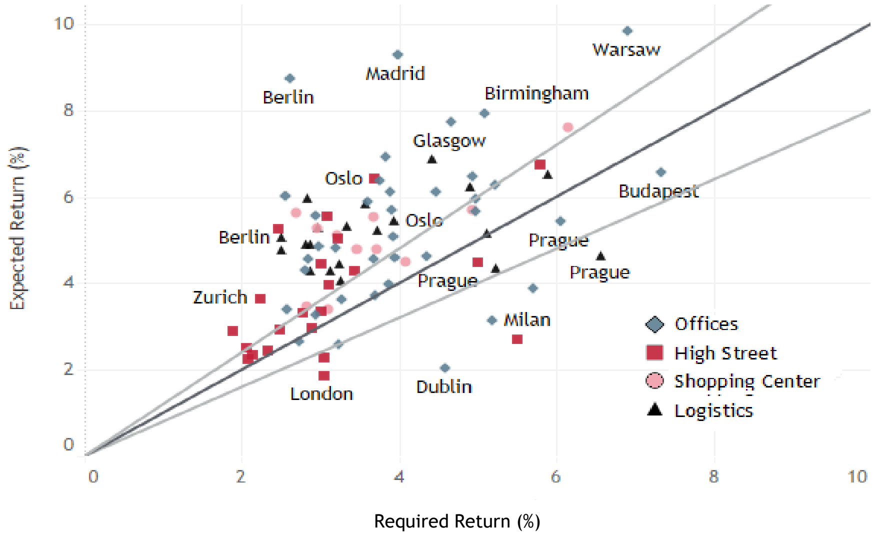
- The results for our lower for longer scenario are shown in the same framework as our 2019 outlook report: by comparing the required versus expected rate of returns across 90 market segments.
- First, the required rate of return (based on our Q4 forecasts) has come down compared to our Q3 outlook as spot government bond yields have tightened.
- Second, our Q4 base case expected rate of return has stayed at 3.4% pa, unchanged from Q3, as lower rental growth is offset by less yield widening.
- But, for our lower for longer scenario, the rate of returns improves to 4.9% pa over the next 5 years.



Sources: CBRE, RCA, MSCI, Natixis & AEW

LOWER FOR LONGER SCENARIO SHOWS MOST MARKETS AS ATTRACTIVE

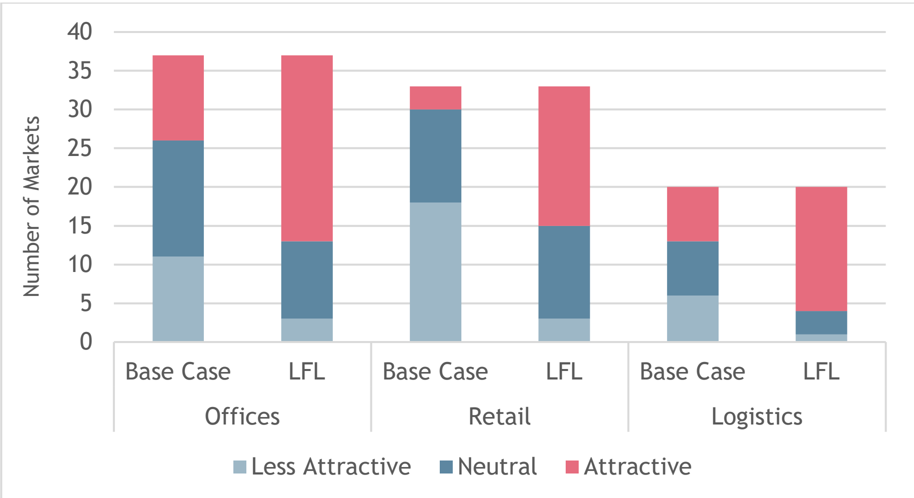
- Results for all 90 markets are displayed as a scatter graph along the required (horizontal) and expected (vertical) rates of return axes.
- Only a few markets have a required rate of return that is higher than the expected rate of return. Markets such as London high-street retail, Dublin offices and Milan offices and high-street retail.
- On the other hand, we see many office markets such as Berlin, Madrid and Warsaw where expected rates of return are significantly higher than required rate of returns following our lower for longer scenario.



Sources: CBRE, RCA, MSCI, Natixis & AEW

JUST ABOVE 60% OF REAL ESTATE PROPERTY MARKETS ATTRACTIVE IN LOWER FOR LONGER ENVIRONMENT

- Across the three property types, 58 out of the 90 markets are rated as attractive compared to only 21 markets in base case scenario, when comparing our base case versus the lower-for-longer (LFL) scenario.
- Expected rate of returns are respectively 4, 3.7 and 2.2% for office, logistics and retail in our base case versus 5.4, 5.2 and 4.2% in our LFL scenario.
- The largest positive move for the LFL scenario compared to the base case is in logistics, where only one market remains rated as less attractive.



Sources: CBRE, RCA, MSCI, Natixis & AEW

ABOUT AEW

AEW is one of the world's largest real estate asset managers, with €63.5bn of assets under management as at 30 September 2018. 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 Investment Managers, one of the largest asset managers in the world.

As at 30 September 2018, AEW managed €29.9bn of real estate assets in Europe on behalf of a number of funds and separate accounts. AEW has close to 400 employees based in 9 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 five years, AEW has invested and divested a total volume of over €20bn of real estate across European markets.

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