A photograph of a modern, multi-story glass skyscraper at night. The building's facade is illuminated from within, creating a warm glow that contrasts with the dark exterior. The structure is composed of a grid of white lines and large glass panels. The building is set against a dark background, and its reflection is visible on a dark surface in the foreground. The overall aesthetic is sleek and architectural.

January 2019 / Research Report

# EUROPE REAL ESTATE STRATEGIC OUTLOOK

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# 1 / Executive Summary

Real estate cycles do not die with old age. We should keep this firmly in mind as we enter what could be the tenth year of positive capital value growth. While it's certainly true that risks have increased over recent quarters and real estate returns are expected to lessen over the coming years, we do not expect to see a material repricing.

From an occupier perspective, things have rarely looked stronger. Vacancy is well down and most major cities are well positioned to see sustained rental growth. However, capital markets are likely to drag on performance as a gradual tightening in monetary policy lifts prime yields from their current record lows.

Pan-European fund-level returns were close to 10% year-on-year in the third quarter of 2018,<sup>1</sup> and returns are set to remain attractive on a relative basis. As such, large volumes of institutional and overseas capital continue to target European real estate. At the sector level we continue to favour prime logistics, while we forecast that France, the Benelux and the CEE will be some of the top performers by region.

Given rising rents and low levels of vacancy, emerging locations and a more active asset management approach are appealing, while structural drivers may help to support the performance of affordable living space. Finally, with investors shunning certain markets, particularly retail, we do see room for selective contrarian bets – although only with a forensic approach to underwriting.

It is important not to forget about risk. Target returns should be set according to risk profile, while any move up the risk curve should be backed up by solid fundamentals. We believe there is also an opportunity to reduce exposure to assets and markets that are expected to underperform over the medium term.

The return from European real estate is likely to soften over the coming five years, however we see plenty of reasons to deploy capital into the sector. From solid fundamentals to attractive relative returns, the market is well positioned. While no cycle lasts forever and financial market and economic risks have increased, we continue to see attractive opportunities in European real estate.

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## EUROPE REAL ESTATE KEY INVESTMENT THEMES:

	Theme	Comment
Targets	Selective Bets	Target outperforming markets, emerging micro locations and segments gaining from structural change
	Active Management	Low vacancy creating opportunities to actively manage office, logistics and residential space
	Contrarian	Forensic approach to find mispricing in less-favoured areas such as retail and the United Kingdom
Risk Awareness	Tailored Risks	Selective focus on fundamentals when moving up the risk curve
	Hurdle Rate	Real estate still attractive in a multi-asset context. Target returns should reflect risk profile
	Exit Yield Rising	Buying income security is likely to come at the expense of long-term performance given today's low yield
Optimise	Sell Underperformers	Take advantage of liquidity to reduce exposure to assets likely to underperform over the medium-term
	Rebalance	Increase allocation to long-term growth segments such as logistics, residential and hotels
	Long-term Focus	Avoid overreacting to periods of market stress. Focus on fundamentals and long-term performance

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<sup>1</sup> MSCI, INREV, December 2018  
 Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

## 2 / The Economy

European economic growth continued to slow during the second half of 2018. Sentiment has worsened, but there are still reasons to be positive. Business and consumer confidence is trending lower and GDP growth has slowed, but all remain well above history. Growth in the Eurozone slowed, but recession seems highly unlikely. And despite a slight reduction in jobs growth, E.U. unemployment continues to fall and is now at its lowest level since records began in January 2000.<sup>2</sup>

After six years of sustained economic growth, it is of no surprise to see the rising tide of late cycle calls. However, we should remember three things: cycles do not die with old age<sup>3</sup>; growth varies hugely across countries and cities; and many core real estate investments are held for longer than a single cycle. We shouldn't ignore the cycle, but it is only part of the equation when investing in real estate.

The current slowdown in activity has been led by the manufacturing sector. In part, one-off factors such as disruption to the German automotive sector have dragged on performance, but more importantly concerns over trade have weighed heavily on sentiment. Service sector growth has also eased during the latter part of the year, but has continued to record a solid rate of job creation. This slowdown has been most acute in Core Europe, with the likes of Germany and France recording multi-year PMI lows in December.<sup>4</sup>

GDP growth is set to moderate further over the next five years, with an E.U. average of 1.6% per annum, down from around 2% in 2018. Regionally, the Nordics and the CEE are the clear outperformers. Poland once again stands out, with a forecast growth rate of close to 3% per annum. France, the Benelux and Spain are set to grow at around the European average, while capacity constraints in Germany and current stresses in Italy are set to lead to weaker than average performance.

Understandably there is much Brexit-related uncertainty surrounding the outlook for the United Kingdom. GDP growth, having been curtailed over the past three years, is projected to have grown by just 1.3% in 2018, with signs of a marked reduction in activity throughout the final months of the year.<sup>5</sup> Beyond this, much will depend on the outcome of Brexit. Without major disruption there is a good chance that activity will pick up as uncertainty lessens and business adjusts. However, given the current political impasse, there is little clarity and a considerable tail risk to our medium-term outlook.

Despite slower economic growth, Europe continues to create jobs. In total a further six million jobs are set to be created across the E.U. over the next five years, of which many will be in the major cities. Of the markets that we cover, only four are expected to see either working age population or employment growth fall below the European average. This is shown in the chart on the following page. Stockholm and Copenhagen certainly stand out as strong performers, with London, Amsterdam, and the German cities also performing well.

While the outlook for demand drivers may look less robust in the likes of Paris, Milan, Madrid and Lisbon, we feel there is certainly potential for a better than expected outturn in all four, as recent reform programmes continue to support employment prospects and in turn are boosting inward migration.<sup>6</sup>

<sup>2</sup> Eurostat, November 2018

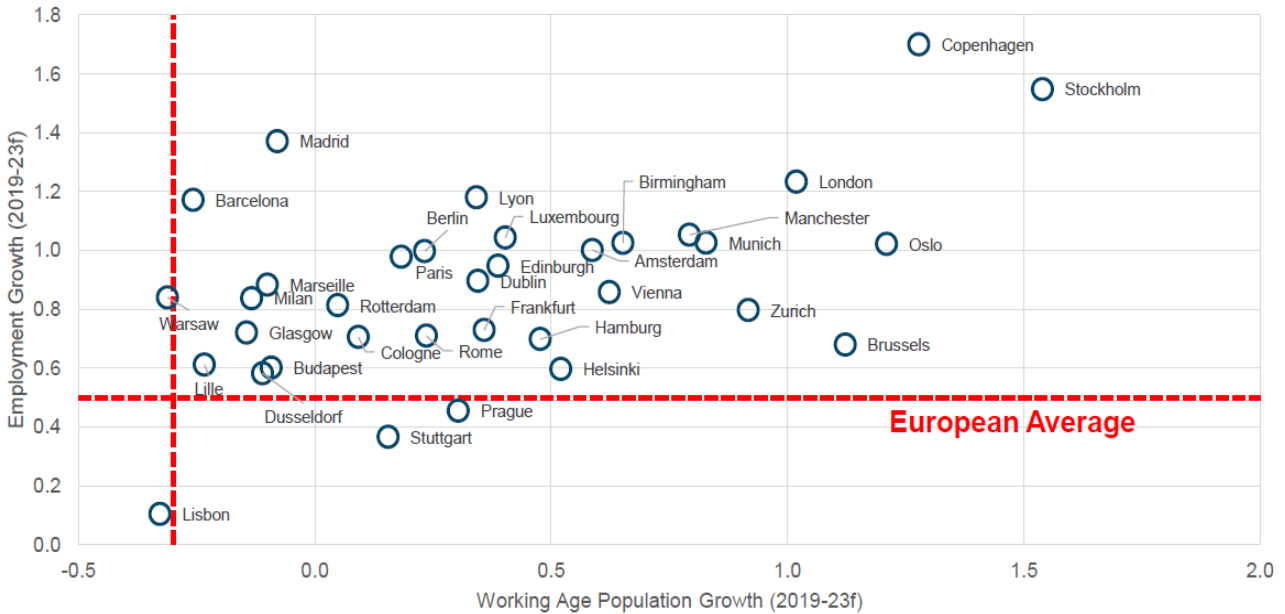
<sup>3</sup> Oxford Economics, October 2018

<sup>4</sup> Markit, January 2019

<sup>5</sup> Oxford Economics, December 2018

<sup>6</sup> Oxford Economics, December 2018

**EXHIBIT 1: EMPLOYMENT AND POPULATION GROWTH (% P.A.)**



Source: Oxford Economics, DWS, November 2018.  
 Note: f = forecast. There is no guarantee the forecasts will materialise.

With unemployment already back to 2008 levels, wage growth and inflation have started to pick up. While the current global slowdown and recent falls in commodity prices may reduce the pressure to act on inflation, we continue to see a trend towards a very gradual tightening of monetary policy. Indeed, the process has already begun, with the ECB ending quantitative easing at the end of 2018 and the Bank of England raising its base rate to 0.75% in August 2018.

Today, much of the focus is understandably on the risks to the economic outlook. From trade to Brexit, Italy to interest rates, there are a number of factors which could weaken activity. However, it would be wrong to ignore the upsides. Not only could these risks not materialise, they may well be resolved in way which supports higher than expected growth.

Overall the economic outlook remains supportive of European real estate performance over the medium term. Even though it does look like we’re entering a period of higher risk, higher volatility and slower growth, we still expect to see jobs growth, rising productivity, positive (but not runaway) inflation, and only a very gradual tightening of monetary policy. A focus on risk is important, but this backdrop may support opportunities across many of the major city regions.

Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

## 3 / Real Estate Performance

### 3.1 Occupier Fundamentals

In the face of moderating economic growth, occupier demand for European real estate continued to increase in 2018, by and large reaching levels well above historical averages. In our mid-year outlook we highlighted underlying strength across many parts of the market – particularly Spain, the Netherlands, Finland and the wider European logistics sector – and largely speaking this continued to play out during the second half of the year. Most sectors enjoyed improving occupier fundamentals over the course of the year, yet the effects of the structural challenges facing the retail real estate market have intensified over the past 12 months, leading us to downgrade our outlook for the sector.

**Office:** With office-using employment growth still running at levels well above the post-GFC average and construction activity remaining in check, the office occupier balance improved further during the second half of 2018. On a rolling annual basis, aggregate take-up in Europe's major office markets reached a record level in the third quarter of 2018, while annual take-up as a proportion of stock was running at 5.4%, the highest level for over ten years. At the same time, despite significant increases in rents and values, as well as still-low borrowing rates, developers remain somewhat cautious. Rolling annual building starts over the twelve months to September 2018 accounted for just 2.1% of current stock, still some way below levels reached at the peak of the last two real estate cycles. This favourable environment has allowed the European vacancy rate to fall to just 7.1%, while prime rents are now growing at 4.6% per annum, a ten-year high.<sup>7</sup>

Although rental growth is expected to slow in the coming years as new supply picks up and employment growth begins to tail off, expected aggregate European growth of 2.0% per annum means that rents should comfortably outpace inflation over the forecast period. In around two thirds of markets we have revised our five year outlook upwards, including the German cities, where vacancy is now below 4% on average.<sup>8</sup>

Madrid and Berlin remain at the top of the tree in terms of expected rental growth, while Lisbon also joins the small group of markets with expected rental growth of more than 3.0% per annum over the next five years. Grade A vacancy is particularly low in the Portuguese capital, but higher quality new stock is also rebasing the market rent level, while there are likely to be upsides to the economic outlook thanks to the government's reform programme.

Other markets we expect to do well include the Paris CBD, where average vacancy is now below 2.0%; Helsinki, which has so far lagged behind in its recovery; and Barcelona, which continues to see significant momentum. In markets such as Stockholm and Dublin, we see a risk that affordability constraints will begin to bite following particularly strong recent rental increases, despite underlying macroeconomic drivers remaining strong. Continued uncertainty is also expected to weigh on the Central London market, with a further correction in headline rental values expected over the coming year.

**Logistics:** The logistics occupier market continues to impress, with rental growth still well above levels typically seen in the past. Take-up of logistics space across Europe reached its highest ever level during the first three quarters of 2018, but at the same time the amount of space under construction continues to grow and has more than doubled over the past three years. Currently, more than 16 million square metres of space – equivalent to almost 7% of the current stock – are under construction across the continent.<sup>9</sup> The majority of new space is still being constructed on a build-to-suit basis, but in the United Kingdom and CEE markets, close to 30% of recent completions have been speculative.<sup>10</sup> Nevertheless, as demand

<sup>7</sup> PMA, November 2018

<sup>8</sup> PMA, November 2018

<sup>9</sup> JLL, Q3 2018

<sup>10</sup> PMA, November 2018

continues to outstrip supply across much of the continent, the average European vacancy rate has fallen to just 4.1%, and in many markets continues to tick downwards.

Logistics operators remain the largest source of take-up, but internet retailers have become a key driver of demand, with many of the recent lettings in this sector concentrated in the United Kingdom, Germany and Central Europe. During the first half of 2018, e-commerce accounted for 17% of total European take-up. Given the potential in much of Europe for significant further growth in the share of e-commerce within the wider retail market, this is likely to be a continuous source of new demand over the next five years and beyond.

With exceptionally low availability of space in many markets, it is perhaps unsurprising that we have seen increases in prime distribution rents, with average European growth currently running at 2.0% per year. For urban logistics units fulfilling a “last mile” delivery function and where there are competing land uses, rental growth has been even stronger. However, despite the underlying strength of the market, we do still see risks within the sector. Retailers – who in total account for around 40% of demand – continue to see margins squeezed; speculative development is picking up in a number of markets; there remains a significant amount of land available for development in many major logistics locations; and global trade tensions are creating uncertainty around future trade-related growth. However, while these factors are expected to have a dampening effect on rental growth looking ahead, growth of 1.9% per annum over the next five years would still be impressive in a historical context and puts logistics more or less on a par with offices.

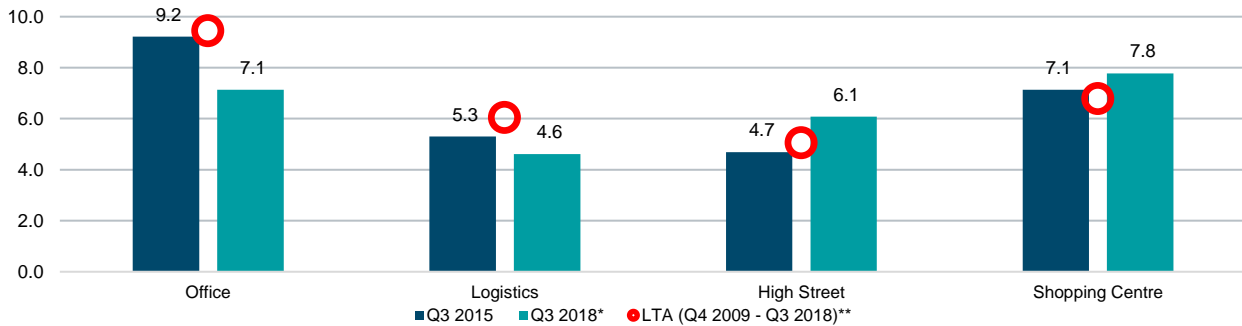
At the city level, London, Munich, Dublin and the Spanish markets are expected to be among the best performers in terms of rental growth. We also see potential for stronger growth in Paris, where the vacancy rate has fallen significantly in recent years. However, while Greater Paris is a major agglomeration, there remains considerable land availability in parts of the region, and therefore we believe the best opportunities are closer to the inner ring and around Charles de Gaulle airport.

**Retail:** In an environment in which inflation and unemployment remain low, wages and total retail sales are continuing to grow, and consumer confidence is well above average, the retail occupier market continues to suffer due to structural change. Development activity has slowed to a trickle, with just 1.6 million square metres added to the European shopping centre stock in 2018 – half the annual average of the past 20 years – and even less space is expected to complete in 2019. But at the same time, vacancy rates continue to track upwards across both shopping centres and high street retail units.

In our mid-year outlook, we highlighted the deterioration in performance within the retail sector, and subsequently downgraded our outlook for rental growth. Over the last six months, the challenges have continued to intensify, and more retailers have announced store closures and falling profits. Department stores in particular have struggled of late. With this in mind, we have further downgraded our five-year rent growth forecast and now expect aggregate shopping centre growth of just 1.2% per year, with risks still tilted to the downside.

Over the next five years, retail sales volumes are expected to grow by 1.9% per annum across Europe, and yet as the share of online sales increases we expect to see little or no in-store sales growth over this period. Certain parts of the retail market are still performing relatively well, and generally speaking we expect to see stronger rental growth in markets where the share of online sales remains low at present. The CEE region and Southern Europe are both forecast to see annual rental increases above the European average; however, beyond the five-year horizon the outlook is likely to weaken for those markets, as the share of online sales grows more rapidly. On the other hand, we are already seeing evidence of rents coming under downward pressure in the United Kingdom, Germany and France and we have downgraded our five-year growth forecast to reflect a weaker near-term outlook.

**EXHIBIT 2: VACANCY RATE BY SECTOR (%)**



Source: PMA, JLL, Cushman & Wakefield, DWS, December 2018  
 \*For retail subsectors Q3 2018 shows latest available data. \*\* Logistics from 2010

**Hotel and Residential:** Outside of the main commercial sectors, the occupier market in the accommodation sectors looks to be on solid ground. In the hotel market, occupancy has been supported by strong demand from both international and domestic travellers, as during the first half of 2018 the number of nights spent in European hotels grew by 1.6%.<sup>11</sup> In the year to November 2018, average European hotel occupancy had risen to 73.3%, up by almost one percentage point since the same period a year earlier. Over the same period, the average daily rate (ADR) was up by 3.9% year-on-year, meaning that revenue per available room (RevPAR) grew by an impressive 5.1%. The supply pipeline has grown considerably since the beginning of the year, with over 140,000 room under construction as of October 2018,<sup>12</sup> although with rising foreign visitor numbers the supply-demand balance should remain in check.

In the residential sector, we also see rising demand for private rented accommodation across a number of European markets. Homeownership rates have continued to fall as social trends and preferences change, while recent house price growth has pushed ownership further out of reach in cities such as London. While residential development activity is increasing, a strengthening labour market and rising disposable incomes should help to keep void rates low in the private rented sector. As interest rates rise, household sizes shrink and the trend of urbanisation continues – counteracting the slowdown in overall European population growth – demand for private rented accommodation is only likely to increase. In Europe’s major cities, rents have grown at over 3.0% per annum over the past ten years, and we expect growth of above 2.0% per year over the next five years.

### 3.2 Capital Markets

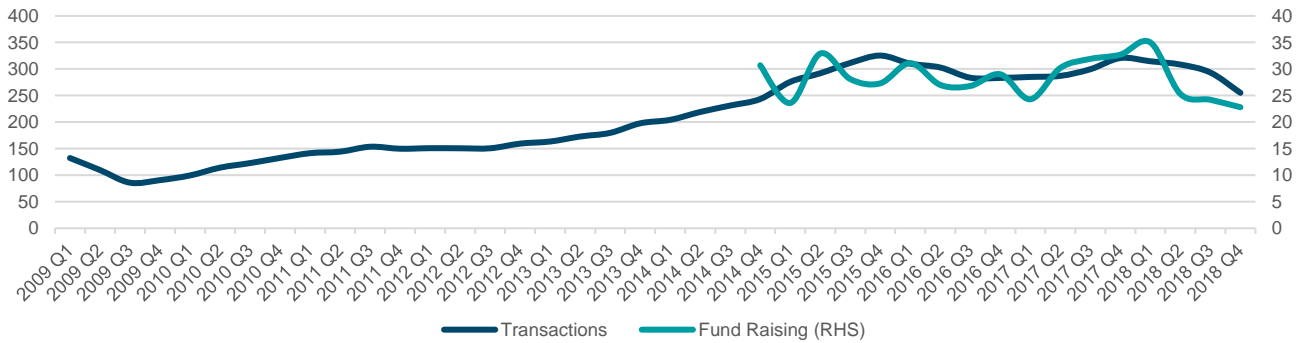
**Investment:** European real estate investment activity looks to have slowed further during 2018. Following a record result in 2017, transaction volumes for the first nine months of 2018 were down by 14% year-on-year. While full year data was not available at the time of writing, early evidence suggests activity in the final quarter remains down on the previous year.<sup>13</sup>

The slowdown in real estate fundraising – a trend we discussed six months ago – also continued into the second half of the year. During 2018, around €23 billion was raised with a focus on Europe. Compared to an annual average of €30 billion over the previous four years, this suggests that the fundraising total will be down some way in 2018. Importantly, fundraising for core and value-added opportunities actually increased slightly in 2018, while a large proportion of the overall drop occurred in the opportunistic and distressed space, which likely reflects fewer opportunities and a growing aversion to risk.<sup>14</sup>

<sup>11</sup> Eurostat, November 2018  
<sup>12</sup> STR, December 2018  
<sup>13</sup> RCA, January 2018  
<sup>14</sup> Preqin, January 2019



**EXHIBIT 3: REAL ESTATE TRANSACTION VOLUMES AND FUND RAISING (€ BILLION)**



Source: RCA, Preqin. As of January 2018.

Note: \*Provisional

However, there are a number of reasons to believe that there is still underlying strength in the investment market. While down from last year, investment volumes are still 40% above their ten-year average and certain sectors such as logistics and residential remain in strong demand.<sup>15</sup> There is also a significant amount of dry powder from closed-end funds targeting European real estate, with the total awaiting deployment reaching a record €63 billion by December 2018. Lending terms remain favourable for borrowers, with margins having compressed further since the start of the year<sup>16</sup> and interest rates still low. And perhaps most importantly, the return currently on offer from real estate, while lower than in recent years, still looks attractive in relative terms. The property yield spread over real 10-year government bonds is currently close to 450 basis points, comfortably above its historical average, while real estate is still set to offer a higher return than other fixed income investments.

There is also still a generally positive sentiment towards many parts of the European real estate market at the moment. There is optimism surrounding the Netherlands, Spain and the Nordic markets, and while retail has fallen out of favour, attitudes towards offices remain broadly positive and logistics sentiment is at a ten-year high.<sup>17</sup> At the same time, real estate continues to be an important part of a multi-asset portfolio, and EMEA-based institutions expect their target allocations to real estate to increase to 11.5% in 2019, up from 11.1% in 2018.<sup>18</sup>

Despite the overall reduction in investment activity, there have been certain sectors and markets that have fared better than others. At the market level, sentiment towards Poland remains strong, with activity looking likely to match the 2017 high, while Ireland, Portugal, the Netherlands and Belgium all saw volumes rise during the first nine months of 2018. Volumes in France were also up by 9% over the same period, although the annual total is unlikely to match that of the previous year given the record fourth quarter total in 2017. However, volumes were down by between 10% and 15% in the United Kingdom and Germany, and the fall was even greater in Italy and the Nordic countries.

With the exception of the residential sector, where volumes in the first three quarters of 2018 were flat in year-on-year terms, there were no other sectors that escaped the slowdown in activity. The shift towards the ‘living sector’ – senior housing, student housing, multifamily apartments and hotels – shows no signs of abating, with these sectors now accounting for 25% of the total European investment volume for the first time, double the share they were achieving ten years ago.<sup>19</sup> With interest rates expected to begin to rise and prospects for further value appreciation becoming more limited, the multifamily sector in particular is garnering significant interest as a possible route to secure income streams.

<sup>15</sup> RCA, December 2018

<sup>16</sup> CBRE, December 2018

<sup>17</sup> PMA, 2018 Q3

<sup>18</sup> Hodes Weill & Associates, October 2018

<sup>19</sup> RCA, November 2018

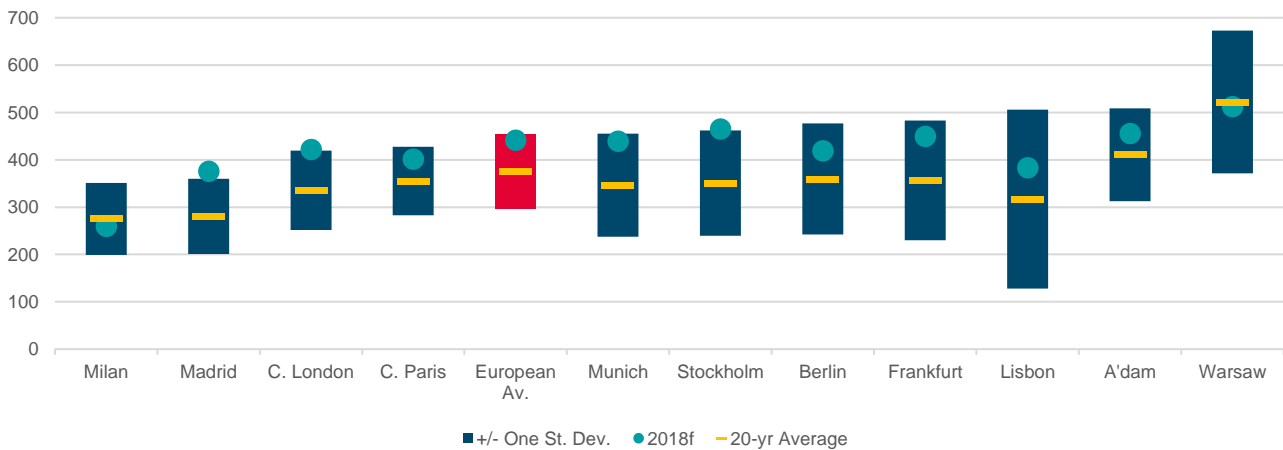
Logistics is also still faring well at the moment, as e-commerce occupiers bring an additional source of tenant demand and rents continue to edge higher.

**Pricing:** Despite the reduction in investment activity in 2018, pricing continued to tighten and yield spreads remained attractive. By the third quarter of 2018, European office yields had compressed by 10 basis points since the start of the year, with logistics yields down by 25 basis points. However, retail is the one sector where we are now starting to see signs of a potential correction.

While aggregate shopping centre yields were broadly unchanged over the first three quarters of the year, we see early indications that in some markets retail yields are now moving out. Given that retail transaction volumes are down significantly – 35% lower than at the peak in 2015 – it may be that data is lagging the reality somewhat, but we see evidence of weaker investor demand, with fewer bidders and downward pressure on pricing.

Since the financial crisis, yield impact has consistently been the main driver of prime capital value growth; however, it looks likely that yield compression is coming to an end for the majority of markets and sectors. The current spread over long-term interest rates remains comfortably above the average of the last 20 years, but with European 10-year bond rates forecast to move out by an average of 200 basis points over the next five years, we foresee an outward movement in property yields of around 50 basis points. This would lead to a narrowing of the real office yield spread to just over 300 basis points, in line with the 10-year pre-GFC average.

**EXHIBIT 4: PRIME OFFICE YIELD SPREAD OVER REAL 10-YEAR GOVERNMENT BOND (BASIS POINTS)**



Source: DWS, PMA, Macrobond. As of December 2018.

Note: f = forecast. As such, the performance and forecast shown represent hypothetical and simulated performance, which has many inherent limitations. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. No assurance is made that forecast returns will be achieved.

The United Kingdom remains an outlier here. Prime Central London office values were broadly unchanged in 2018, but we see the potential for a further decline in 2019. Moving into the next decade, we expect the U.K. to outperform as a revival in transaction activity may relieve some of the pressure on pricing, although this view is highly sensitive to political events.

The popularity of the logistics sector can be seen in the yield spread over offices, which has historically averaged 180 basis points, but now stands at 125 basis points. And with the weight of capital targeting the sector, we expect this to narrow to 100 basis points by 2023. On the other hand, with the exception of Central and Eastern Europe, shopping centre yields have drifted some way higher than office yields and in many cases retail pricing is now comparable to the logistics sector.

Given how far yields have come in, it's perhaps unsurprising that the outlook for further capital value growth is limited, despite reasonable rental growth prospects. In fact we believe that for most markets 2019 is likely to be the last year in which any meaningful capital value growth is achieved, and we expect to see marginal value declines for offices and retail over the next five years, although still positive growth in the logistics and residential sectors.

### 3.3 Returns and Market Calls

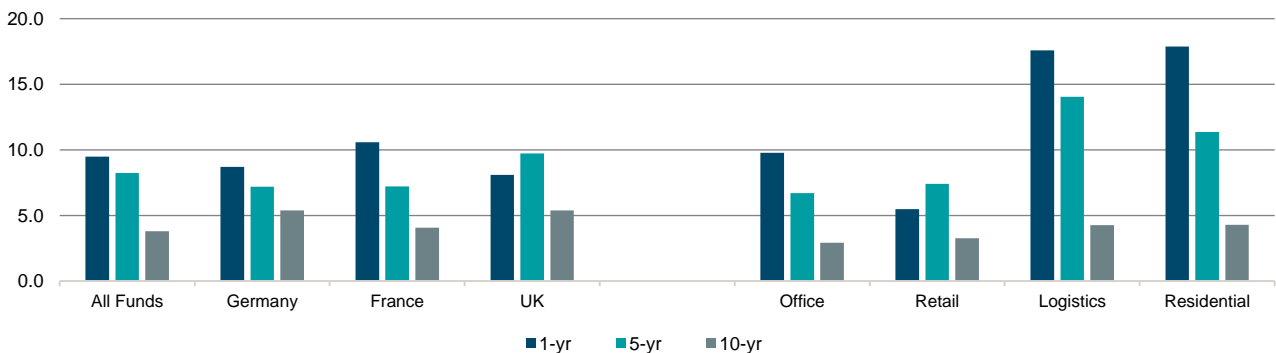
While many parts of the European real estate market will begin to see returns decelerating towards more normal levels, some locations and sectors are still seeing significant momentum and we expect certain segments to produce above-average total returns in 2019. However, from 2020 onwards, we predict that performance will moderate across the board.

**Recent performance:** While there are certainly signs that returns are slowing in some market segments, the strength of the current market in total can be seen in the performance of the MSCI Pan-European Property Fund Index and the INREV Quarterly Index. As of the third quarter of 2018, both indices were showing annual total returns of close to 10%, comfortably above their historical averages.<sup>20</sup>

Six months ago we highlighted the Netherlands and Finland as overweight markets, and both continue to perform exceptionally well, with total returns of 16.7% and 18.5% in the year to September 2018, respectively. While returns in both Germany and the United Kingdom have slowed since the beginning of the year, they are still some way higher than their respective ten-year averages. France, on the other hand, has seen performance accelerate this year and is now recording returns above the all-fund average.

There remains a wide gap in performance between the sectors, and our continued positive views regarding logistics and certain residential markets are supported by the most recent performance results. Annual returns in the third quarter of 2018 were 17.6% for industrial and 17.9% for residential. On the other hand, retail – where we have been cautious for some time – recorded returns of just 5.5% over the same period.<sup>21</sup>

**EXHIBIT 5: ANNUAL FUND LEVEL RETURNS TO Q3 2018 (%)**



Source: INREV, December 2018

Note: Past performance is not indicative of future results.

**Return outlook:** With capital values now close to the expected peak, it should be of no surprise that we are forecasting total returns to moderate over the next five years, with income return becoming the main driver of performance. Interestingly, while the INREV index has levelled off since the start of the 2018, year-on-year returns have actually accelerated within the

<sup>20</sup> INREV, MSCI, December 2018. Please see Appendix section for historical returns.

<sup>21</sup> INREV, MSCI, December 2018. Please see Appendix section for historical returns.

Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

MSCI index. Nevertheless, with rising interest rates and lower GDP and employment growth, we are now forecasting an all-property prime return of 3.5% over the next five years.

Compared to the returns achieved over the past five years, this would represent a significant dip in performance. However, when viewed in context with other fixed income investments there is still a clear case for investing in real estate, with the German ten-year Bund, for example, currently yielding just 0.3%.<sup>22</sup>

Within the wider real estate market, we expect to see a wide range of returns. Structural changes mean that some sectors are primed for stronger growth than others, while within each sector there will be outperformers and underperformers. Our forecast for all property prime total returns over the five years from 2019 has been lowered slightly compared to six months ago. Crucially though, our view on offices and logistics remains broadly unchanged at the aggregate level, but a marked weakening in shopping centre performance means we now expect annual retail returns to be around one percentage point lower over the forecast period.

Generally speaking, we expect the number of suitable opportunities to meet fixed return targets at the prime end of the market to begin to dwindle. With that in mind, we are increasingly focused on specific sub-markets, development opportunities, alternative sectors or asset management plays, but importantly without taking on excessive risk.

At a sector level, Logistics remains our strongest performer with an average prime total return of 5.3% per annum over five years, supported by an income return some 100 basis points higher than offices. The outlook for shopping centre returns remains reasonable, although it's fair to say that risks are still tilted to the downside for both rental growth and pricing. As we continue to stress, however, the retail market remains highly polarised, and there will be a wide disparity between the best and worst performing schemes. Within the traditional sectors, the largest spread of expected returns is in the office sector, ranging from -0.5% in Stockholm to 6.0% in Budapest.

**EXHIBIT 6: PRIME TOTAL RETURNS BY SECTOR AND REGION (2019-23F, %)**



Source: DWS, December 2018

Notes: f = forecast. Core Europe = Germany, France, Benelux, Nordics, Austria & Switzerland; Periphery = Iberia, Italy, Greece & Ireland; CEE = Czech Republic, Hungary & Poland. There is no guarantee the forecast shown will materialise. As such, the performance and forecast shown represent hypothetical and simulated performance, which has many inherent limitations. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. No assurance is made that forecast returns will be achieved.

Prime private residential returns are expected to be relatively low at 2.8% per annum, but this hides a significant range across major cities. Returns in the main German cities, which account for over 40% by weight of the markets we cover,<sup>23</sup> and where net yields can be below 2.5%, are expected to be the lowest in Europe at around 2.0% per annum – although

<sup>22</sup> Macrobond, as of 13<sup>th</sup> December 2018

<sup>23</sup> Weight is defined as average transaction volumes over the past ten years.

we continue to see attractive opportunities for more affordable space. Dublin, Warsaw and the Spanish cities are set to offer stronger performance, with returns of between 6% and 8% per annum.

On an absolute return basis, Iberia and the CEE markets are still set to see some of the strongest all-property returns over five years. In fact the CEE region is expected to offer the highest returns in Europe for both offices (5.0% p.a.) and logistics (6.6% p.a.), although this does not take into account the higher risk associated with these markets.

In Italy, the weaker economy is adversely impacting the prospects for real estate performance, particularly for offices and retail. However, we still expect Italian logistics to be among the better performers, given a likely acceleration in the pace of online sales and the strategic importance of the Milan market. Lower returns are typically expected in the Core European markets, although Nordic logistics and Benelux offices are foreseen as outperformers within their respective sectors.

In the United Kingdom, perhaps surprisingly, we are forecasting returns above the European average for offices and retail. Unlike the rest of Europe the U.K. market has already gone through a price correction, and there are likely to be a number of investors waiting to move once there is greater certainty around the country's future position within Europe. The U.K. office outlook is particularly sensitive to the final result of the Brexit process, but a relatively strong underlying economy should help to underpin the occupier market in the case of a favourable outcome.

**Market calls:** In the map on the next page, we summarise our market-level calls for the three main commercial sectors and the residential private rented sector over the five years from 2019. It is worth noting that these calls are made within and not between sectors. If compared against an all property average, the share of overweight calls in logistics would certainly increase given the strength of the sector in general. Likewise, the share of underweight calls in the office sector would increase.

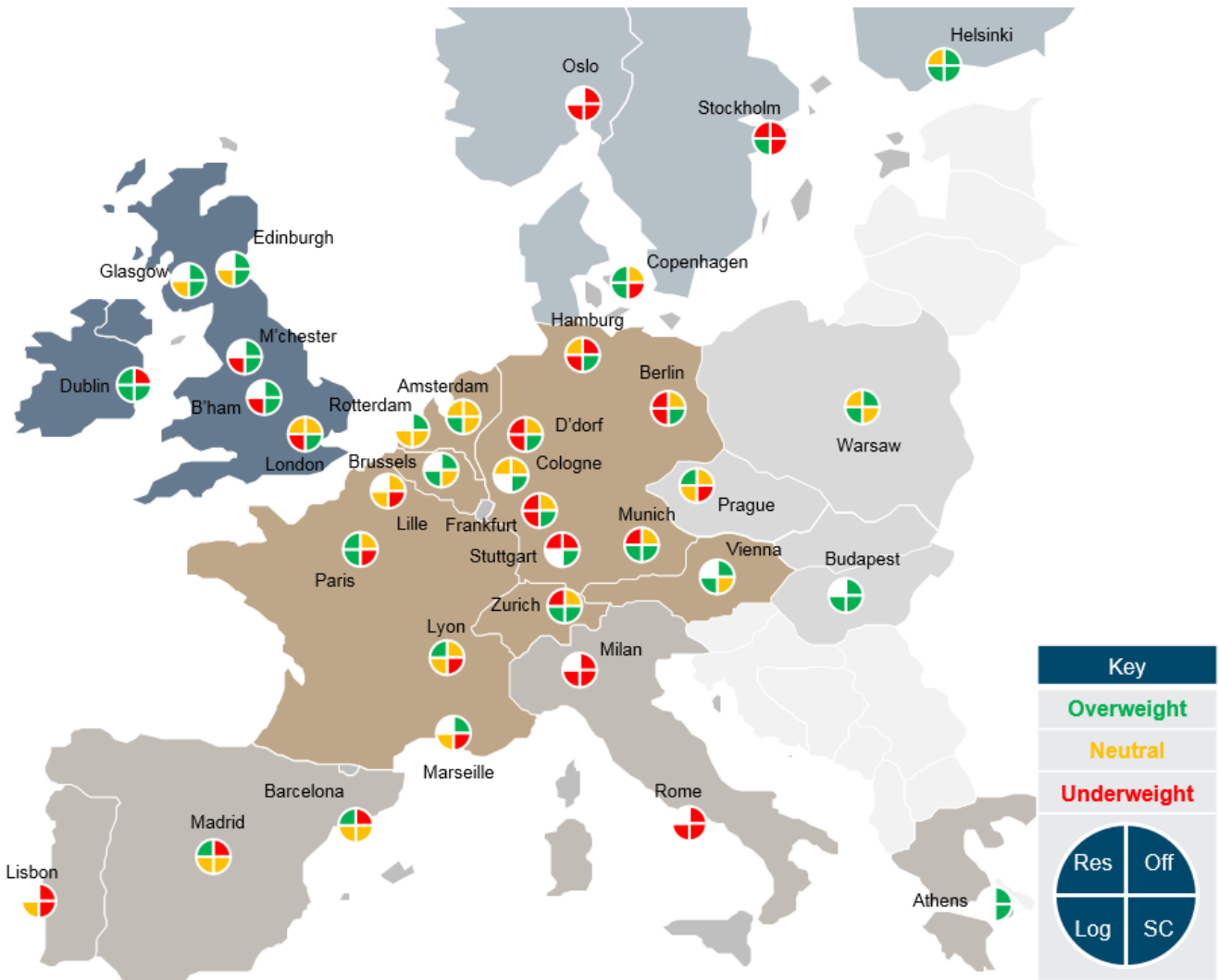
These numbers are based on our forecasts for prime property performance and also account for market risk. The map provides our views on market selection; however, these are not all encompassing within the real estate investment universe and therefore should be considered in conjunction with the strategic themes shown in this document.

There are relatively few markets where we have a clear call one way or the other across all property types. Generally speaking, we continue to anticipate stronger risk-adjusted returns in Helsinki, Brussels and the CEE markets. Helsinki remains slightly behind the curve in its recovery cycle, and we see upsides to the economic outlook there, underpinning stronger than average rental growth, while yields are still comfortably above the European average.

Brussels, on the other hand, is not expected to be an outperformer in terms of rental growth, but benefits from low market risk, and also offers an income return premium. Pricing has moved quickly in the Dutch office and logistics markets, although we expect further rental growth, particularly in Amsterdam offices, and given the low vacancy rate there may be opportunities through active asset management.

The Warsaw office market has seen a significant pick-up in returns recently, and we think that this momentum should carry through into 2019. Despite high levels of construction activity, strong demand has kept a lid on vacancy, and 2018 looks likely to have been the first year in which prime rents have increased for seven years. The Polish economy also has good longer-term prospects and we maintain our overweight call for both offices and logistics.

**EXHIBIT 7: MARKET INVESTMENT OUTLOOK**



Source: DWS, December 2018

Note: Countries are coloured by DWS Country Cluster. Overweight, Neutral and Underweight calls are made on the risk-adjusted total return relative to the sector average. Based on a hedged euro investment over a 5-year hold period. The information herein reflects our current views only, are subject to change, and are not intended to be promissory or relied upon by the reader. There can be no certainty that events will turn out as we have opined herein. Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models or analysis which may prove to be incorrect. No assurance can be given that any forecast or target will be achieved. Source: DWS, as of December 2018.

The picture is somewhat mixed in Germany. While an underperformer in absolute terms, German shopping centres look to be one of the more attractive retail segments on a risk-adjusted basis due to recent price corrections, low return volatility and a highly liquid investment market. Offices and residential, on the other hand, are generally underweight as the very low yields offered by these two sectors mean that income returns are low and even small outward movements in the yield can create a significant drag on capital value growth.

The logistics market in Paris looks particularly interesting on a risk-adjusted basis, as yields are still 150 basis points higher than offices and we expect to see strong rental growth there. Given that Paris is a large agglomeration, logistics vacancy is low, land availability closer to the centre is relatively limited and online sales are growing fast, we expect smaller urban logistics locations to perform particularly well. Conversely, we have an underweight call on French retail, where there remains a lot of space under construction, vacancy is rising and rents are under pressure. There is growing evidence that yields across all retail formats are beginning to move out, and we expect further outward movement in 2019.

In Spain, there are still pockets of opportunity, with residential likely to offer some of the most attractive risk-adjusted returns, although the institutional PRS market is still relatively small. In the office sector, some of the rental upside has already been taken, and while the occupier market is expected to improve further, pricing for prime property is now looking stretched. The best returns in Portugal are expected to be delivered within the logistics sector, but while we remain positive on the Portuguese outlook in general, our neutral-to-underweight call on all sectors there reflects a greater level of risk.

Finally we have a number of overweight calls in the United Kingdom. Relative to the rest of Europe, the office and shopping centre markets look relatively attractive priced. Furthermore, according to our central case the economy should accelerate as we go into the new decade. However, there remain considerable risks around this outlook – although not solely to the downside. At the time of writing, we are firmly within the eye of the Brexit storm; however, we anticipate that more clarity will emerge over the coming few months. While today there is more focus on those sectors (e.g. tourist hotels) and assets (e.g. long-income) which are relatively resilient against a No Deal Brexit, should our central case be realised, we would anticipate increased liquidity and a growing appetite for riskier assets.

**Summary:** Average European real estate returns were once again above their long-term average in 2018, and while the overriding performance trend over the next five years will be one of moderation, there will undoubtedly be opportunities to outperform the wider market. In some cases this may require a move up the risk curve, or a focus on emerging locations and subsectors, but there are also still a select number of markets and sectors where we see value in the prime segment.

<b>Germany</b>	<ul style="list-style-type: none"> <li>— Yields close to 3% mean prime pricing is increasingly prohibitive but it remains a low-risk market.</li> <li>— Overall a neutral call on prime assets, but active management an attractive approach to investment in most major cities given low vacancy and typically low volatility.</li> </ul>
<b>France</b>	<ul style="list-style-type: none"> <li>— Increasingly attractive market with potential for reform-led economic upsides. Strong performance for Paris logistics, bolstered by rising demand from online retailers.</li> <li>— Some upside taken in Paris emerging locations such as Saint-Denis, but opportunities still exist.</li> </ul>
<b>U.K. &amp; Ireland</b>	<ul style="list-style-type: none"> <li>— Pricing looks relatively attractive although uncertainty is reducing market activity. Brexit a major risk over the coming months, but potential for outperformance from the early 2020s.</li> <li>— Dublin office rents now close to peak; modest correction expected as new supply comes in. Stronger economy to support overweight call on retail, logistics and residential.</li> </ul>
<b>Southern Europe</b>	<ul style="list-style-type: none"> <li>— Strong economy still supporting Spanish rental recovery but value growth likely to slow after 2019. Spanish residential offering some of the best returns in Europe.</li> <li>— Political risks high in Italy; prime pricing strong. Remain highly selective and focus on asset plays.</li> </ul>
<b>Benelux</b>	<ul style="list-style-type: none"> <li>— Still one of the better performing regions on a risk adjusted basis. Upsides in Amsterdam have increasingly been taken, but Rotterdam and Brussels slightly earlier in the cycle.</li> </ul>
<b>Nordics</b>	<ul style="list-style-type: none"> <li>— Helsinki and Copenhagen prime offering the best opportunities within the region. Swedish logistics an outperformer but affordability remains a concern for prime Stockholm offices.</li> </ul>
<b>Central &amp; Eastern Europe</b>	<ul style="list-style-type: none"> <li>— Polish market benefitting from a strong economic outlook and falling vacancy. Office, logistics and residential all look attractive on a risk-adjusted basis.</li> </ul>

## 4 / Office Market

**Current Conditions:** The European office market is in good health. In spite of the weakening economic climate, this is a landlords’ market. Occupancy rates are at their highest level since 2001 and following almost a decade of very low levels of construction, many cities are now reporting shortages of good quality space. It therefore comes as no surprise that our latest estimates show prime rental growth accelerating to 4% in 2018 – a rate more than twice the historical average.

This strength is widespread. Across both Core and Southern Europe rental growth is estimated to have averaged 4.5% last year. Even in the CEE, where despite strong supply holding back the Warsaw market, rents in the region as a whole are estimated to have grown by a very respectable 3%. The most obvious outlier is the United Kingdom. Notwithstanding some growth in Birmingham and Edinburgh, and lower than expected vacancy in Central London, rents on the whole were broadly flat.

**Outlook and Investment Strategies:** European offices are well positioned for further rental growth. With low vacancy, positive jobs growth and only a modest pick-up in supply, office rent growth is set to average well in excess of 3% in 2019. Moving into the 2020s we anticipate that increased construction activity will act to slow the annual pace of rental growth; however, recent experience suggests a clear risk to this view and that we shouldn’t expect a surge in development activity.

Across all the cities we cover, we expect positive employment growth over the next five years due to in-migration to city centres. This will be an important driver of additional office demand. While the likes of Stockholm, Copenhagen and Madrid stand out, almost every major market is set to outperform the European average.<sup>24</sup>

In spite of this demand, we do expect a modest increase in vacancy over the next five years. Nonetheless, with vacancy levels well below historical norms and many cities reporting shortages of good quality stock, prime rental growth is set to feature across all but a small handful of markets.

The Iberian cities and Berlin stand out as some of our top performing rental markets over the coming five years, while Paris and many of the other major German cities should also beat the European average. At the other end of the hierarchy stand London, Stockholm and Dublin. For Dublin and Stockholm this comes on the back of a period of very strong rental growth, stretching affordability and in the case of Dublin inducing a supply response.

Prime office yields are now averaging 3.60% and pricing looks increasingly stretched. Despite the strength of the occupier market, prime, long-let offices often do not meet target return requirements. Given this backdrop, taking on more active asset management could be appropriate. Delivering high quality assets into stock-starved markets with solid fundamentals and a clear growth story should provide an additional premium while not representing a major move up the risk curve.

	Theme	Comment
Office Strategies	Manage to Core	Record low grade A vacancy and a marked divergence between prime and average pricing. This is supportive of repositioning well-located secondary stock in the likes of Paris and the German cities.
	Emerging Locations	Offices in non-established central locations within growing parts of major cities such as London, Paris, Stockholm and Berlin. Focus on well connected locations with a high degree of vibrancy.
	Low Risk	Focus on low volatility markets where today's vacancy and the development outlook are modest. Markets include the German cities, Amsterdam and regional France.

<sup>24</sup> Oxford Economics, November 2018



## 5 / Retail Market

**Current Conditions:** Retail is difficult. It is highly likely that the sector once again underperformed the real estate market in 2018 – for the third year in a row.<sup>25</sup> Stores continue to close as traditional retailers consolidate their portfolios in the face of online sales migration and falling margins. Transaction volumes are down as investors struggle to understand the changing landscape. And despite the backdrop of low interest rates, yields are now starting to drift higher as shorter leases, lower NOI growth, higher depreciation and illiquidity all add to the risk premium on retail assets.

Core Europe and the United Kingdom have so far been most exposed. Germany and France have recorded falling prime shopping centre rents over the past two years, but it is the United Kingdom where the market is really suffering. Battered by the combined forces of weak disposable income growth, rising costs and one of the highest online sales rates in the world, 2018 saw a renewed spike in the number of retail failures, and with it lower rents and a collapse in investor demand.<sup>26</sup>

This bleak picture is not universal. Southern Europe and the CEE continue to perform well, buoyed by rising disposable incomes and still-low levels of online penetration. While rental growth looks to have slowed in 2018, with further yield compression, its likely that both regions recorded double-digit total returns over the year.

**Outlook and Investment Strategies:** We see no immediate turnaround in the retail property climate, and today we are taking an underweight position on the sector. However, there will continue to be marked differences within the retail sector, between both locations and types of retail property.

Over the coming year much of Southern Europe and the CEE should continue to do well. However, we do not believe that any market will be immune to the impact of online sales migration. While structural and cultural factors may temper the propensity to shop online, over the long-term we anticipate a broad convergence between regions. As such, by the end of our forecast period prime shopping centres in Spain, Italy and Poland are set to be underperforming the European average.

Next year is expected to be another tough year for the United Kingdom and Core Europe. However, in places the seeds of recovery are being planted. Markets are adjusting, with both falling rents and a considerable reduction in the development activity. In addition, given the sustained underperformance of recent years, the spread between prime shopping centre and office yields is now at its highest level on record.<sup>27</sup>

We firmly believe that this sector will remain a major part of the investable universe. While more focused on food, services and leisure, places to discover, understand and experience products will remain in high demand. Not all locations will meet the needs of consumers and retailers, and even where they do, getting a full understanding of the true value of the store will be difficult, dissuading many from engaging with the sector for the foreseeable future, but also opening up opportunities.

	Theme	Comment
Retail Strategies	Contrarian	Find value in markets such as the United Kingdom and Germany. Take a forensic approach to understanding the current and future value of the store, and sustainability of rental income.
	Locally Dominant	Dominant retail locations within smaller cities. Focus on centres with low competition and sufficiently large catchment, where major retailers operate profitable stores while supporting online sales.
	Integrated Urban	Grocery anchored centres that are well integrated into the urban community and cater for frequent, small-basket shops. Focus on areas of gentrification in major cities such as London, Berlin and Paris.

<sup>25</sup> INREV, November 2018

<sup>26</sup> PMA Survey of Investor Sentiment, December 2018

<sup>27</sup> PMA, Cushman & Wakefield, December 2018

## 6 / Logistics Market

**Current Conditions:** Although economic growth has moderated, structural drivers continue to support occupier demand for logistics space. E-commerce is propelling requirements from retailers, 3PLs and parcel delivery operators for modern distribution, fulfilment and last mile delivery space. Distribution hubs are also gravitating closer to population centres in order to serve store networks or last mile facilities more efficiently and quickly, particularly as consumers demand flexibility and faster delivery.

In turn the demand for last mile “spokes” is rising, with some occupiers opting for purpose built urban facilities while others retro-fit well-located industrial spaces. These facilities have typically seen outsized rental growth given the strength of demand and constraints on supply.

Importantly, logistics vacancy continues to fall. Although development activity has picked up, particularly in the United Kingdom, we have not seen a surge in speculative construction. Vacancy across Europe now sits at close to 4%, which in turn has led to the emergence of rental growth.<sup>28</sup> In total we anticipate that rents grew by just over 2% in 2018, with particularly strong increases in Iberia, Berlin, Copenhagen and Dublin.

**Outlook and Investment Strategies:** Logistics is expected to remain our top performing sector. While yields may bottom out over the next 12 months or so, rent growth and higher income returns will likely drive total returns over the coming years. In total we expect rents to continue to expand by around 2% per annum, considerably more than the historical average.

At the market level, we predict some of the strongest rent growth in London, Paris, the Iberian cities, Milan and Munich. The sheer size of London and Paris coupled with a need to be close to customers will drive rents in the two gateway cities. While development has picked up in Spain, take-up has been strong, buoyed by the economic recovery as well as e-commerce growth, both of which we expect to continue well into the next decade.

But there are risks on the horizon for some markets: supply is picking up across most locations, particularly in Spain, France, Poland and the United Kingdom; yields are reaching record lows; and values in a number of markets are now well above pre-crisis peaks. This is most notable in the United Kingdom; while recent performance here has surprised to the upside, we expect that it will moderate sharply going forward, underperforming the European average.

Given the recent success of the sector, it is important not to become complacent. Certainly current risks to international trade pose a threat to trade-linked facilities. Furthermore, with the sector intrinsically linked with retail, the failure of traditional retailers has an impact on logistics, with space often coming back to market.

For now we remain confident that logistics will continue to outperform the office and retail sectors. However, investors should focus on fundamentals and never forget that in many places logistics space is easily replicable.

	Theme	Comment
Logistics Strategies	Speculative Construction	Focus on delivering modern stock in markets with low vacancy and high barriers to new supply (land constraints, planning). Paris (North), Madrid (A2), Milan (East), Dublin (North) and Stockholm.
	Last Hour Logistics	Well-connected ‘last hour’ assets that serve stores or customers across a large catchment within one hour HGV drive time. Rhine-Ruhr (DE), Randstad (NL), Mechelen (BE), HMA (FI) and select U.K.
	XXL Distribution	Focus on 50,000 square metre plus units in key hub locations, in markets with low but fast growing e-commerce penetration, such as France, Spain, Northern Italy and Poland.

<sup>28</sup> JLL, November 2018

## 7 / Residential Market

**Current Conditions:** The European residential market is performing exceptionally well. According to INREV fund level returns are running at near 18%, almost double the all property average.<sup>29</sup> The sector is perfectly placed to benefit from an array of positive drivers: the low interest rate environment; a sustained period of undersupply; the structural changes of urbanisation and falling owner-occupancy, among others.

Given the host of factors supporting both occupier and investor demand, rents and values have been growing across major cities. Over the past five years, of the cities we cover, prime rents have increased by an annual average of almost 3% and yields have fallen by around 75 basis points, leading to prime capital value growth of close to 9% per annum. Performance has been particularly strong in Spain, Ireland, Germany and the Netherlands<sup>30</sup> and while the pace does look to have softened in 2018, prices still grew by more than 5% and the yield spread over bonds remains comfortable.

**Outlook and Investment Strategies:** According to our forecasts, prime residential real estate should continue to see solid rental growth and rising values over the next five years. However, returns are expected to be modest, particularly in core markets like Germany and the Netherlands. With entry yields well below 3.00% and a total return projection of just 2.8% per annum, it is hard to make a strong case for prime residential outside a handful of markets such as Dublin and Madrid.

With population growth, rising disposable incomes and few signs of overbuilding, the potential for low void risk and stability of income is likely to prove attractive if market volatility grows. But in general, this outlook suggests that prime residential will be a drag on portfolio returns.

However, prime residential is only a small part of the core, investable market. We see many of the same positive occupier fundamentals in the more affordable parts of the market. Indeed, often demand is even greater given its mass market appeal, while build costs in major cities can often be prohibitive to delivering this type of stock. With cities such as Munich, Stuttgart and Barcelona recording prime rent growth of around 7% per annum since 2014, certainly we expect more and more of the population to be pushed out of the prime segment and into the more affordable part of the market.

In line with affordability pressures, and supported by urbanisation and demographics, we also expect to see growing demand in the commuter belt. Whether it be due to cost push, or the pull of schools, green space and larger units, with the number of people in Core Europe aged between 35-45 set to rise by 7% over the next decade,<sup>31</sup> we see significant population growth in suburban areas.

With affordable private residential, particularly in the suburbs and commuter belt, offering sustained demand, low levels of vacancy and a yield premium over prime of around 50 to 100 basis points, we see a compelling investment story for this part of the market, which we would expect to outperform the prime segment.

	Theme	Comment
Residential Strategies	Outperformers	Focus on buying and funding in markets such as Madrid, Barcelona, Dublin, Paris and Copenhagen.
	Affordable	Focus on affordable housing in major agglomerations and key regional cities, which often benefit from strong appeal among the younger population, supply shortages and lower replacement costs.
	Commuter Belt	Focus on well-connected suburban locations with access to fast-growing, but expensive city centres. Examples include Fürstenfeldbruck near Munich and Badalona on the edge of Barcelona.

<sup>29</sup> INREV, December 2018

<sup>30</sup> Local data sources, November 2018

<sup>31</sup> World Bank, Oxford Economics, December 2018

## 8 / Private Debt

**Current Conditions:** Financing conditions are still favourable for European borrowers, with 5-year swap rates close to all-time lows. Still, returns from private lending remain competitive in relative terms. Lending to prime property currently provides a return of around 2% on average across Europe’s major cities.<sup>32</sup> At the same time, European BBB bonds are currently yielding 1.5%,<sup>33</sup> and while direct property can offer higher absolute returns, this comes with more risk attached. With monetary policy expected to normalise, direct real estate returns are also set to diminish over the next five years. However, for lenders, floating-rate loans should offer some protection against rising rates. And with lending terms still conservative, the risk-adjusted returns currently available make private debt a strategic investment opportunity.

The private debt market continues to generate interest, with funds targeting a European debt strategy raising around €4 billion in the first eleven months of the 2018. While the 2018 annual total looks unlikely to match the previous year’s record volume, the amount of Europe-focused dry powder targeting a debt strategy sits close to €14 billion as of December 2018, accounting for over 20% of all the capital awaiting deployment to the wider European real estate sector.<sup>34</sup>

**Senior:** Since the middle of 2017, lending margins across Europe have fallen, and now range between 90 and 190 basis points for prime Western European offices. The tightest margins are found in the mature markets of Copenhagen, Helsinki, Paris, and Amsterdam, all of which have seen a fall of 20-25 basis points over the past year or so, as well as Berlin, where margins have remained unchanged. Spain has seen the largest decline, with lenders competing to take advantage of the Spanish recovery, and at 125 basis points is now at a similar level to London, Stockholm or Brussels. The CEE region still offers a noticeable premium, although Warsaw is now approaching levels seen in some Western European markets.

Senior LTVs of 70% and above are still rare in Western Europe, with lenders in the majority of countries offering a maximum loan of 55%-65%. Maximum LTVs have on average edged out slightly in recent quarters, but taking into account changes in swap rates and lenders’ fees, the weighted average total cost of debt is broadly unchanged since mid-2017.<sup>35</sup>

**Mezzanine:** The United Kingdom remains the largest market for mezzanine lending, but with increasing demand for alternative (non-bank) lending across the continent, the range of products being offered – including mezzanine loans and whole loans – is growing. Lending on prime offices is usually available at LTVs of up to 75%-80%, while margins can range from 500 to 800 basis points, although terms can differ significantly within markets depending on the individual property.

**Outlook and Investment Strategies:** Similar to our strategies for direct real estate, the prime and traditional segments are looking less attractive compared to growth sectors like student housing and hotels, or office properties with curable deficiencies in strong locations. This is where competition from other lenders is lower, and where creditors with strong local market knowledge can benefit significantly from widening margins, which are often 100-200 basis points higher than prime. Despite ongoing Brexit uncertainty, the U.K. market still offers good opportunities, although extra caution should be had, particularly for mezzanine. The retail sector in particular looks weak, with very few lenders willing to provide financing outside the very best schemes.

	Theme	Comment
Private Debt Strategies	Senior	Focus on core properties outside the prime segment in France, Italy, Spain and the United Kingdom. As well as offices, consider emerging segments like student housing, PRS and hotels.
	Mezzanine	Strong focus on asset selection rather than market allocation. Given market uncertainty, exercise caution in the United Kingdom, despite it being the largest market.

<sup>32</sup> CBRE, December 2018

<sup>33</sup> Macrobond, January 2019

<sup>34</sup> Preqin, December 2018

<sup>35</sup> CBRE, December 2018

## 9 / Listed Market

**Current Conditions:** The European listed real estate market outperformed the wider market during 2018. Despite recording a negative return of -7.8%, the EPRA total return index was 301 basis points above the Stoxx 600. Logistics continued to be the strongest performer in 2018 with the likes of WDP and Segro substantially outperforming the wider listed real estate market. Unsurprisingly, retail was a clear underperformer. Still facing structural headwinds, the whole sector returned -28% in 2018 and by the end of the year was trading on a spot discount to NAV of -39%. Unibail, the largest European listed REIT, saw its discount to NAV widen from 11% in July 2018 to 34% in December 2018, following its takeover of Westfield.

The London office market has been remarkably resilient in the face of political uncertainty while European office stocks had a mixed performance. German residential remains in a good shape thanks to the low bond yield environment and the embedded demand/supply imbalance, although the regulatory framework continues to become more restrictive. Any stocks exposed to the Berlin market were clear winners with Deutsche Wohnen and ADO notable outperformers.

**Outlook and Investment Strategies:** UK REITs have a heavy domestic bias, making them particularly sensitive to Brexit sentiment and outcome, with most trading at significant discounts since Brexit. This risk, alongside slowing expected total returns (especially in retail), has meant major names now trade at their widest discount to NAV since the GFC, which may attract M&A activity. Smaller companies that are operating in alternative, less cyclical areas, such as student housing or PRS, are expected to deliver the strongest NAV growth and should continue to deliver relatively appealing earnings growth.

On the continent, we expect continued strength in the office market with strong earnings growth in France, Germany, Spain and Scandinavia. Vacancy rates across all larger office locations in Germany have continued to decrease and a large proportion of upcoming new space under construction has already been pre-let. Accordingly, German office companies posted solid like-for-like rental growth and have indicated further upside potential in both rent and asset values. In France, Gecina, the largest Paris office player, also saw positive rental growth and the company reiterated its willingness to focus on the city centre, where rental levels should benefit from further decreases in immediately available supply.

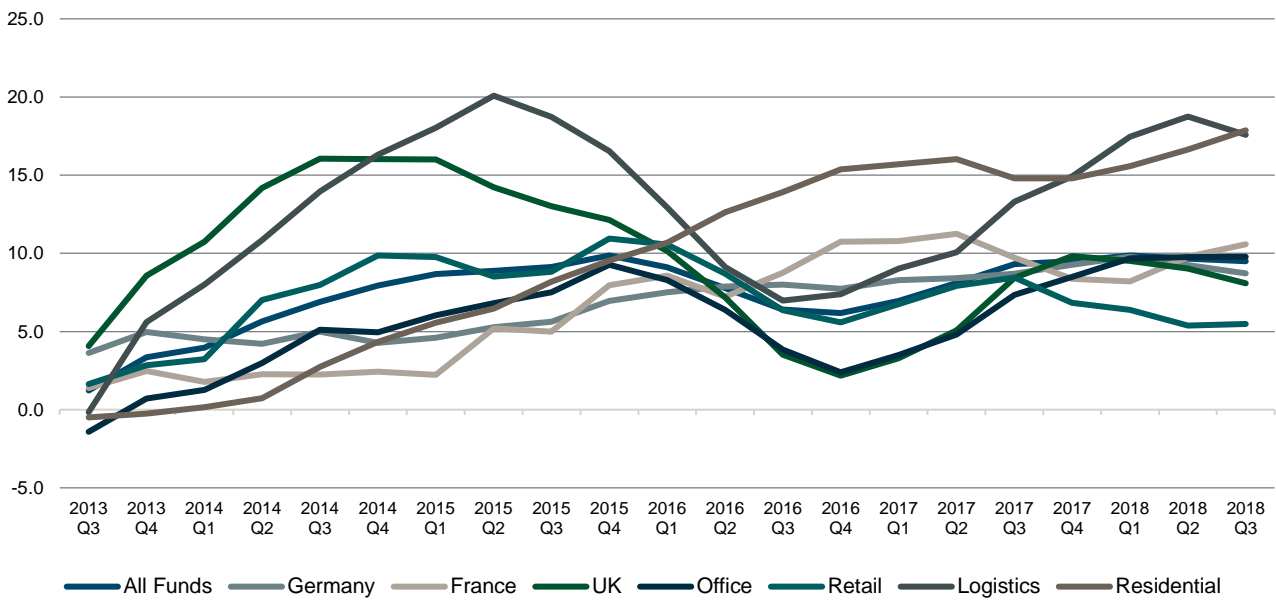
German residential has a sound basis with solid like-for-like growth and continued yield compression but as a sector it has a strong correlation to bond yield movements. The main risks lie in market rent regulation and politics, which could potentially imply some negative headlines on further rent controls. However, based on the latest rent regulation changes, the listed German property companies stressed that there should not be any material impact on their business models. While the final details still need to be clarified, a potentially lower like-for-like rental growth should be compensated by higher efficiency gains from growing portfolios and lower financing costs.

The retail sector remains our least favoured. Nonetheless, we believe that the best quality shopping centres should be able to attract footfall and sustain underlying operating numbers. The earnings results from Unibail-Rodamco-Westfield and Klépierre clearly indicated solid development in rents, rent reversions and footfall. However, yields for prime quality shopping centres are at risk of increasing as tenant concerns persist.

	Theme	Comment
Listed Market Strategies	United Kingdom	Slowing returns for U.K large caps suggest discounts to NAV unlikely to reverse in the short term, especially given political backdrop. Logistics and London office-focused names offer development surpluses that support returns.
	Continental Europe	Growth at a reasonable price – we expect office companies in Paris, Germany and Spain to be towards the top of the performance list.
	Non-cyclical alternatives	We expect student accommodation, healthcare and residential companies to deliver above-average earnings growth, higher dividends and ultimately superior returns.

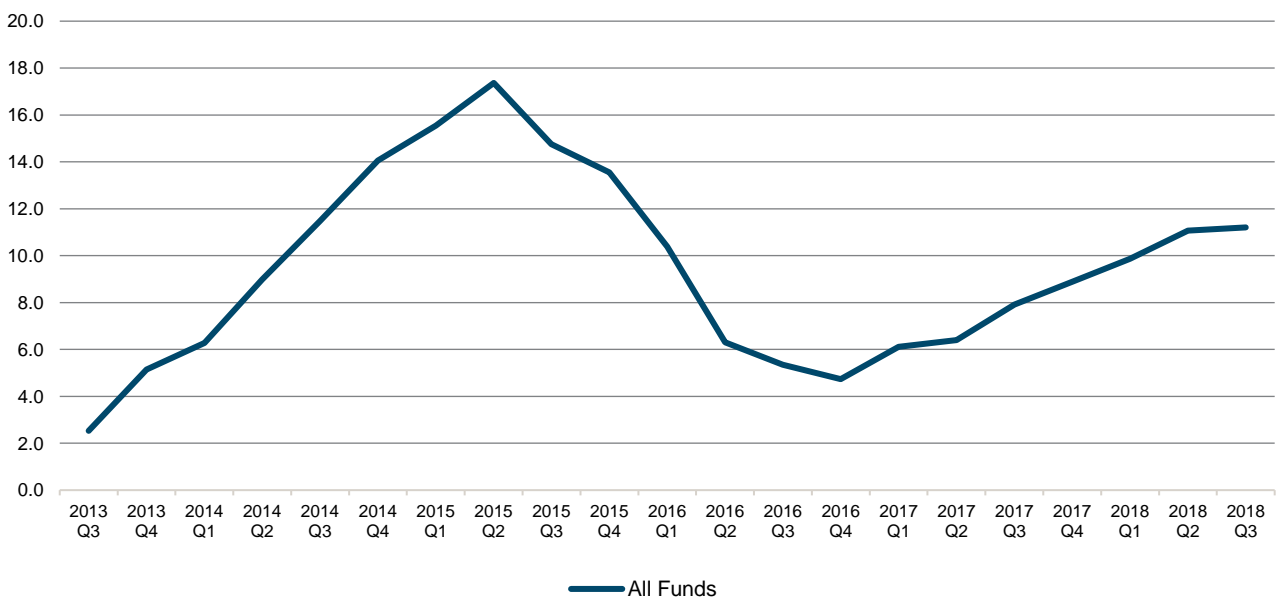
# 10 / Appendix

**EXHIBIT 8: HISTORICAL ANNUAL INREV FUND LEVEL RETURNS TO Q3 2018 (%)**



Source: INREV, December 2018  
 Note: Past performance is not indicative of future results.

**EXHIBIT 9: HISTORICAL ANNUAL MSCI FUND LEVEL RETURNS TO Q3 2018 (%)**



Source: MSCI, December 2018  
 Note: Past performance is not indicative of future results.

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The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time.

Investment in real estate may be or become nonperforming after acquisition for a wide variety of reasons. Non performing real estate investment may require substantial workout negotiations and/ or restructuring. Environmental liabilities may pose a risk such that the owner or operator of real property may become liable for the costs of removal or remediation of certain hazardous substances released on, about, under, or in its property. Additionally, to the extent real estate investments are made in foreign countries, such countries may prove to be politically or economically unstable. Finally, exposure to fluctuations in currency exchange rates may affect the value of a real estate investment.

Investments in Real Estate are subject to various risks, including but not limited to the following:

- Adverse changes in economic conditions including changes in the financial conditions of tenants, buyer and sellers, changes in the availability of debt financing, changes in interest rates, real estate tax rates and other operating expenses;
- Adverse changes in law and regulation including environmental laws and regulations, zoning laws and other governmental rules and fiscal policies;
- Environmental claims arising in respect of real estate acquired with undisclosed or unknown environmental problems or as to which inadequate reserves have been established;
- Changes in the relative popularity of property types and locations;
- Risks and operating problems arising out of the presence of certain construction materials; and

- Currency / exchange rate risks where the investments are denominated in a currency other than the investor's home currency.

An investment in real estate involves a high degree of risk, including possible loss of principal amount invested, and is suitable only for sophisticated investors who can bear such losses. The value of shares/ units and their derived income may fall or rise.

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