Deutsche
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Marketing Material

Research Report

Europe Real Estate Strategic Outlook

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Passion to Perform

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1 Executive Summary

- Our outlook for Europe remains one of gradual recovery. However, unlike previous years and notwithstanding macro shocks, Europe seems on a firmer footing due to a combination of factors, namely; Quantitative Easing, a weaker Euro, the stimulating effects from immigration, lower energy costs and structural reforms in certain labour markets. Although the continent hasn't been immune to recent global uncertainty, consumers and businesses seem so far undeterred, leading to an acceleration of GDP growth in 2015.[1]

- The underlying drivers of the real estate occupier market continue to improve. The market balance remains fragile and there are still risks to the recovery, but occupancy is improving across a number of locations and rental growth is starting to accelerate.

- Across the major commercial sectors, development activity has been exceptionally low for a number of years now. For both offices and shopping centres, the past four or five years have represented the lowest levels of net completions for more than two decades. And while activity in the construction sector is slowly beginning to pick up, it is still subdued by historical standards, and therefore vacancy rates should continue to decline over the coming years.

- The real estate investment market showed signs of ongoing strength in 2015, with all property transaction volumes exceeding €270 billion[2], a rise of more than 23% year-on-year. Given this weight of capital, yields across a large number of markets continued on their downward path in the final quarter of 2015. Despite this, property still looks attractive on a relative basis, with government bond yields remaining near record lows. However, as total real estate investment volumes begin to show signs of peaking and with bond yields expected to pick up in the medium term, we are forecasting property yields in the majority of locations and sectors to reach a floor over the next two years.

- Annual pan-European property returns for 2015 are not yet available from MSCI, but signs from those markets that report quarterly data are positive. In the prime market, returns also continued to strengthen. We estimate all property prime total returns last year were 17%, up from the 14% recorded a year earlier and the strongest performance since 2006. We are still expecting returns to moderate gradually over the coming years. That said, given the outlook for bonds to remain lower over the medium term, we do not foresee any significant downward correction to our return projections, despite recent outperformance.

- All property prime returns are set to average 6%[3] over the next five years, with the logistics sector performing slightly better than both offices and retail. Total returns are forecast to increasingly be driven by rental growth over the rest of the decade as the impact of yield compression lessens.

- On a risk adjusted basis, we believe Spain, the Netherlands and the Top 7 German cities are currently offering the most attractive returns, with Regional France and Sweden also presenting interesting opportunities. While Central London and parts of Central Paris are currently seen as relative underperformers on a five year average, both are likely to have returned to prominence by the end of the decade.

- Strategically, core real estate remains an attractive investment, offering a stable and relatively high income return at a time of continued global uncertainty. Here we see the greatest opportunities in the residential sector, parts of the logistics markets, and across central retail and office locations where assets cannot be easily replicated. While the improving demand environment may open up opportunities to take on additional risk, given a plentiful supply of space in secondary locations, this strategy should only be undertaken very selectively.

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[1] Oxford Economics, January 2016. Past performance is not an indicator of future results.
[2] RCA, February 2016. Past performance is not an indicator of future results.
[3] Deutsche AM, January 2016. Past performance is not an indicator of future results.

2 European Real Estate Strategic Themes[4]

The Alternative and Real Assets (ARA) Research team has developed a proprietary quantitative model that forms the foundation of our understanding of future real estate market performance and how it reacts to economic developments. This is combined with the qualitative insights from our investment teams and also considers a number of risks (e.g. political risks) and sentiment, and provides in total the basis for our market views.

Status Quo:

- Core real estate saw strong capital value growth during 2015, but despite taking some of this upside, the rationale for investment remains intact, with the asset class still offering attractive returns relative to other parts of the real estate market and when compared to asset classes such as bonds.
- Our current Top 5 investment recommendations include a “sell strategy”, while also cautioning against specific actions at this time in the cycle.
- Some strategies (German residential, refurbishments of standing investments) should offer options throughout the cycle.
- While the current outlook for Central London is one of weak risk-adjusted returns, this should change within the forecast period, offering attractive counter-cyclical entry strategies with high capital growth potential before the end of the decade.
- We are conscious of political risks that make certain themes vulnerable to review over the next six months.

Our resulting forecasts and house views are presented in terms of a number of executable strategies that facilitate detailed discussions with our investors regarding European real estate over the next six months. The following five recommendations represent our top calls for the European market:

1. **Supply scarcity in German residential:** We recommend a focus on the low-to-medium price segment where tenant demand is hugely outweighing supply, as capital values are still some way below replacement costs. The pressure on the residential market has been high for 12 months, but with the large number of refugees this should further increase demand for affordable space in a number of large and medium sized cities. This strategy does not focus on a significant capital growth element, as rent regulation has become a political battleground and the discussion is often sensitive. When looking at Top 7 locations, investors may only achieve modest cash returns over the holding period. However, those looking for a stabilising element in their portfolios should appreciate the exposure to defensive investments where void risks are as low as they can get in the context of European real estate.
2. **Higher income and long-term change in the logistics sector:** While the most attractive entry period in this sector has likely passed, given that yields have dropped sharply over the past 24 months, the sector still offers some of the highest risk-adjusted returns over the next five years. Income returns in France, Italy and Benelux are still above 5% and provide a healthy risk premium over sovereign bond yields. More importantly, the logistics sector provides a compelling investment outlook for a few key reasons. The rise of e-commerce in combination with increased urbanisation will continue to drive demand for space in locations with easy access to large and expanding conurbations. Currently the logistics sector is seeing polarisation between infrastructure-linked large mega-distribution / e-fulfilment facilities and smaller edge-of-town urban parcel delivery centres. Over time, available land will become scarcer, which will increase competition for the best located schemes. Long-term prospects are favourable, which could result in narrowing spreads relative to more established sectors.
3. **Underweight London today but prepare for a return:** ARA Research is currently underweight to Central London given affordability constraints, rising supply and a projected interest rate rise. With this in mind, there is a high risk of a large capital value adjustment. However, the long-term fundamentals of London are good and we anticipate a strong bounce back after the adjustment, as is typical in this market, supporting outsized returns. While our underweight call remains valid over the next 12 months it’s already time to prepare to move back in once market adjustments/corrections materialise. The current forecast suggests this could be as early as 2018 – although key indicators should be closely monitored to evaluate the cycle on a regular basis. The coming correction should be less severe than in previous cycles, but nonetheless large enough to reward investors with elevated returns during the up-cycle.
4. **Avoid the value trap:** It’s a common feature in the later stages of a real estate cycle that investor start to explore higher yielding segments to achieve projected returns above their hurdle rates. This can work but

[4] Any forecasts provided herein are based upon Deutsche AM’s opinion of the market at this date and subject to change dependent on the market.

it is very risky, in particularly, when Investors' targets lack competitiveness. In particular assets in out of town office parks are vulnerable to long-term void periods when major lease events collide with new development completions and tenants are poached. Also the segment remains illiquid in large parts of the cycle, which makes the holding period anything but flexible. Also rents are typically exposed to (at times significant) downward adjustments when occupiers prolong their lease or new leases are agreed. Investors should rather look at this segment at the beginning of a cycle, shortly after values got punished by capital markets fleeing into haven assets. This is when replacement costs are way above current values, the yield spread vs. prime is close to its peak and owners can aggressively price out competition for tenants throughout the holding period if needed.

5. **Use the favourable investment market for disposal of non-core assets:** The non-core segment has finally become liquid again. We advocate using the strong influx of overseas money to dispose of those buildings that will deteriorate further in coming cycles due to age, location or general quality. This opportunity doesn't materialise often and large fund managers should use this window for serious portfolio optimisation. A detailed hold and sell analysis should identify those assets that could even be sold at a loss, as additional time will most likely not cure major deficiencies. Portfolio sales could be an efficient way to carry out this strategy, as in particular USD investors seem to have a strong appetite for Euro assets at the moment.

In addition to those detailed above, we see a number of other compelling investment calls.

These include, buy calls on prime retail on the major high streets which continue to attract international retailers looking to showcase and brand build, and in the Iberia markets where a strong rental rebound is now being realised. A call for caution against style drift, and a Sell call to realise gains in those markets that look to have reached the top of their cycle.

	Theme	Type	Sector	Country	Focus	Main rationale
Top 5	Supply Scarcity ★	Buy	Resi	Germany	Multi-Family	Regional migration; massive shortage of supply
	Higher Income ★	Buy	Logistics	Pan-Europe	Growing Metros	Exploit impact of megatrends; population and urbanisation
	Prepare to Return ★	Buy	Office	London	Prime Pitch	Buy counter cyclical from 2018 onwards
	Value Trap ★	Caution	Office	Pan-Europe	Out-of Town	Caution towards out of town locations with structurally high vacancy
	Portfolio Sales ★	Sell	Office	Pan-Europe	Underperformer	Take advantage of short time window to dispose non-core assets

	Theme	Type	Sector	Country	Focus	Main rationale
Buy	Prime Office	Buy	Office	Pan-Europe	Prime Pitch	Stable income allowing asset to be held across cycle
	Highstreet	Buy	Retail	Pan-Europe	Highstreet	Supply constrained. Demand for brand building / showrooming
	Regional Hubs	Buy	Various	Pan-Europe	Late recovery markets	Exploit good value in regional late recovery markets
	Iberia (Top 3)	Buy	Office	Iberia	Central locations	Take advantage of improving occupancy and rent growth potential
	Refurbishments	Buy/Hold	Various	Pan-Europe	Refurb/Lease Up	Create value improving well located standing investments
	Spec construction	Buy	Various	Pan-Europe	Spec Construction	Exploit low availability in major office, residential and logistics hubs
	Theme	Type	Sector	Country	Focus	Main rationale
Caution	Prepare to move	Caution	Office	CEE	Prime Pitch	Yield spread looks attractive but political risks haven risen sharply
	Style drift	Caution	Office	Pan-Europe	Non-prime assets	Caution against assets with risk in excess of portfolio strategy
	Economic Risk	Caution	Various	Finland	All	Economic weakness and emerging political risk
	Political Risk	Caution	Various	Various	All	Growth of non-mainstream parties; regional separatism; stresses to E.U.
	Theme	Type	Sector	Country	Focus	Main rationale
Sell	Markets at Peak	Sell	Office	Pan-Europe	CBD	Realise strong capital gains of current cycle

Source: Deutsche AM, January 2016. The comments, opinions and estimates contained herein are based on or derived from publicly available information from sources that we believe to be reliable. We do not guarantee their accuracy. This material is for informational purposes only and sets forth our views as of this date. The underlying assumptions and these views are subject to change without notice.

3 The Economy

Our outlook for Europe remains one of gradual recovery. However, unlike previous years, Europe seems on firmer footing due to a combination of factors, namely; QE, a weaker Euro, the stimulating effects from immigration, lower energy costs and structural reforms in certain labour markets. Although the continent hasn't been immune to recent global uncertainty, consumers and businesses so far seem undeterred, leading to an acceleration of GDP growth in 2015.[5]

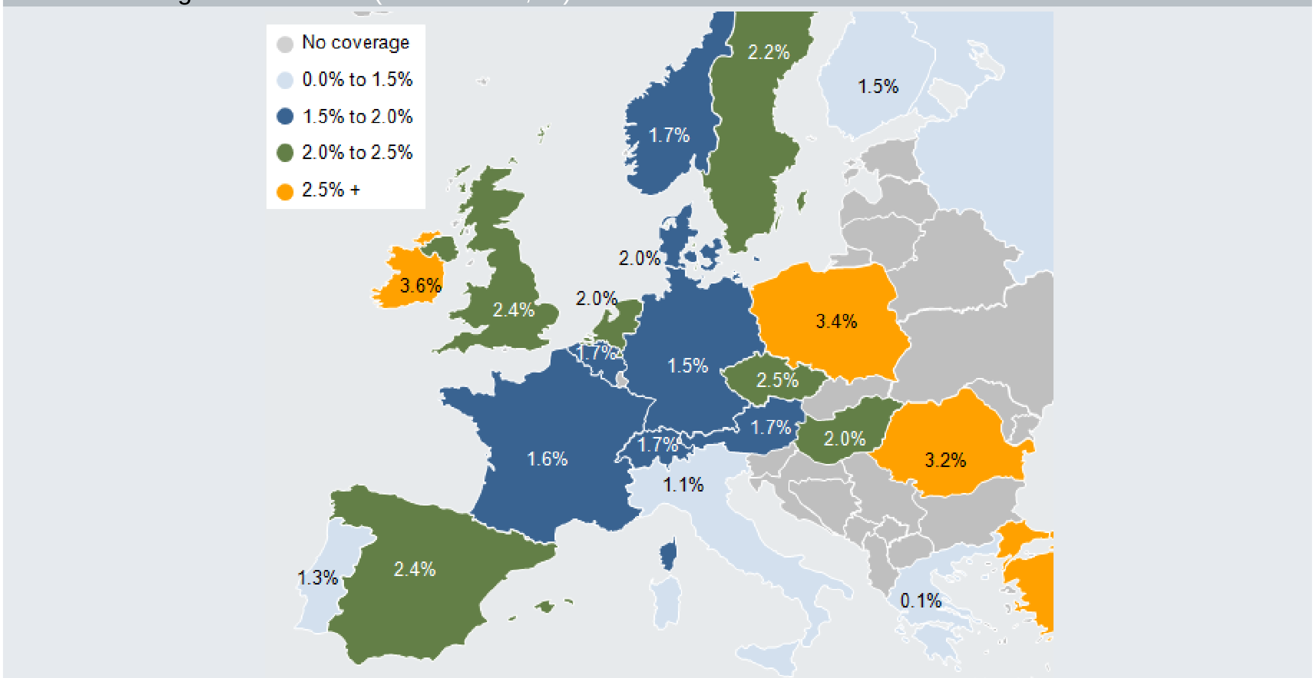
Despite financial market volatility and some moderation in January, many lead indicators continued to show solid growth in early 2016. This was evident in the Purchasing Managers' numbers which showed private sector growth in the Eurozone still expanding at a decent pace.[6] And with the European Commission's Economic Sentiment Indicator still well above average in January, this suggests that this growth should be sustained throughout the early part of 2016.[7]

The acceleration of growth is being driven by the consumer and exports. Household balance sheets are benefitting from the continued fall in fuel prices and the creation of an additional 2.5 million European Union jobs over the past year, while the weakening of the Euro supported export growth of around 5% in 2015. Going forward business investment is set to become an increasingly important part of the recovery story, having been hampered by banking sector deleveraging, as credit conditions are now easing.[8]

Euro depreciation has come on the back of further easing by the ECB. The ECB has not been alone in loosening, with rate cuts seen in both the Nordics and the CEE. With inflation running close to zero, record low bond yields remain with 5-year yields negative in countries such as Germany and Sweden.

This return to growth is not expected to be highly inflationary. Although the drag from falling oil prices will likely fade this year, there remains considerable spare capacity and monetary policy should thereby remain accommodating for the rest of the decade. With this, the relative attractiveness of real estate income returns should be favourable for some time. Even in the United Kingdom, where policy rates may rise as early as 2016, rates are forecast to be less than half their pre-recession level at the end of the decade.[9]

Annual Average GDP Growth (2016f-2020f, %)



Source: Oxford Economics, December 2015.

Note: f = forecast. There is no guarantee that the forecasts will materialise.

[5] Oxford Economics, January 2016.
[6] Markit, February 2016.
[7] European Commission, February 2016.
[8] European Central Bank, October 2015.
[9] Oxford Economics, January 2016.

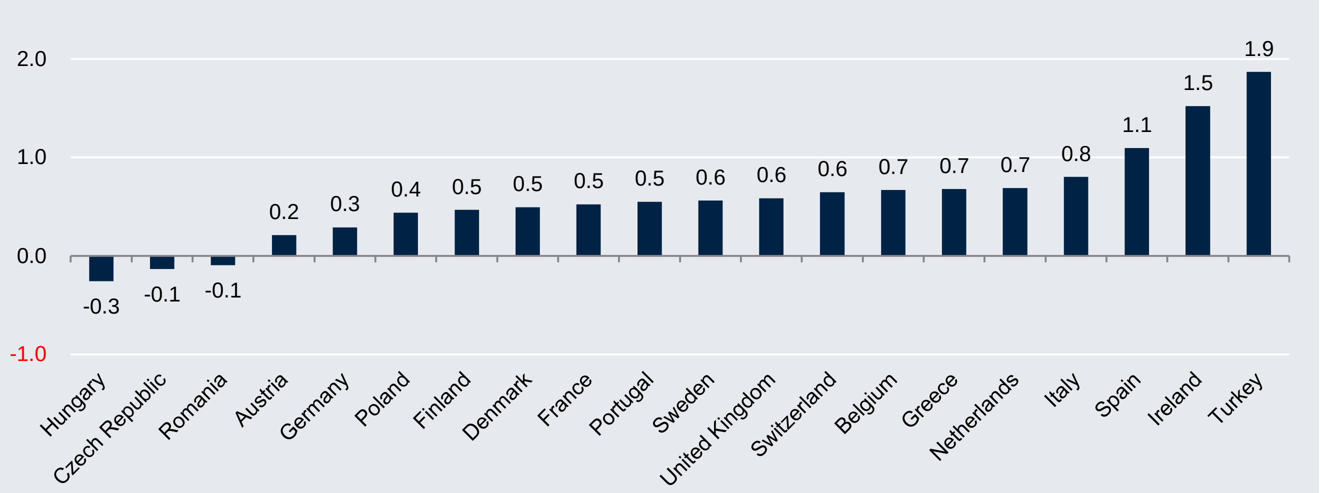
GDP growth in Europe is still tending to be strongest in countries outside the Eurozone, although the gap is closing. Although on average the outlook is little changed from six months ago, countries such as the Netherlands and Sweden have been modestly upgraded.

Of the three largest economies – accounting for half of E.U. output – Germany is doing well and is likely to benefit from additional spending to support recent inflows of refugees, while the French recovery may now gather pace in 2016 on the back of a more business friendly policies environment. Having slightly disappointed in 2015, the United Kingdom is set to remain one of the better performers over the coming years, although uncertainty over E.U. membership could dampen activity in the run up to the referendum.

Across the rest of Europe, Spain saw some of the highest growth in 2015, and should continue to benefit from previous reforms and cost adjustments, while Italy is showing signs of outperforming expectations. The exporting countries of the Benelux are set to benefit from the weaker Euro, while Sweden is the stand out performer in a Nordics region buffeted by lower commodity prices and required structural adjustment. CEE countries should further converge with Western Europe, although recent moves by the new Polish government have increased downside risks to the outlook.

The unemployment rate fell across virtually every country in the European Union during 2015,[10] and on aggregate is forecast to trend lower over the rest of the decade. Despite projections of an almost unchanged working age population, the revival of the labour market is set to create an additional six million jobs by 2020 and will be one of a key driver of real estate demand.[11]

Employment Growth (2016-20f, % p.a.)



Source: Oxford Economics, January 2016.
Note: f = forecast. There is no guarantee that the forecasts will materialise.

Political risk remains evident across the continent. Elections in Portugal and Spain yielded inconclusive results, while the actions of the new government in Poland are already under scrutiny from the European Commission.
The high volume of refugees entering the European Union, could provide a long-term boost for real estate demand, but today is straining relations between governments and threatening the future of the Schengen free-travel zone. Any restrictions on border-free travel could have a considerable impact upon cross-border trade and the logistics sector.

Political risk is on the rise in the United Kingdom. This year will see the vote on European Union membership and the Scottish parliamentary elections in May look set to solidify the majority of the Scottish National Party, raising the risk of a second referendum on independence.

In general however the macroeconomic environment in Europe should be supportive to real estate activity. GDP growth and the creation of jobs would continue to boost occupancy demand at the same time as low interest rates remain supportive of real estate pricing.

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[10] Eurostat, January 2015.
[11] Oxford Economics, January 2015.

4 Real Estate Performance

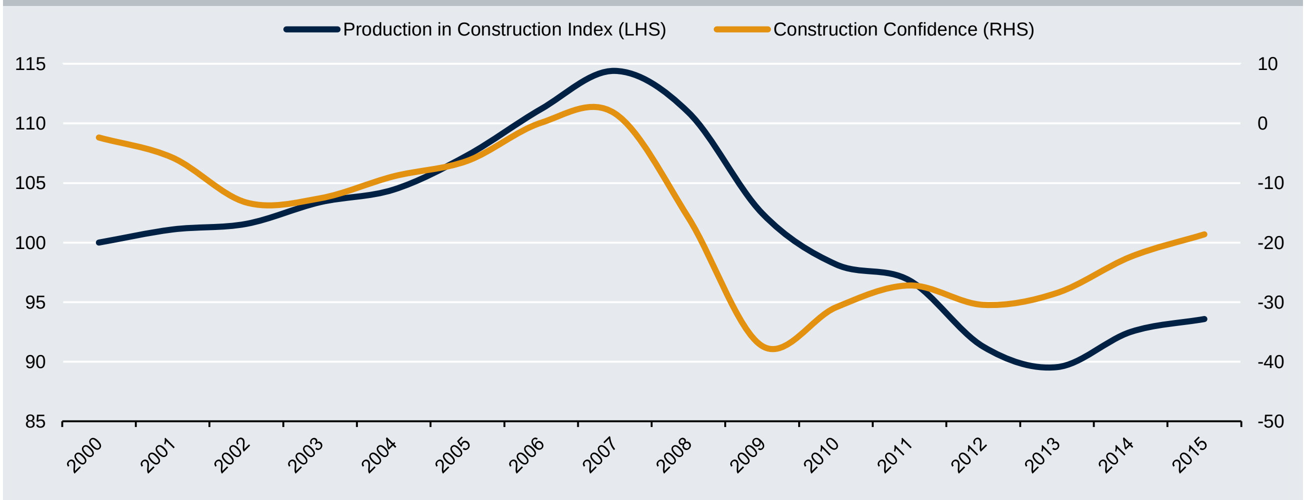
The underlying drivers of the real estate occupier market continue to improve. While the market balance remains in its recovery phase, occupancy is improving across a number of locations and rental growth is starting to accelerate.

4.1 Occupier Fundamentals

Economic growth is undeniably one of the most important drivers behind European real estate performance. When the economy performs well, businesses are generally more profitable and look to expand, taking on more employees. Consumers also tend to have increased levels of income at their disposal, which leads to growing retail sales, and in turn to an increased need for logistics space. The correlation between European all property prime rental growth and GDP growth is high, at 0.7 over the past 25 years.[12]

However, economic growth is only one piece of the puzzle. The volume of new construction in the market should also be monitored carefully, as even a stable economy can struggle to cope with excess supply. Across the major commercial sectors, development activity has been exceptionally low for a number of years now. For both offices and shopping centres, the past five years have represented the lowest levels of net completions for more than 20 years. And while activity in the construction sector is slowly beginning to pick up, it is still subdued by historical standards.

EU Construction Indicators



Sources: Eurostat, European Commission, January 2016.

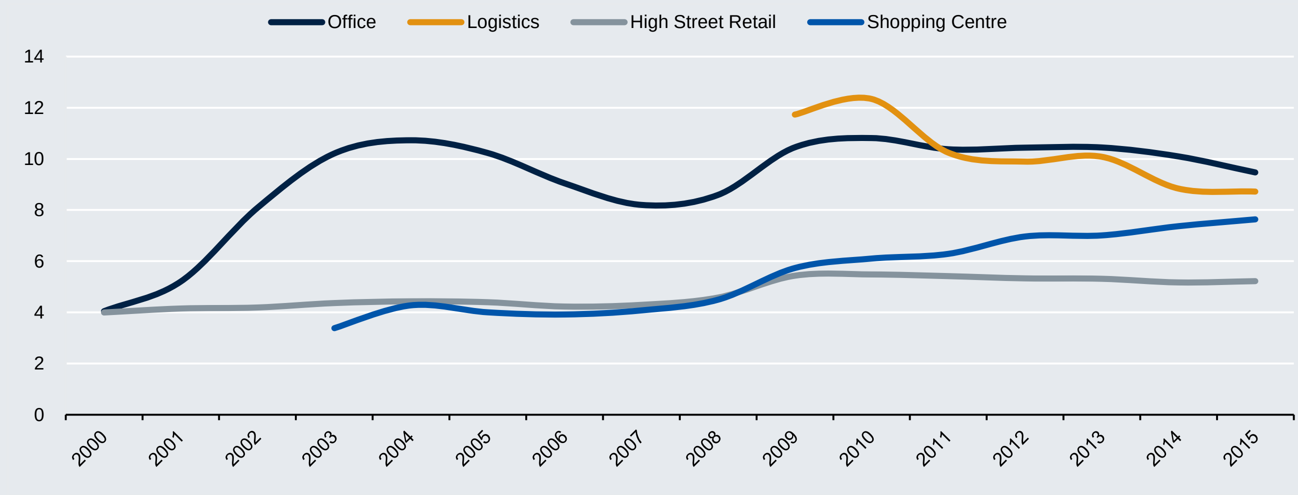
In the office and logistics sectors, the proportion of speculative development remains low. Developers are still cautious as underlying occupier conditions are only gradually improving, and at the same time availability of development finance has been quite low. In the United Kingdom, which is perhaps slightly further ahead in the cycle, just one quarter of lenders surveyed were prepared to offer financing for speculative development as of mid-year 2015, although over half would finance pre-let development. There is also still a reluctance to lend on property outside the major cities. In the case of the United Kingdom, over 50% of lenders would consider lending on development in London, but this figure is cut in half when looking at the U.K. regions.[13]

Following the overhang of supply that was started during the previous boom and completed during the worst of the crisis, vacancy rates across all sectors remain above average. Certain sectors have begun to see the positive effects of recovering occupier demand combined with weak development. The logistics sector in particular has seen a notable fall in vacancy in recent years, with demand buoyed by recovering external demand and by structural changes to retailing, although these changes have had a very different impact on the retail sector itself. While vacancy on the high street has slowly edged downwards since the crisis, shopping centres have

[12] Oxford Economics, Deutsche Asset Management, January 2015.
[13] De Montford University Commercial Property Lending Market: Mid-Year 2015.

on average struggled to maintain occupancy levels, highlighting the challenges that face the sector. That said, although the trends discussed here are certainly visible in the aggregate European numbers, there are clear discrepancies between locations and within sectors, as discussed below.

Pan-European Commercial Vacancy Rates (%)



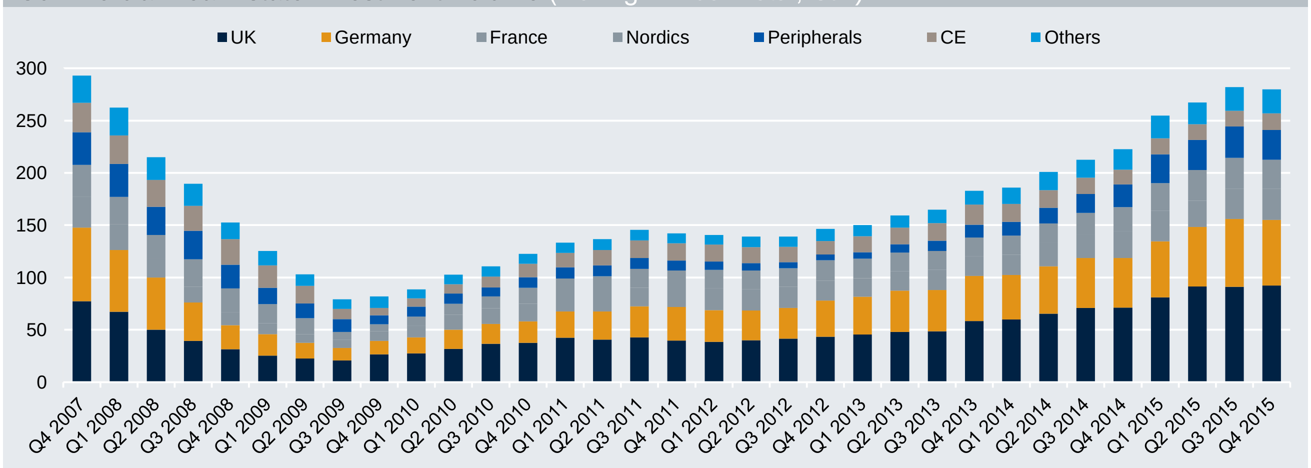
Sources: PMA, Deutsche AM, January 2016.
Notes: 2015 figures relate to forecast year-end for offices and to latest available observations for logistics and high street retail. Retail vacancy relates to % of units. Weighted by volume of stock in each major European market.

Completions of office and logistics space are set to increase, yet the supply picture should still support a further decline in vacancy in the short term. Toward the end of the decade, we expect that development activity will accelerate, putting upward pressure on vacancy. This is most likely to be apparent in the office sector, although we also expect to see increasing levels of speculative logistics development. The retail supply pipeline is limited, with shopping centre development in particular remaining exceptionally low. This will not necessarily have a positive impact on average shopping centre vacancy given the general reduction in retail demand. However, we expect further polarisation, with the best-performing centres maintaining high occupancy, while prime high streets in major cities should maintain their current low vacancy levels.

4.2 Capital Markets and Pricing

The real estate investment market showed signs of ongoing strength in 2015, with all property transaction volumes exceeding €270 billion, a rise of more than 23% year-on-year. Although final quarter volumes are yet to be finalised, the pace of expansion appears to have slowed slightly in the fourth quarter and it is possible that final quarter investment will be down marginally compared to the same period in 2014.

Commercial Real Estate Investment Volume (Rolling Annual Total, €bn)



Source: RCA, January 2016.

The rise in investment activity was relatively equally spread across the continent, with the Benelux, CEE and Southern European regions, as well as Germany and the United Kingdom, seeing annual growth of 20%-30%[14]. France saw slightly weaker growth after a slow second quarter, although strong activity in the second half of the year meant that annual volumes were up by 15%. After a surge in activity in 2014, Spain saw the slowest growth of the major Eurozone economies at just 5%, although this still represents over €11 billion of transactions.

In Poland, short-term over-supply is still a concern and investment activity was flat year-on-year. The Polish market is likely to attract continued investment due to its strong long-term growth prospects, however, recent political events are causing some uncertainty, and this may constrain investment in the short term.

Outside the main commercial sectors, both apartment and hotel volumes set new records, easily passing their previous peaks from 2007. Although the investable hotel market remains relatively small, more than €23 billion of deals completed across Europe in 2015, a rise of almost 50% year-on-year[15].

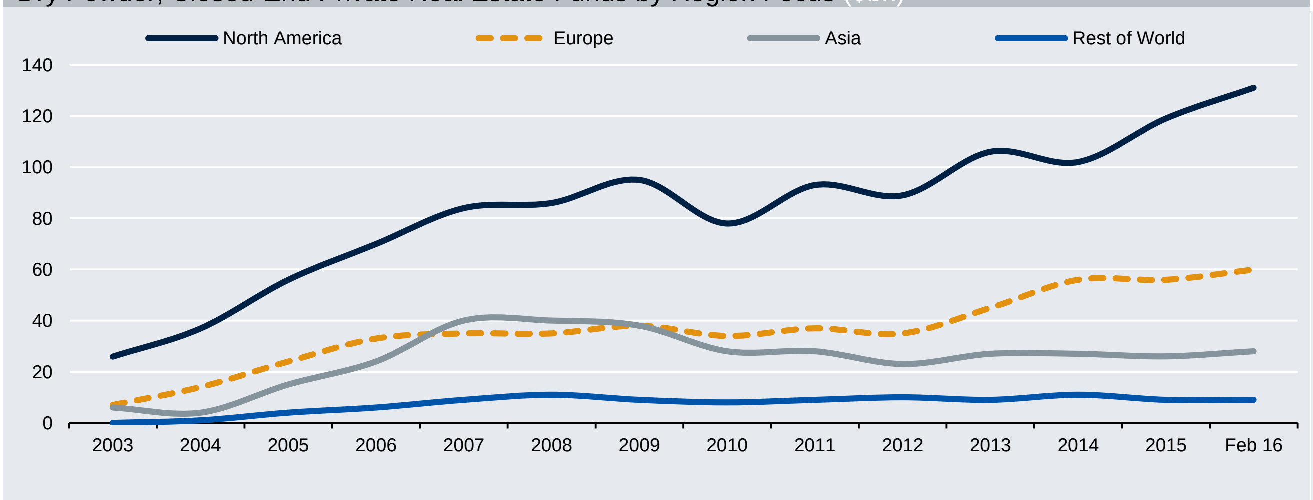
Six months ago we noted a rise in portfolio transactions across the continent. While the proportion of portfolio transactions has reached a plateau at around one third of total investment over the past year, we are still seeing anecdotal evidence that such deals continue to attract a pricing premium, whereas two or three years ago the reverse was true.

Capital flows continue to be supported by an accommodative monetary policy environment, lower financing costs, increasing availability of debt and overseas investors seeking to increase their European holdings. However, LTVs remain considerably lower than in 2006/07.[16]

Global capital continued to pour into Europe last year, and around one third of total investment came from non-European investors, with North America accounting for the majority of that[17]. It seems European investors are also looking to build up their portfolios further, as around two thirds expect to increase their real estate allocation over the next two years, with the majority of any increased allocation destined to stay within Europe.[18]

There is still significant Europe-focused fundraising in the private real estate market, although the total raised during the first 11 months of 2015 was down by 40% compared to the same period a year earlier. However, the proportion of investors globally that are targeting Europe over the next 12 months has increased to 47%, from just 36% a year ago. And as of February 2016, there was $60 billion of dry powder available for European investment, up by $4 billion since the end of 2015.[19]

Dry Powder, Closed-End Private Real Estate Funds by Region Focus ($bn)



Source: Preqin, January 2016.

[14] RCA, February 2016.
[15] RCA, January 2016.
[16] CBRE, November 2015.
[17] RCA, January 2016.
[18] INREV, January 2015.
[19] Preqin, December 2015 / January 2016 / February 2016.

That said, as core pricing, which is already at record levels in a number of markets, continues to tighten further, investors are edging further up the risk curve, looking towards second and third tier cities and non-traditional property sectors, a trend we expect to continue. With the economic recovery broadening, occupier risks in these markets are generally falling; however, there are still a number of out-of-town locations suffering from very high vacancy, and this strategy requires investors to be highly selective and to hold a detailed understanding of local conditions.

In the final quarter of the year, early indications are that yields largely continued on their downward path. While a small majority of markets saw no change on a quarterly basis, there were still a large number of locations where yields fell. There was no clear geographical pattern, but yields were generally decreasing in the Benelux countries, Stockholm, and major cities in the United Kingdom, France and Germany. The decline slowed a little in Southern European offices, where yields have moved rapidly over the past two years.[20] Across Europe, it is logistics yields that are falling fastest at the moment, but the sector still offers a significant premium over offices and retail.

Despite lower real estate yields, property still looks attractive on a relative basis. With government bond yields near record lows, the spread with property yields is still well above the long-term average. We expect the gap between logistics and the other sectors to close further this year, given the weight of capital looking for investment in the logistics sector, attracted by structural changes in retailing. However, as total real estate investment volumes begin to show signs of peaking and with bond yields expected to pick up in the medium term, we are forecasting property yields in the majority of locations and sectors to reach their floor over the next two years.

One exception to this trend is likely to be the CEE region. On one hand the political situation and potential real estate oversupply in Poland are leading some investors to take their foot off the pedal for now, which we expect to put the downward yield trend on hold temporarily. But on the other hand, the strong growth forecast and continued convergence with Western Europe should lead to continued investment demand across the region in the medium term, reducing the yield spread over Western Europe.

Elsewhere, the pace and timing of property yield expansion towards the end of the decade is anticipated to vary with market fundamentals and as monetary policy outlooks diverge. Recent Monetary Policy Committee meetings in the United Kingdom suggest that a rate rise is still some way off, but this is still likely to be ahead of a similar move by the ECB. We foresee a slight rise in European property yields over the five years, although the current large spread over bonds and pick up in expected rent growth should keep a lid on the rise.

4.3 Commercial Real Estate Returns

Annual IPD pan-European property returns – a measure of the market average – are not yet available for 2015, but signs from those markets that report quarterly data are still generally positive. In the United Kingdom, the level of returns slowed in 2015; however, at 13% were still well above average. Likewise in Ireland, returns of 25% in 2015 were down from the previous year's record figure, although were still double their long-term average. The Netherlands commercial property market, which has been slower to recover following the previous crisis, has continued to strengthen. All property returns of 7.6% year-on-year in the third quarter were up significantly since 2014, and full year returns are likely to return close to historical levels.[21]

In the prime market, returns also continued to strengthen. All property prime total returns last year are estimated to be 17%, up from 14% a year earlier and the strongest performance since 2006. Given the ongoing falls in property yields, which have happened slightly faster and to a greater extent than we had expected, these estimated return figures represent a slight upward revision compared to our forecasts six months ago.

We are expecting returns to average 6%[22] per annum over the next five years, with the logistics sector performing slightly better than both offices and retail. We believe this return is set to be somewhat frontloaded, as yields continue to move lower during 2016. By the back end of the decade, returns will increasingly be driven by rental growth as the impact of yield compression lessens and in places reverses as bond yields pick up from today's record lows. In addition to rising headline rents, periods of falling vacancy and declining incentives should also give a further boost to net operating incomes – upsides not directly captured in these forecasts.

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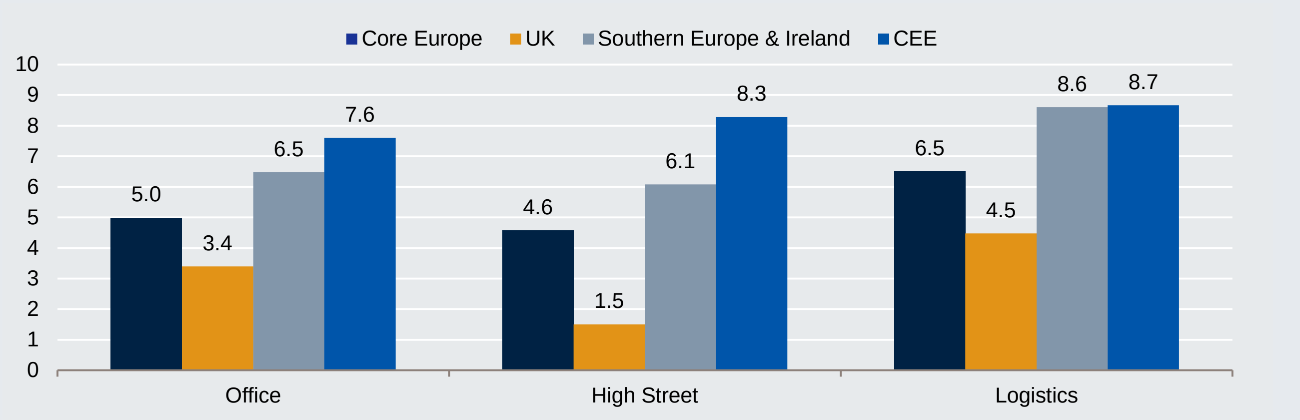
[20] JLL, January 2016.
[21] IPD, January 2016.
[22] Note: f = forecast. There is no guarantee that the forecasts will materialise.

Compared to other asset classes such as bonds, real estate returns of 6% still look attractive. As at the end of 2015, the average yield on a five year Eurozone government bond had fallen close to zero, with the average 10-year bond at less than 1.5%.

Annual Average European Prime Total Returns by Sector and Region (2016-20f, %)



Source: Deutsche Asset Management, January 2016. Note: f = forecast. There is no guarantee the forecast will materialise.

Office returns increased for the third consecutive year last year to reach a nine-year high. Although rent growth has yet to really take off – rents grew by a modest 1.3% during the first nine months of the year – yields fell by 30 basis points over the same period, boosting capital values.[23] Total returns are estimated to have reached 16% over the year, with Southern Europe some way in front in terms of performance.

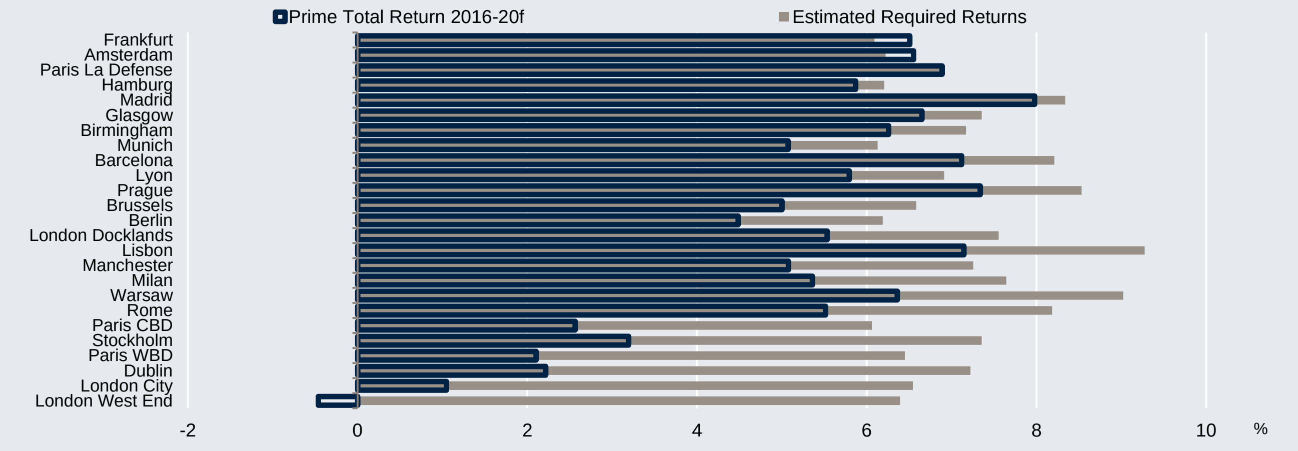
This year should see another period of above average office returns across most countries, with Southern Europe remaining the top performing region. But from 2017 onwards it is the CEE markets that we expect to outperform. This should particularly be the case in Warsaw, once the supply situation there is resolved and when investors will hope to have a little more clarity on the political situation.

Six months ago, our estimates of a typical institutional investor’s required return (ungeared) over the period 2015-19 showed that there were still a number of locations that offered good relative value. The estimates in the charts below are of a typical institutional investor’s required return (ungeared) over the period 2016-20. By looking at the risk-free rate and taking into account a number of factors such as market transparency, return volatility and investment liquidity, it is possible to estimate the required rate of return for each market and compare this to the expected total return. Re-running this analysis for the period 2016-2020 and based on our latest forecasts suggests that there are now fewer markets where this is the case, although clearly it is still important to consider relative attractiveness, and possible upsides to returns from lower vacancy and reduced incentives.

Based on this methodology, the German, Benelux, Spanish and regional French markets still appear to offer reasonable value, coming close to matching their target rates of return. But at the other end of the scale, markets such as Paris CBD, Paris WBD and Stockholm, where pricing has become very tight, have begun to look less attractive both in absolute and relative terms.

[23] PMA, November 2015; Deutsche Asset Management, January 2016. For illustrative purposes only. Past performance is not an indicator of future results.

Prime Office Total Returns & Estimated Required Returns (% p.a.)



Sources: Deutsche Asset Management, January 2016 based on data prepared by Oxford Economics, PMA, JLL, and RCA.

Note: f = forecast. There is no guarantee the forecast will materialise.

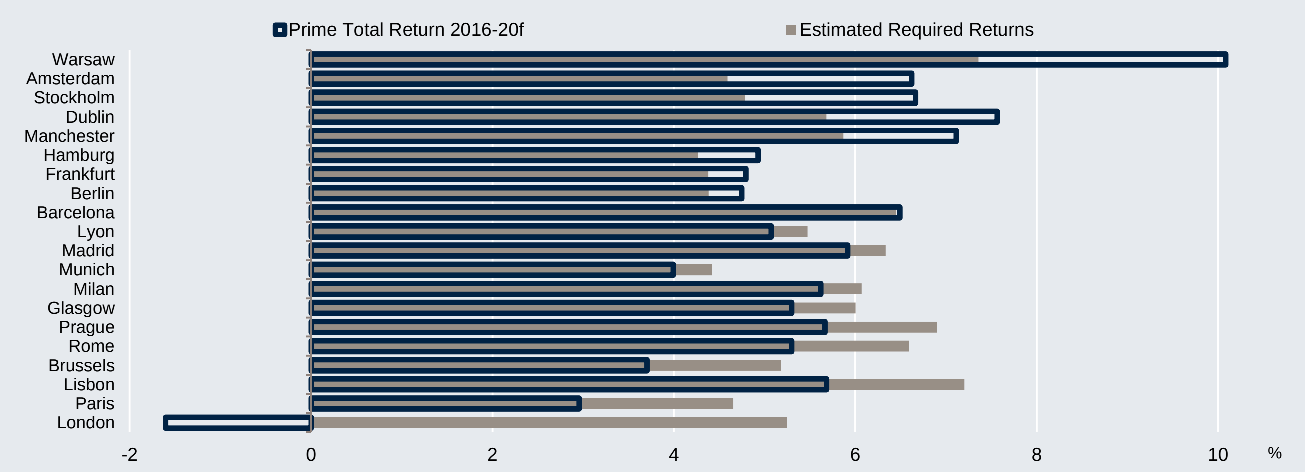
On a five-year basis, London remains firmly rooted to the bottom of the table, with a stronger yield rise and potential rental correction expected to drag down returns in the medium term. However, we believe that the market should begin to offer some countercyclical opportunities in several years time. Another market that appears near the bottom of the table is Warsaw. Like London (although for different reasons) we expect Polish offices to perform well towards the back end of the five-year forecast period.

Looking away from the major cities, we believe there are still be opportunities in select secondary cities, although this strategy has largely already played out in the United Kingdom and Germany. Other parts of the CEE region such as Istanbul and Bucharest may also begin to offer more opportunities at the higher-risk end of the spectrum, but with the potential to benefit from longer-term convergence as these markets develop.

High street retail has consistently outperformed the other commercial sectors over the past ten years, and last year was no different. Estimated total returns for the year surpassed the 20% mark, and the sector is once again expected to be the top performer this year, driven by strong rent growth in London and Southern Europe, as well as falling yields across all markets.

From next year, despite rents continuing to grow, the high street's low and rising yields will begin to weigh on total returns. We are still forecasting London and Paris, where a number of prime retail investments have transacted at yields below 3%, to lag behind towards the end of the forecast period, following a period of strong returns. On the contrary, the CEE markets are set to outperform over the second half of the forecast period due to a combination of higher income returns and continued convergence towards Western Europe.

Prime Retail Total Returns & Estimated Required Returns (% p.a.)



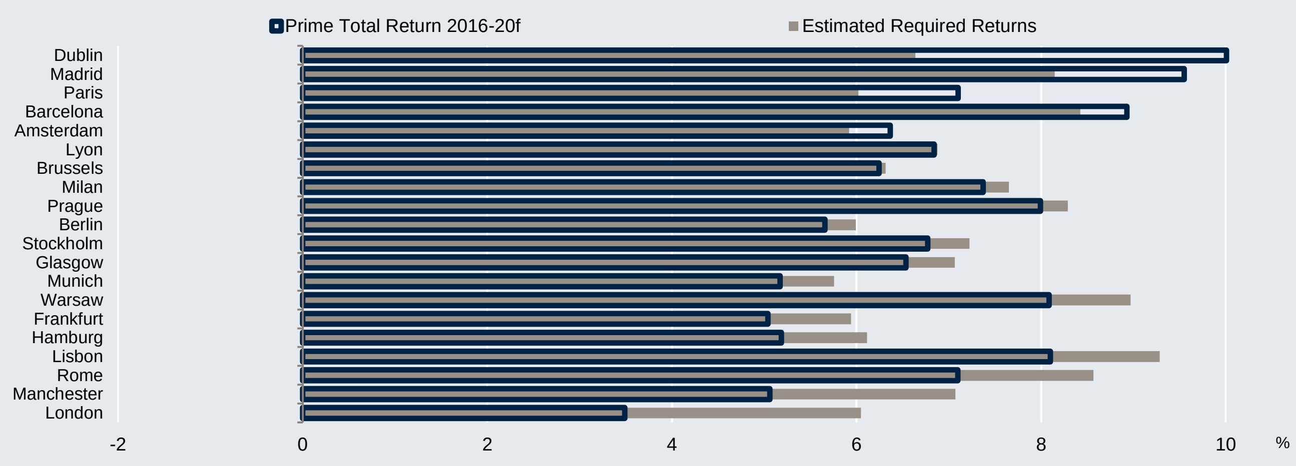
Sources: Sources: Deutsche Asset Management, January 2016 based on data prepared by Oxford Economics, PMA, JLL, and RCA.

Note: f = forecast. There is no guarantee the forecast will materialise. For illustrative purposes only.

Prime logistics returns have surpassed 18% in 2015. Given strong occupier demand, rising rental growth and falling yields, it is perhaps unsurprising that logistics market performance has been improving. The spread between office and logistics yields reached a cyclical high of 250 basis points in 2013, but growing interest in logistics has put increased pressure on yields within the sector, and the spread over offices has since fallen by 40 basis points. Over the coming five years, we are forecasting this spread to fall below 200 basis points, a factor that should help logistics to be the best performing commercial sector, bolstered by higher income returns.

We continue to favour the Southern European markets over the next five years, although France should also provide good opportunities, particularly the Greater Paris region. Paris logistics still offers a yield spread of close to 300 basis points over prime central Paris offices, while rents have begun to increase during the past 12 months. Conversely, like the other sectors, London is set to fall well short of its target rate.

Prime Logistics Total Returns & Estimated Required Returns (% p.a.)



Sources: Deutsche Asset Management, January 2016 based on data prepared by Oxford Economics, PMA, JLL, and RCA.

Note: f = forecast. There is no guarantee the forecast will materialise. For illustrative purposes only.

4.4 Market Positioning Calls

The table below provides a regional summary of suggestions for market positioning given the performance outlook for real estate across cities and sectors.

Based on our forecasts for prime real estate, these calls provide guidance on where investors are likely to find the highest risk-adjusted returns over the next five years, and where they should look to reposition their exposure to real estate over the coming 12 months.

Our recommendations are not all encompassing within the real estate investment universe and therefore should be viewed in conjunction with the strategic themes shown in this document.

	Office	High Street Retail	Logistics
Spain	Overweight	Overweight / Neutral	Overweight
Netherlands	Overweight / Neutral	Overweight	Overweight
German Top 7	Overweight / Neutral	Overweight / Neutral	Neutral
Regional France	Overweight / Neutral	Neutral	Overweight / Neutral
Sweden	Underweight	Overweight	Neutral
Czech Republic	Neutral	Neutral	Overweight / Neutral
Poland	Neutral / Underweight	Overweight	Overweight / Neutral
Italy	Neutral / Underweight	Neutral	Neutral
Regional UK	Neutral / Underweight	Overweight / Neutral	Underweight
Central Paris	Neutral / Underweight	Underweight	Overweight*
Central London	Underweight	Underweight	Underweight*

Note: *Greater London / Ile de France.

Source: Deutsche Asset Management, July 2015. For illustrative purposes only.

5 Office Market Outlook and Strategies

5.1 Current Conditions

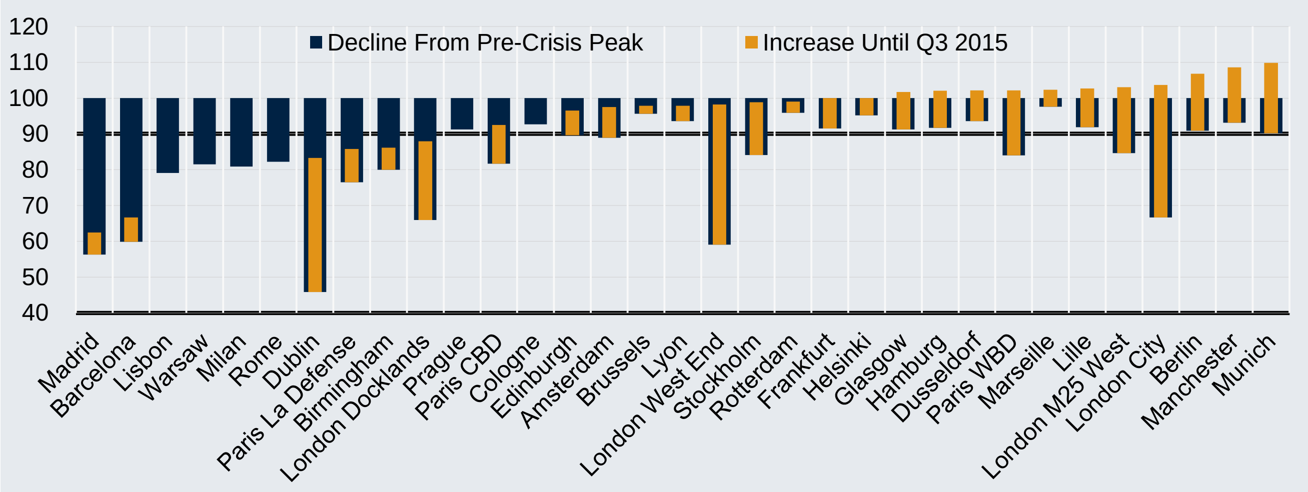
Occupier fundamentals have improved across the majority of major European office markets. Importantly, business confidence is positive across much of Europe which has manifested itself in an estimated 300,000 extra office jobs during 2015, a rise of 1.7% on the previous year. The strongest office employment growth was seen in Spain, Central Europe and parts of the United Kingdom – in particular London and Manchester.[24]

This has translated into higher demand for office space. Aggregate European office take-up in the third quarter was up by around 9% on a rolling annual basis, with the Southern and Central European markets seeing growth of around 30% and 70% year-on-year, respectively.[25]

Meanwhile, although net completions reached their highest levels for five years in 2015, activity is still well down on historical levels. There are a few exceptions to this, however. Annual net completions in Warsaw are running at around 7% of stock, while developers are building again in Central London with starts up 70% in 2015.[26]

European average vacancy fell again in the third quarter, reaching 9.6%, its lowest level since 2009. In turn, prime office rents also grew for the twelfth consecutive quarter, and early indications are that the trend continued in the final three months of the year.

Decline and Recovery of Prime Office Rents (Last Peak = 100)



Note: Last peak between 2006-2009; Trough between 2008-Q3 2015.
Source: PMA, November 2015.

Having turned a corner, the Spanish market remains the current top performer, with prime rents up by 11% year-on-year in both Barcelona and Madrid. The United Kingdom also continued to do well, with rental growth accelerating in both London and the regional markets. While growth in the German Top 7 has been more modest, this comes on the back of a sustained period of outperformance, and rents are already above previous peaks. Paris remains subdued, with rents bucking the trend and moving lower during 2015, while Warsaw is still suffering from major oversupply and despite record levels of take-up saw a third year of rental decline.

5.2 Outlook

The gradual recovery of the European economy, and the addition of an estimated 2.5 million E.U. office jobs, will be the key driver of office demand over the second half of the decade. Without much additional new supply

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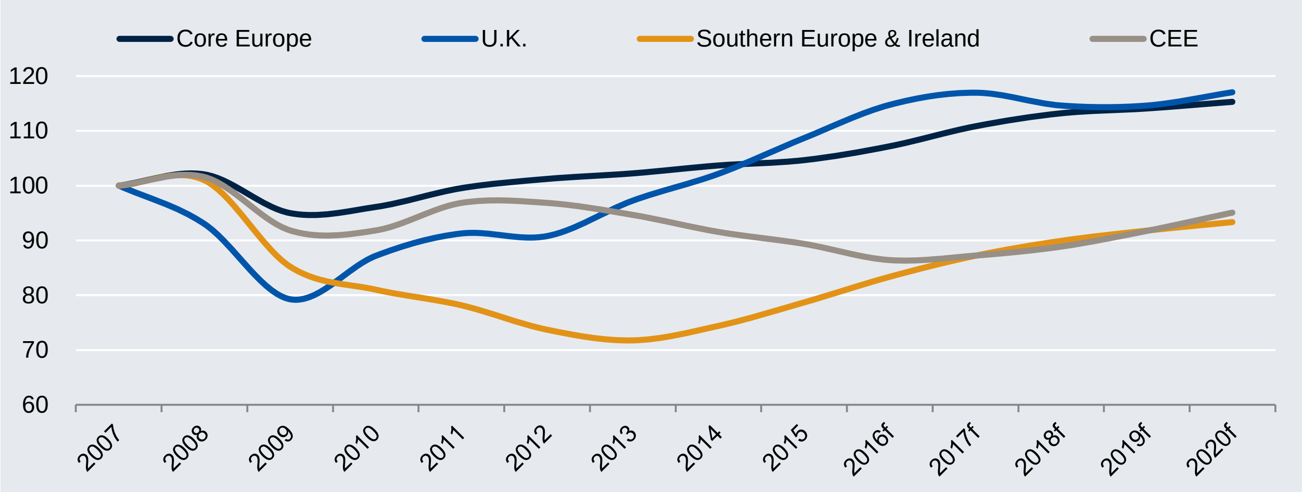
[24] Oxford Economics, October 2015.
[25] PMA, November 2015.
[26] PMA, January 2016.

in the coming two years, vacancy is expected to fall back towards pre-recession levels, and in many cities high quality, centrally located space is likely to be increasingly in short supply.

Over time, new supply is expected to return. Central London, particularly the City, is set to see a sharp increase in net completions, beginning in 2016. In part, this is a response to vacancy levels at a 15 year low, but also as capital values are now well above replacement costs. With at least another two years of value growth expected across European cities, it is believed the lure of development – including speculative construction – is set to spread.

Prime Office Rent Forecast by Region (2007 = 100)



Sources: PMA, December 2015 (historical data); Deutsche AM, January 2016.
Note: f = forecast. There is no guarantee the forecast will materialise.

In general the projected fall in vacancy should lead to an acceleration of rental growth, but we now see a number of distinct cycles emerging over the next five years.

Early recovery markets like the United Kingdom and Germany should maintain momentum into 2016, before tailing off as supply resumes. The bounce-back starting to be seen in parts of Southern Europe should last through much of the rest of the decade, particularly as prime headline rents in Madrid remains around 35% lower than their pre-recession peak. Finally, late recovery markets such as Paris and parts of the CEE region may still have more to come but should look relatively attractive from around 2017 onwards.

Improving fundamentals and low interest rates are expected to lead most prime office yields lower over the coming few years. The key exception to this is London, where prime yields look to have reached a floor already and are at risk of reversal, particularly if the highly cyclical City occupier market loses momentum.

The highest risk-adjusted returns are expected in Spain, while parts of Amsterdam and the Top 7 German cities should also do well. Regional France, with prime yields around 100 basis points above the European average, is also looking increasingly attractive, particularly as rental growth returns.

5.3 Strategies

- **Buy prime office for long-term hold:** Those investors who think long-term and can apply a flexible holding period may still benefit from acceptable risk-adjusted returns. High-quality assets in the right locations can typically maintain status over time if asset management is applied with care. At this point, we see the best value in Amsterdam, Vienna and some of the German Top 7 cities.

- **Revive value of office properties:** When opportunities to invest are increasingly hard to find, owners could shift resources to the active management of their existing portfolio. Unexplored potential in assets located in established office (sub-) markets should be improved proactively. Owners should target completion and marketing before the anticipated upturn in development activity.

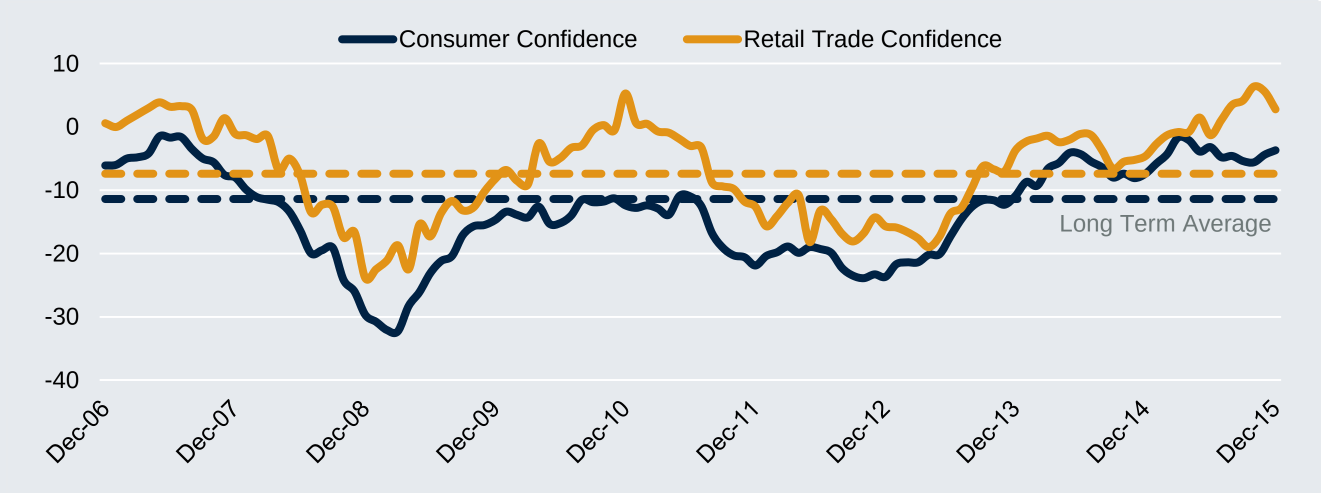
6 Retail Market Outlook and Strategies

6.1 Current Conditions

Retailers and consumers are confident in their outlook for the future.[27] Employment and real wages are growing, and the sharp decline in energy prices is boosting discretionary income across the continent.

Despite inflation running at close to zero, the value of retail sales grew across almost all European countries during 2015. Much of Core Europe saw sales growth in the range of 1%-2%, although Southern European growth tended to be more modest. The Nordics saw a stark contrast between strong Swedish growth and Finnish recession, while Central Europe was again the best performing part of the continent.[28]

E.U. Consumer and Retail Confidence (Balance)



Source: European Commission, December 2015.

Online sales migration and the implementation of 'omni-channel' strategies continue apace. Internet penetration rates vary massively but even in markets such as Italy where online sales account for less than 3% of sales, the rate of growth is 20% per annum. This trend is adding caution to store expansion plans, but in some ways is enhancing the requirement for physical space – particularly as retailers look for differentiation and a full service offer.

Retailers looking to expand their international portfolio identified Germany, the United Kingdom and France as the top target destinations for portfolio expansion in 2015, with much of the rest of the continent within the top 20 worldwide.[29] Although retail development activity increased in 2015, the rise in demand led to vacancy remaining relatively stable across Europe.

A number of major high streets are now experiencing very low levels of vacancy – with rates of 3% or below in the likes of London, Paris, Milan, Munich and Amsterdam and – leading to higher rent growth across Europe. Shopping centres have so far lagged behind but rents are now on an upward trajectory.

6.2 Outlook

Retail spending is set to accelerate further over the coming five years. As the proportion of online transactions rises, not all of this growth will be translated into in-store sales. It is unclear what the new equilibrium balance between online and in-store will be, but assuming Europe will trend towards a common level suggests the likes of Spain, Italy and Poland face a greater level of sales diversion going forward.

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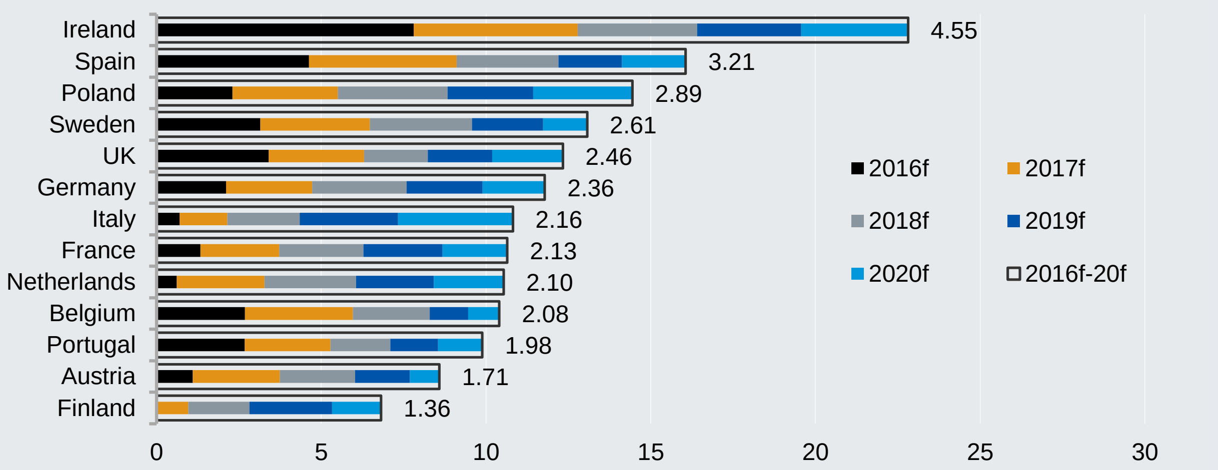
[27] European Commission, December 2015.
[28] Oxford Economics, January 2016.
[29] CBRE, June 2015.

Online sales migration will not necessarily mean higher vacancy. Even in those markets with the largest share of sales online, stores are still a fundamental part of retailing, supporting the supply chain, brand building and the showrooming of products. However, these additional functions are better suited to certain locations, and in general will add cost, particularly if landlords face pressure to churn retailers to keep centres feeling fresh.

This changing environment will likely see a lower trend level of retail development going forward. European shopping centre stock is expected to grow over the next two years at only half the annual rate over the past decade, before rising only modestly thereafter.

Some of the highest vacancy rates are still to be found in the United Kingdom but the strong consumer economy means it is forecast to be one of the better performers in terms of rental growth. Elsewhere, rental growth is set to be highest in countries with healthy consumer fundamentals such as Germany and Sweden, alongside the recovering economies of Spain and Ireland. Despite higher levels of development, with strong spending growth and vacancy among key centres in Poland and the Czech Republic some of the lowest in Europe, the CEE region should also see good growth.

Cumulative Prime Shopping Centre Rent Growth (%)



Notes: Numbers in rent growth chart show compound annual growth rates (CAGR). f = forecast. There is no guarantee the forecast shown will materialise.

Sources: PMA (historical data), November 2015, Deutsche Asset Management, January 2016.

With strong rental growth and security of income, the yield on prime high street is set to fall further in 2016. However given low income yields of around 3.5%, total returns may prove relatively low, particularly if recent yield compression edges higher. Although shopping centre rent growth is set to be less, returns would benefit from vacancy falls and a higher income yield which is more closely aligned to the long-term average.

6.3 Strategies

- **High footfall and tourist locations:** These destinations provide retailers with the opportunity to brand build, showroom and achieve high sales densities. Yields are low but so are voids and rental growth is expected to be strong. Additional value may be found in nearby emerging pitches.

- **Dominant shopping centres:** Critical mass to provide an experience and the technological investment needed to support omni-channel retailing. Typically recording some of the lowest vacancy rates and rental recovery.

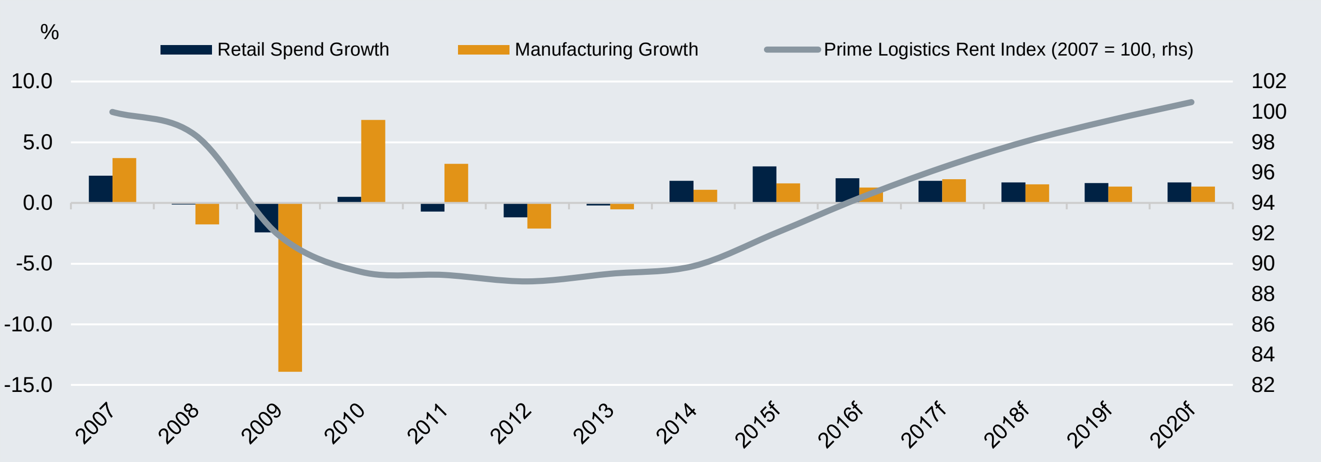
- **Unrestricted retail parks:** Providing consumers with convenience of free parking and easy access for frequent / small basket shopping, and retailers with a lower cost location to the high street that supports click-and-collect and other supply chain operations.

7 Logistics Market Outlook and Strategies

7.1 Current Conditions

The logistics market continues to perform, buoyed by improving economic conditions across Europe. Consumers are benefitting from lower oil prices while a weaker Euro is spurring exports driving retail and manufacturing occupancy of logistics space. Falling availability is supporting the return to rent growth while investment appetite remains high.

European Logistics Demand Drivers and Prime Rent Index



Source: Deutsche Asset Management, January 2016.

The 'omni-channel' retail revolution continues to gather pace with pure play e-commerce companies beginning to take physical store space for brand building and show rooming. Shifts in consumer behaviour such as a rising appetite for fast fashion, increased mobile-based transactions and broadening expectations for same / next day delivery are leading to supply chain re-configuration.[30]

Demand from online retailers alongside third party logistics companies for ever larger high quality e-fulfilment / distribution centres in proximity to major population centres continues to intensify, as tenants seek to maximise efficiency gains from economies of scale. Furthermore, B2C delivery is growing, fuelled by online retailing, resulting in growing requirements for parcel distribution, sortation and urban delivery facilities.[31] This polarisation between large distribution centres (50,000 sqm and above) and smaller urban centres (less than 10,000 sqm in size) is expected to become a feature in the industry, placing mid-sized assets (10,000-50,000 sqm), particularly in peripheral locations at growing risk in the longer-term.

Grocery retailers are a key source of logistics occupancy. While distribution assets remain a major component of supermarket logistics networks, increasingly 'dark stores' on the edge of town to fulfil online grocery deliveries are becoming integral. The sector faces increasing competition from discount retailers such as Aldi and Lidl in the United Kingdom and online retailers such as Ocado in addition to new entrants such as Amazon Fresh.

The 3PL industry is undergoing a period of transformation. Amazon is accelerating its strategy of building a logistics platform to internalise its distribution activities and offer third party logistics services while on-demand players such as Deliveroo, Postmates and UberRush are disrupting the same-day delivery market. While these may pose a challenge to established players, for logistics property it represents both opportunities and risks.

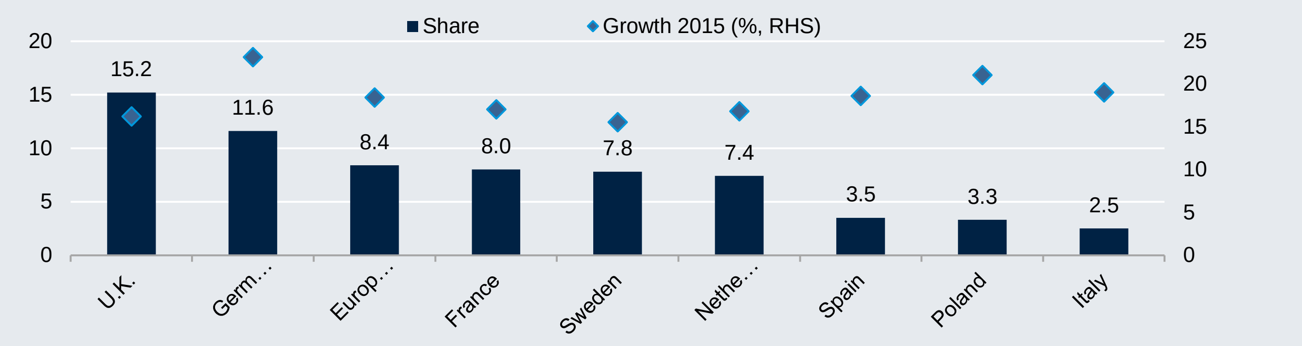
[30] DHL, Omni-channel Logistics, December 2015.
[31] Colliers, October 2015.

7.2 Outlook

Although a weaker Euro has supported manufacturing and exports demand for logistics property in 2015, global trade conditions are expected to be choppy over the medium-term as China adjusts to a consumer-led economy and emerging markets growth softens.[32] Going forward manufacturing and exports activity is forecast to slow, leading to lower take-up from this segment.

Domestic demand is projected to remain buoyant across much of Europe supported by rising consumption.[33] As digital connectivity continues to rise, we believe online sales are likely to grow by double digits over the next five years, particularly in Southern Europe. This should sustain occupier demand for high quality, well-located distribution centres and edge of town urban assets geared towards online grocery or parcel deliveries.

E-Commerce Share as a % of Total Retail Sales



Source: Centre for Retail Research, June 2015

With availability increasingly limited across most European cities, speculative activity will likely broaden beyond Poland, United Kingdom and Germany although these assets are likely to be absorbed in a limited space of time in the near-term. Build-to-suit will remain the preferred route to market for many occupiers requiring a customised solution.

Rent growth is forecast to accelerate in the short-term, propelled by rising demand and limited availability before decelerating towards the end of the decade as speculative activity expands. There is limited room for yield compression this year, with prime yields expected to remain generally stable in 2017 before rising thereafter should bond yields rise as forecast.[34]

7.3 Strategies

- **Large distribution / e-fulfilment centres:** We recommend focusing on exceptionally located high quality distribution / e-fulfilment assets with excellent infrastructure connectivity and proximity to a large population catchment underpinned by a strong covenant.
- **Urban delivery centres:** The 'last mile' is becoming an increasingly competitive battleground for retailers and parcel companies. We suggest targeting exceptionally located, cross-docked assets with long-leases on the edge of town of major cities.
- **Trade-linked logistics:** We suggest being selective on port / airport logistics assets given the headwinds to global trade. Dual-purpose port logistics assets in major conurbations which also serve large domestic population catchments for distribution purposes could offer opportunity.
- **Caution mid-sized distribution centres:** We recommend being cautious of mid-sized distribution centres (10-50,000 sqm) as tenants seek to maximise scale economies from 50,000 sqm + facilities. There is a clear trend towards larger distribution centres.

[32] Oxford Economics, January 2016.
[33] Oxford Economics, January 2016.
[34] Deutsche AM, January 2016.

8 Residential Market Outlook and Strategies

8.1 Current Conditions

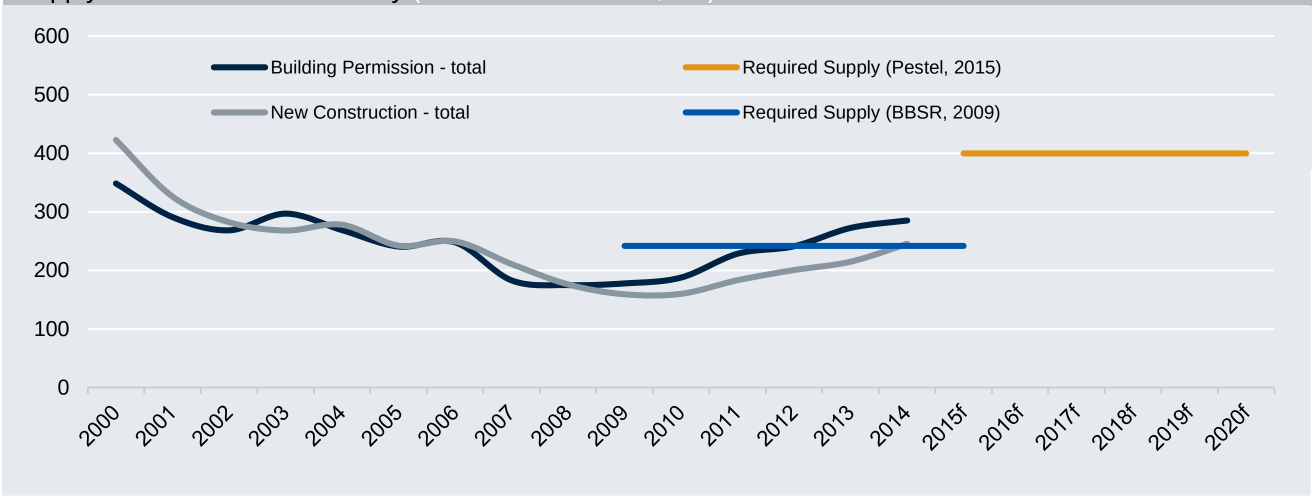
As a defensive investment segment, which is mainly driven by local demand and supply fundamentals, residential markets have limited exposure to major market downswings. Generally, residential investments are characterised by a non-cyclical and persistent housing demand with limited void risks, in addition to stable income streams. Over the medium term, residential investments also offer a moderate inflation hedge and provide diversification potential.[35] Consequently, with growing political uncertainty in Europe and increased global market volatility, European residential markets currently receive even more investor attention than in the past.

Although European residential markets differ greatly, institutional investment is most common in Germany, France, the Netherlands, Switzerland and increasingly in the United Kingdom. Of these, the German institutional market is by far the most active market, recording almost €17 billion of apartment sales in 2015, more than the other four markets combined.[36] One reason behind this is the high ownership ratio of well above 60% in the Netherland, France and the United Kingdom.

Apartments are the preferred investment form for institutional investors, since they are easier to manage. Germany provides the greater investment opportunities with a 45% share of residential units being apartments, in contrast to France (31%), the Netherlands (19%) and the United Kingdom (14%).

Switzerland also has a high share of apartments but given the high proportion of direct residential investments of Swiss domestic investors, Germany offers a more accessible residential market with a rising share of closed-ended Spezialfonds and listed companies. The appeal of the German residential market to domestic and international investors alike is visible in the rise of transaction volumes in recent years.

Supply and Demand in Germany (residential units in 1,000)



Note: f = forecast.
Source: Pestel Institu November 2015, RIWIS 2016.

On a regional basis, several German residential markets can be characterised by supply-shortages, resulting from a rising number of inhabitants. This is normally the case in metropolitan agglomerations or regional cities with strong pull factors, especially for younger people. In total, an estimated 950,000 residential units are required to meet demand countrywide. This can be broken down to an annual demand of 400,000 units for replacements, new demand and additional supply to reduce the existing overhang.[37]

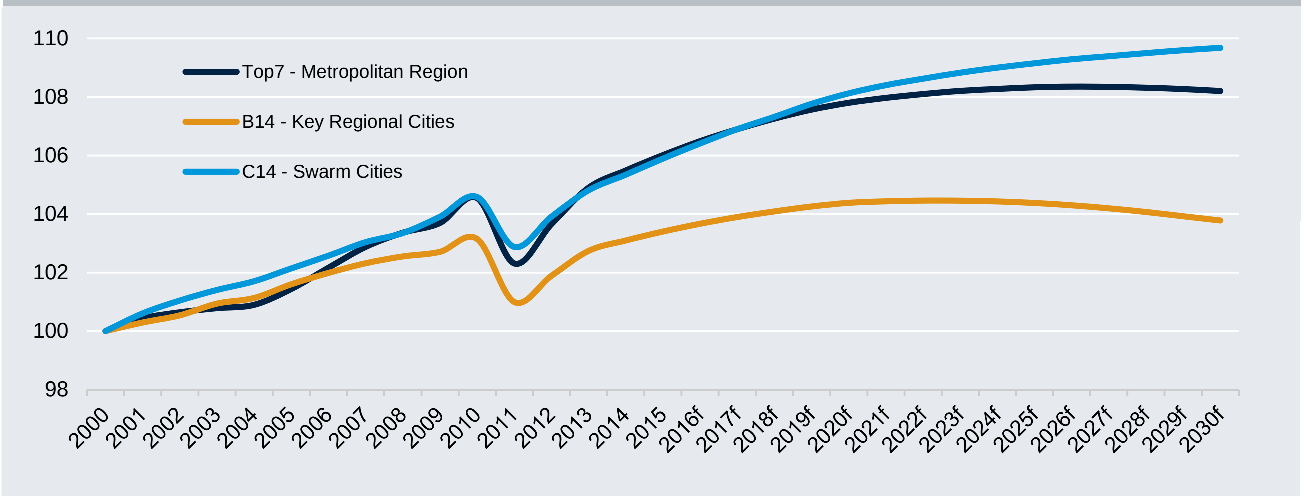
[35] IPF, Residential Investments in International Markets, November 2014.
[36] Real Capital Analytics, January 2016.
[37] Pestel Institut September 2015.

8.2 Outlook

With stable returns and positive market fundamentals, in addition to persistent economic and political uncertainties, demand from institutional investors for residential stock is set to grow further. The already strong investor interest in residential investment is most visible in Germany, where rent levels have risen significantly and average yields in the Top 7 markets have dropped by 150 basis points since 2006.

On a regional level, large urban agglomerations and smaller cities with strong population levels in the 20-35 age group, so called “Swarm Cities”, are registering the strongest population growth in Germany, it is believed this is mainly due to regional and international migration. Hence, rental pressure and subsequently investor interest and yield compression is likely to be strongest in these markets. Going forward, already low entry yields and the widening implementation of rent regulations could dampen rental growth to a certain extent, making residential investments more attractive for long-term, cash-flow-oriented investors.

German Population Development by City Category (Index, 2000=100)



Note: f = forecast. There is no guarantee the forecast shown will materialise. *The graph is based on official figures from 2009, which are likely to be revised upwards with the next update in 2016/17.
Source: Destatis, RIWIS 2016.

Outside Germany, other residential markets are quickly gaining in importance. In particular, the private rented sector in the United Kingdom which increased in size by 135% between 1991 and 2011 and accounted for around four million homes or 17% of all households. By the end of 2016 this figure is expected to have increased to around five million households[38] with the focus being on Greater London, where 25 % of the total housing stock already belongs to the private rented sector.[39]

8.3 Strategies

- **Large Agglomerations:** Persistent focus on German metropolitan regions and key regional cities as rental markets are characterised by supply shortages and a demand backlog.
- **Swarm Cities:** Widening investment scope beyond large markets, focus on smaller cities with population growth and strong appeal for young people. Examples include university cities and cities with a strong share of inhabitants in the age band 20-35 years.
- **Residential Developments:** Consideration of large-scale development projects in selected cities with significant population growth and in co-operation with local municipalities to strengthen the supply in the mid-market range.

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[38] Knight Frank, 2014.
[39] Carter Jonas, Q1 2015.

9 Real Estate Securities

The real estate equity markets did not start on the right foot in 2016[40] on the back of several devaluation episodes in China, which pushed equity indices into negative territory across the board. It is difficult to position oneself in this environment but a consensual view seems to have emerged that 2016 would be a volatile year for equities in general, including real estate securities.

This volatility rests on a number of unanswered questions such as the implications of Federal Reserve tightening against continued loose monetary policy in Europe; continued worries about China; political uncertainties in Europe (E.U. membership referendum in the United Kingdom, refugee issues potentially giving some support to populist parties) and pressure on commodity prices. Against this backdrop, it is almost certain that it won't be a quiet year on the equity front.

Despite their defensive features, we believe real estate securities will not be insulated from general volatility in the markets. This is especially true after the recent years of strong returns, fostered by a low interest environment that attracted a number of non-traditional investors in this space and led to a sector expansion through IPO and secondary issues. In the context of credit spreads potentially widening from historical lows, the influx of liquidity into the real estate equity market might be more limited than in the past, resulting in less primary and secondary issuances.

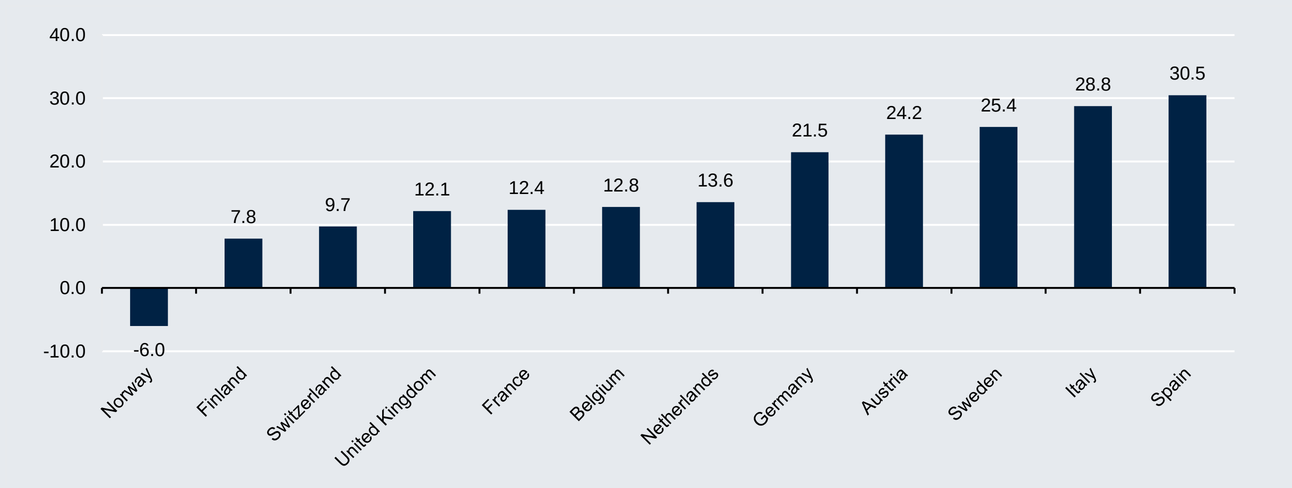
More specifically, looking at the different property sub-sectors in Europe, it seems much more difficult to get to consensual views compared to the past.

The United Kingdom is no longer seen as an obvious buy as yields have now reached historical lows for London offices, while growing divergences are mounting between management teams calling the peak of the cycle and those still having a positive view in this sector.

In Continental Europe, French offices seem to be better oriented but one should be careful considering the less than positive macro backdrop in the country. Retail is not an obvious case either considering the number of potential issues companies in this space are facing (growing share of online sales, higher costs in France due to higher security).

German residential has been a top performer in the last years backed by strong NAV growth potential, solid rental growth compared to other sectors and consolidation. NAVs have grown significantly following yield adjustments from valuers, while companies seem to have captured most of the earnings upside from low-rate refinancing. All of this, coupled with intense (and more questionable) M&A operations, could lead to the end of significant outperformance.

EPRA Real Estate 2015 Equity Returns (Local Currencies, %)



Source: EPRA, Macrobond, January 2016. Past performance is not indicative of future returns.

[40] RIWIS, January 2016.

The listed real estate sector (EPRA Europe +18.8%) outperformed the broader equity market (MSCI Europe +9.1%) in 2015. Country wise, the outperformers were Spain (+30.5%), Italy (+28.8%), Sweden (+25.4%), Austria (+24.2%) and Germany (+21.5%) while the underperformers were the Netherlands (+13.6%), Belgium (+12.8%), France (+12.4%) and the United Kingdom. (+12.1%). On a subsector perspective, the best performers were the Nordics (up 23% in local basis), residential stocks (up 21%) and small and mid caps in the United Kingdom (up 21% in local basis). Swiss names (up 9.7% in local basis), U.K. large cap names (up 9.4%) and Continental Office (up 11.7%) were the worst performers while Continental Retail (up 14.5%) was in the middle of the pack.[41]

Looking ahead, we feel the listed property sector remains attractive for the following reasons:

- Even in a scenario of credit spread widening, the yield spread between bonds and property yields would still be attractive;
- The real estate property sector is mostly domestic with no revenue exposure to emerging markets;
- There is still some upside on NAV for Continental European names, while growth is still solid in the United Kingdom.

[41] EPRA, January 2016.

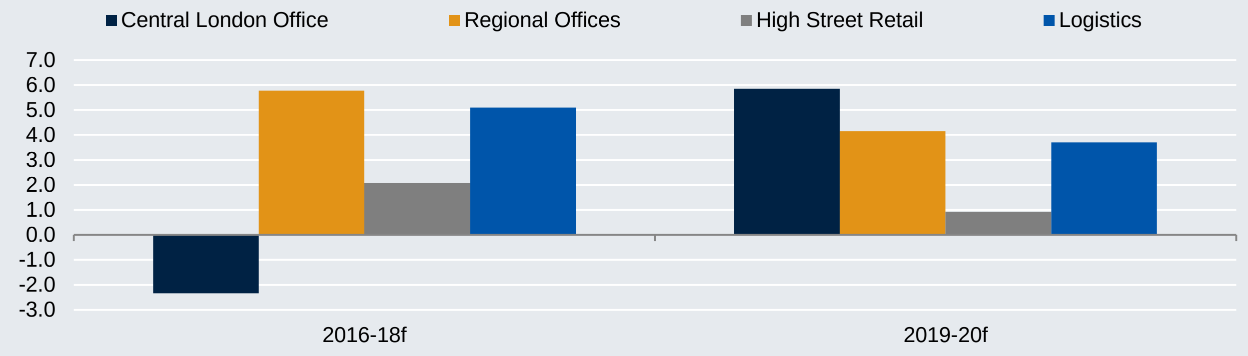
10 Overview of Key European Markets

Strategic Outlook: United Kingdom

U.K. real estate recorded another strong year of returns in 2015. However, returns are now gradually moving lower as the impact of yield compression fades. Lower yield impact is being somewhat compensated for by higher rent growth, but this is not expected to be enough to prevent capital values weakening should yields rise in response to higher bond yields during the latter part of the decade. Central London looks at most risk of a pricing adjustment – and is also considered most exposed to a potential U.K. withdrawal from the E.U. – and therefore we continue to hold an Underweight call on all sectors in the capital. There remain selective opportunities to be had in regional markets, including smaller cities such as Cardiff. Although yields here have also compressed, income returns are 100 to 200 basis points above the Capital, while occupier fundamentals are now supporting higher rents.

Occupier	Central London vacancy at near historic low, but supply response has been more than expected. Vacancy rising over coming years. Prime rents in Central London at around historic highs. Affordability risks. Rents set to adjust lower during the second half of the decade. Take-up rising across major regional markets.[42] Supply response evident but little available Grade A and rent growth has returned. Retail recovery lagging other sectors. Regional retail to benefit from rates revaluation and retailers focusing on select major city locations.
Investment	IPD all property return fell by around 500 basis points according to the monthly index, but remained well above historic average.[43] Record volume of investment in 2015 but with recent evidence suggesting the market peaked during the middle of the year. Prime yields are well below historic average levels and although in general the spread over Gilts remains large, this is no longer the case in Central London. Yields projected to flatten in 2016 before rising in 2017/18 as the Bank of England starts to tighten and rent growth lessens. Capital value correction to create higher return opportunities in Central London by the back end of the decade.

Prime U.K. Sector Returns (%)



Sources: Deutsche AM, January 2016.
Note: f = forecast. There is no guarantee the forecast will materialise.

[42] CBRE, January 2016.
[43] IPD, January 2016.

Strategic Outlook: Germany

The positive economic sentiment supports the dynamic development of the German real estate market in 2015, with market values continuing to rise, transaction volumes close to historic heights and occupier markets performing well. Low interest rates are expected to persist in the near to medium term, as the ECB extends its quantitative easing policy in contrast to the US Federal Reserve. In line with this, we expect prime yields to contract further in 2016 and 2017. Going forward, we expect a robust economic environment with positive effects on German real estate markets, but downward risks are increasing due to economic and political uncertainties on a global basis.

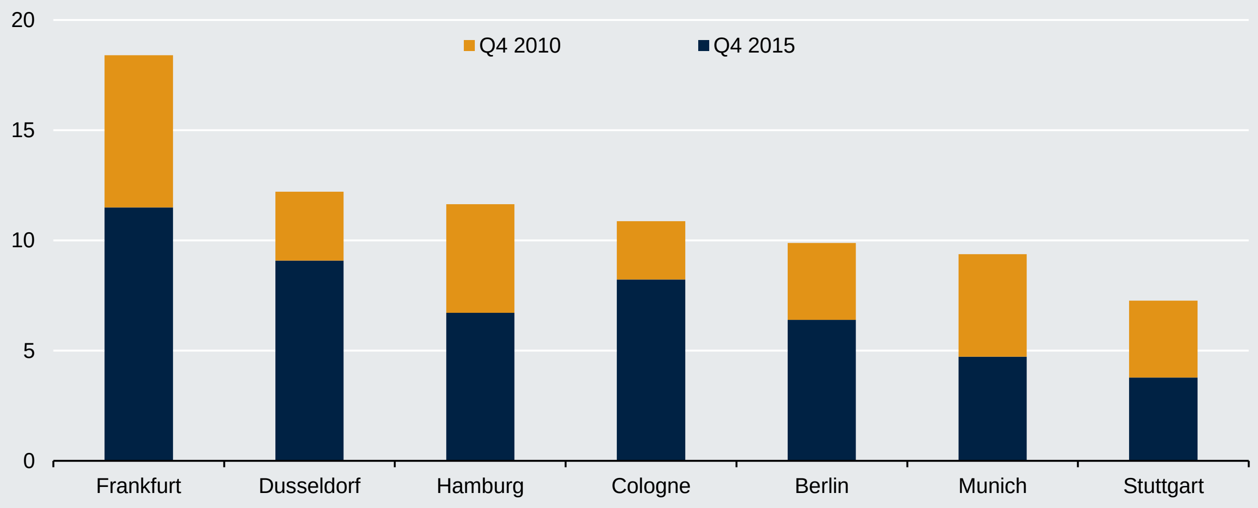
Occupier

- Despite a slow start to the year, demand for office space in 2015 topped the take-up levels in recent years, thanks to a strong fourth quarter.
- Berlin and Dusseldorf performed exceptionally well, with Berlin reaching an all-time high in terms of take-up.
- Vacancy rates continue to decrease across all Top 7 office markets, falling strongest in Dusseldorf, thanks to large-scale letting deals.
- Although project developments remained subdued in most markets throughout 2015, we expect speculative construction to increase in line with favourable financing conditions, limited supply of modern space and persistent tenant demand.

Investment

- Real estate continues to look cheap in relative terms, but high investment pressure and persistent capital inflows into Germany lead to further falls in prime yields – in most markets well beyond historic lows.
- Thanks to their higher yield levels, niche segments, second-tier locations and properties with asset management potential are increasingly coming into investors' focus.
- Going forward, more defensive investment schemes, but also project developments might play a more important role again.

Office Vacancy rates (%)



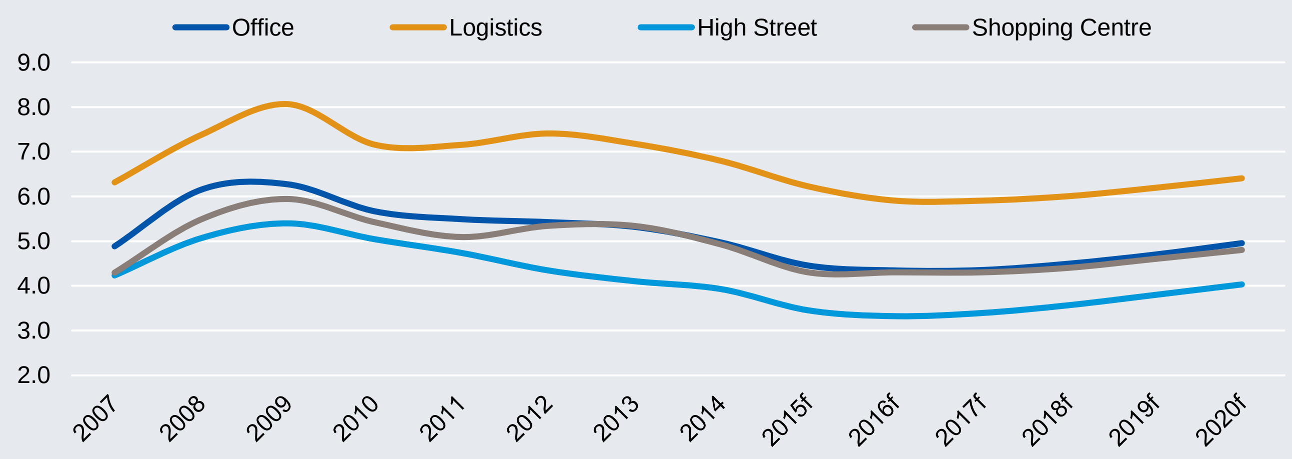
Source: PMA, CBRE, Deutsche Asset Management, January 2016.
There is no guarantee the forecast will materialise.

Strategic Outlook: France

The French economy continues to improve, although progress is slow, with unemployment finally falling but still high. The recovery should gather pace this year on the back of a more business friendly policy environment. Sentiment is comfortably above average and investment is expected to pick up given easing credit conditions. Real estate fundamentals are still weaker than usual, although there have been signs of improvement to underlying demand. With economic growth and employment expected to pick up, this should lay the foundations for a more broad-based improvement to the occupier markets. Yields continue to fall, although the pace of decline is expected to moderate this year. Even in Central Paris, where office and retail yields are close to 3.00%, there remains a comfortable spread over long-term government bonds. Rising rent growth should act to keep yields lower, although as the spread over bonds is eroded, prime yields are set to come under pressure towards the end of the decade.

Occupier	▪ Despite weak occupier demand during the first half of 2015, improvements to economic growth now seem to be feeding through. Final quarter office take-up in Central Paris was the strongest for ten years and the regional markets are also beginning to pick up. ▪ Office vacancy fell across Central Paris at the end of the year, and with logistics markets along the backbone on course for a significant rise in annual demand, availability of logistics space is also on the way down. ▪ Logistics rents are rising at their fastest rate since the dotcom boom, and growth is expected to pick up in all sectors this year. Despite a hiatus in completions this year, there is still a sizable pipeline of new office space, which could slow rent growth in the sector, particularly given high vacancy rates in some markets. ▪ The retail sector continues to face challenges, with vacancy edging up further. Rents in shopping centres are still under pressure, although stronger consumer spending should provide a boost. Lack of availability in prime areas of the high street should also lead to stronger growth.
Investment	▪ French investment volumes were up by 16% year-on-year, a lower rise than in other major European countries. Volumes were held back slightly by a fall in the proportion of foreign investors, who faced stiff competition from active domestic investors, although France remains high on investors' wishlist at the moment. ▪ Central Paris yields are now below their previous market peak, but other parts of the capital still offer good opportunities, particularly logistics, where yields remain elevated. ▪ Regional markets still benefit from low vacancy and stable rents across sectors, and currently offer an increased yield premium over Paris.

Average Prime Yields by Sector (%)



Sources: PMA (historical data), September 2015; Deutsche AM, January 2016; INREV, January 2016.
Note: f = forecast. There is no guarantee that the forecasts will materialize.

Strategic Outlook: Spain

The recovery in Spain was in full flow during 2015. Not only did yields continue to compress, the occupier market saw the first signs of the long anticipated bounce back in prime rents. Although yields are now at levels where we don't expect significantly more compression, the forecast rent recovery is more than enough to lead prime returns in Madrid and Barcelona to be some of the highest in Europe over the next five years. With the economic recovery becoming established, GDP and jobs growth is expanding across the country, this is opening up opportunities with higher income returns beyond central Madrid and Barcelona. However, with vacancy in out of town locations and less transparency in smaller cities, caution and an in-depth understanding of the local market are required.

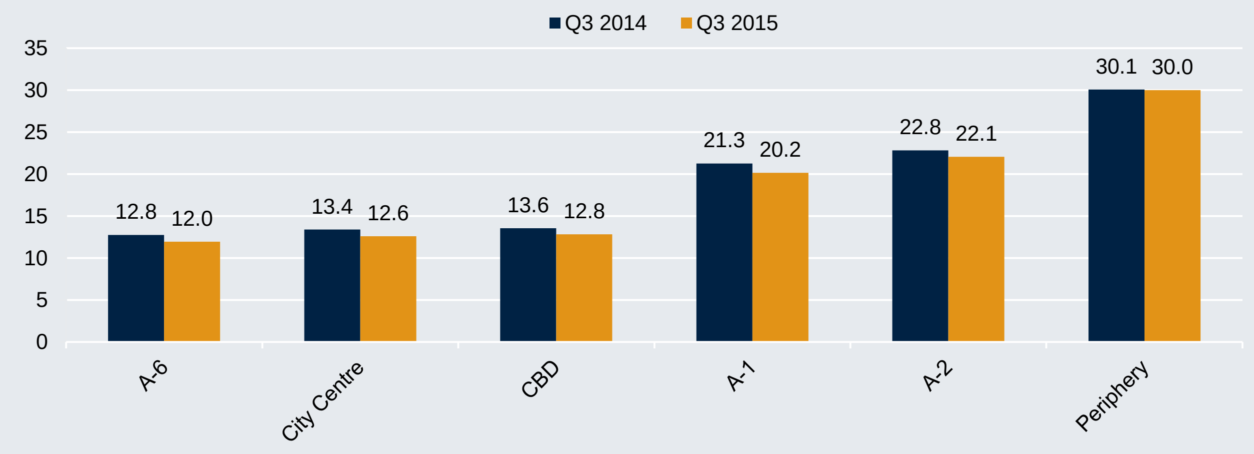
Occupier

- The Spanish economy was one of the fastest growth rates in Europe in 2015 and is set to continue to outperform over the rest of the decade.
- Office vacancy fell in Madrid and Barcelona, as absorption edged higher while net additional remained close to zero.
- Prime rent growth looks to have returned across all sectors during 2015. With rents still well below their historic peaks, there remains plenty of scope for a rebound over the coming years.
- Vacancy trending lower in out of town locations, but often the rate is above 20% and likely to restrict rent recovery in most locations.
- The inconclusive outcome of December's General Election remains a risk to occupier and investor confidence.

Investment

- Transaction activity lessened slightly during the second half of 2015 to record around €11 billion of sales during the year.
- Prime Spanish yields continue to fall in 2015, but the rate of compression looks to be slowing. A floor is expected to be reached in 2016/17 before rising during the final part of the decade.
- Yields in out of town locations in Madrid and Barcelona have also compressed but still offer a premium over CBD of around 150 basis points – similar to the long-term average.
- Given rising exports, growth of online sales and an income yield 200 basis points above offices, logistics is forecast to offer the highest returns over the next five years.

Madrid Vacancy Rate by Submarket (%)



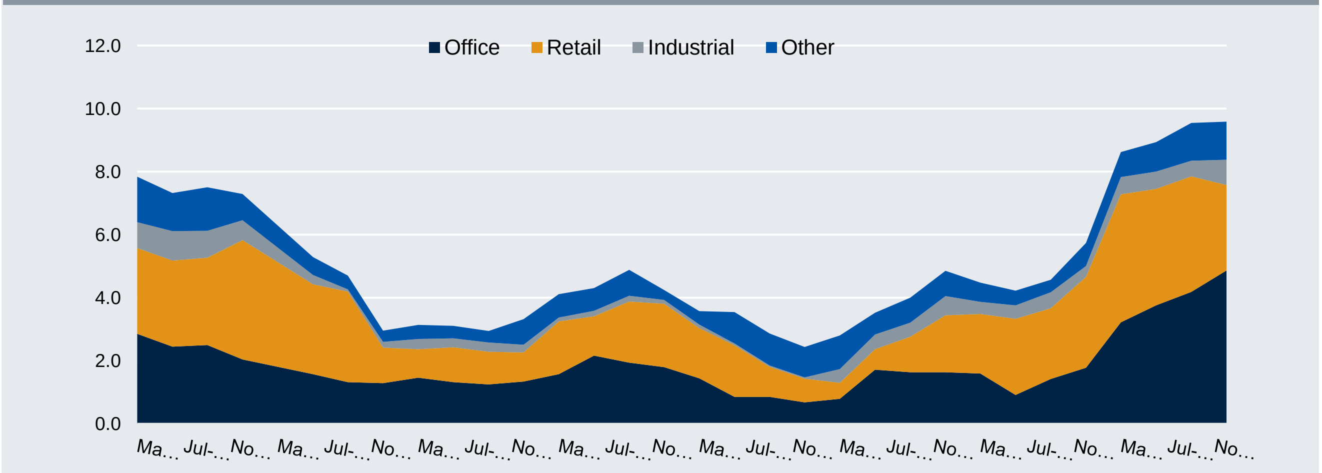
Source: CBRE, January 2016.

Strategic Outlook: Italy

Italian GDP returned to growth in 2015. The performance of the economy surprised on the upside during the year leading to several upward adjustments in the outlook and a sharp reduction in unemployment. With this, real estate fundamentals have started to improve, while investors have returned in droves, pushing prime yields down to record low levels. There is now a risk that the investment market has moved beyond fundamentals. Unless recent reforms lead to a marked upgrade to forecast GDP growth, the projected rental growth will not be enough to support a substantial outperformance compared to the rest of Europe. Retail and logistics forecast to outperform offices on a return and risk-adjusted basis.

Occupier	▪ Italian unemployment fell by 500,000 during 2015, supporting occupier demand. This led to the first fall in office vacancy since 2007.[44] ▪ Despite expectations of modest GDP growth, vacancy is forecast to trend lower over the next five years as annual net additions are set to remain below 1% of stock. ▪ Prime rent growth looks to have returned in 2015, and is set to accelerate over the coming years to average 2-3% per annum across the main sectors. ▪ Rent growth projections below other recovery markets such as Spain due to a less adjustment during downturn, lower GDP growth and continued availability of high quality space. ▪ Rental growth projected to be highest in the retail sector – particularly on the major high streets where retailers struggle to find available units. Growth of e-commerce and a lack of large, modern units is set to support the return of prime rental growth in the logistics sector.
Investment	▪ Investment volumes reached almost €10 billion during 2015, almost double the previous year.[45] ▪ The return of investors saw prime yields fall by 50 to 100 basis points across the three main sectors. Having offered a considerable yield premium over the rest of Europe twelve months ago, much of this has now been eroded. ▪ Rising rents expected to become a greater driver of returns over the coming years as yields reach a floor over the next 12 months. ▪ Prime logistics expected to see the highest returns over the next five years, with Milan high street retail the next best performer.

Italian Investment Volumes (€ billion, 12 month rolling average)



Source: Real Capital Analytics, January 2016.

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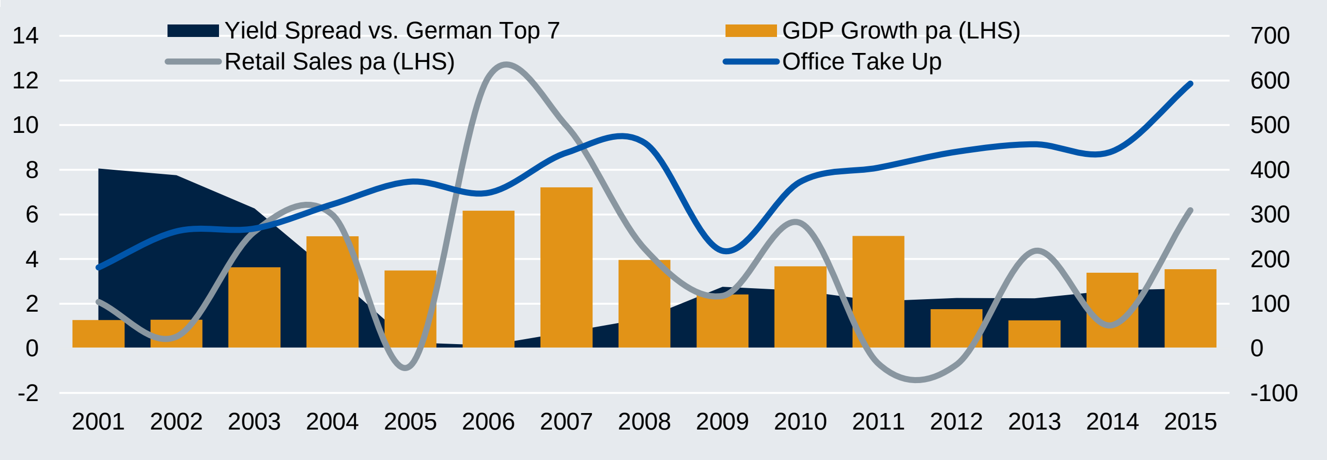
[44] Eurostat, January 2016.
[45] Real Capital Analytics, January 2015.

Strategic Outlook: Poland

Until the end of the year 2015, the polish real estate markets were well on track to become one of the most exciting investments in Europe again. ARA Research has been promoting the case to move back in to the polish market for some time, as the mix of strong economic growth, spiking occupier demand in combination with an attractive risk premium has been promising. However, latest political events have raised questions about good governance and increased uncertainty of doing business. Significant Bank levies and windfall taxes for retailers have already been pushed through legislation. The polish zloty has been in freefall and this should eventually have an impact on rents, as they are paid in Euro but businesses need to generate the turnover in local currency resulting in unhealthy effort rates.

Occupier	▪ A record high amount of tenant demand over the past three quarters (above 200'000 sqm per quarter) resulted in stabilization of vacancy rates at around 12.3%, lower than previously expected. ▪ Nevertheless, to prevent a significant hike in vacancy rates, demand would need to stay on this high level and this is the area of concern given the potentially worsening sentiment. ▪ Headline rents are currently being somewhat protected by rising incentives. However, given that new supply is expected to pick up further, further downward adjustments will be inevitable in the short – to medium term. ▪ Retail sales in Poland have also been on the rise, shopping centre markets in the regions are still subject to significant new development, putting a lid on rental growth in the short term. ▪ The Logistics sector has also seen robust demand, driven by strong demand from producers but also operators which are trying to benefit from low operating costs in the country (e.g. Amazon).
Investment	▪ Given rising uncertainties, we would recommend to remain very cautious about additional exposure to the Polish real estate markets at the moment. As the market has to cope with a large construction pipeline anyway, a potential dip in occupier demand could further enhance the imbalance between supply and demand. ▪ Deutsche AM is monitoring the events in Poland closely and if the situation eases, we would clearly reassess the situation. The past 12 month have shown, that the market has the potential to gain serious traction. While its characteristics remain sophisticated, it could offer an interesting growth element in an otherwise difficult and expensive European market environment.

Office Vacancy Rates (2000-2019f, %)



Sources: CBRE, January 2016; Deutsche Asset Management, January 2016.

Strategic Outlook: Nordics

The Swedish economy continues to outperform while Finland remains mired in recession with political risk of a Euro exit heightening. Norway is struggling in light of lower oil prices while Denmark is expected to bounce back this year following a weak second half of 2015. Investment volumes continue to flow into the Nordics, supported by attractive financing options and low bond yields. Rising bond yields are projected to put upward pressure on prime yields towards the end of the decade, although the pace and shift across markets and sectors is likely to be varied. High street retail and logistics offer the best risk-adjusted opportunities.

Occupier

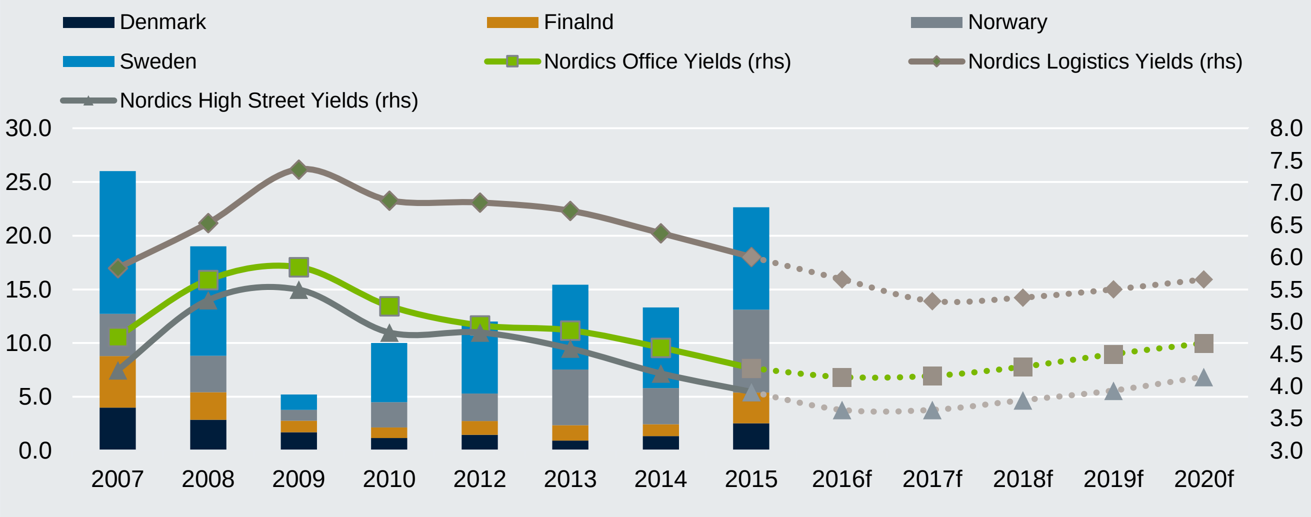
- Sweden's economy has outperformed in recent years and will continue to do so, in light of strong private consumption. Finland is struggling.
- Occupier demand is elevated across all segments in Stockholm with vacancy low across all sectors. Helsinki is seeing rising vacancy.
- Speculative activity is limited in Helsinki and modest in Stockholm. Rising development activity observed in Copenhagen.[46]
- Strong rent growth in Stockholm. Stable rents in Helsinki masking underlying weakness; rents are likely to fall as economy weakens further.
- Rising consumption is supporting retail and logistics demand in Stockholm and Copenhagen,

  Underpinning rental growth outlook.

Investment

- Investment volumes in the Nordics market grew significantly in 2015, supported by low bond yields and attractive financing conditions.
- The projected rise in bond yields will push yields outwards and narrowing spreads, affecting total return outlook.[47]
- Prime Stockholm office returns underperform. Higher risk-adjusted returns from developing stock in supply constrained CBD while logistics and retail offer opportunity.
- Copenhagen logistics assets outperforming on a risk-adjusted basis.

Nordics Investment Volumes (€bn) and Weighted Prime Yields (%)



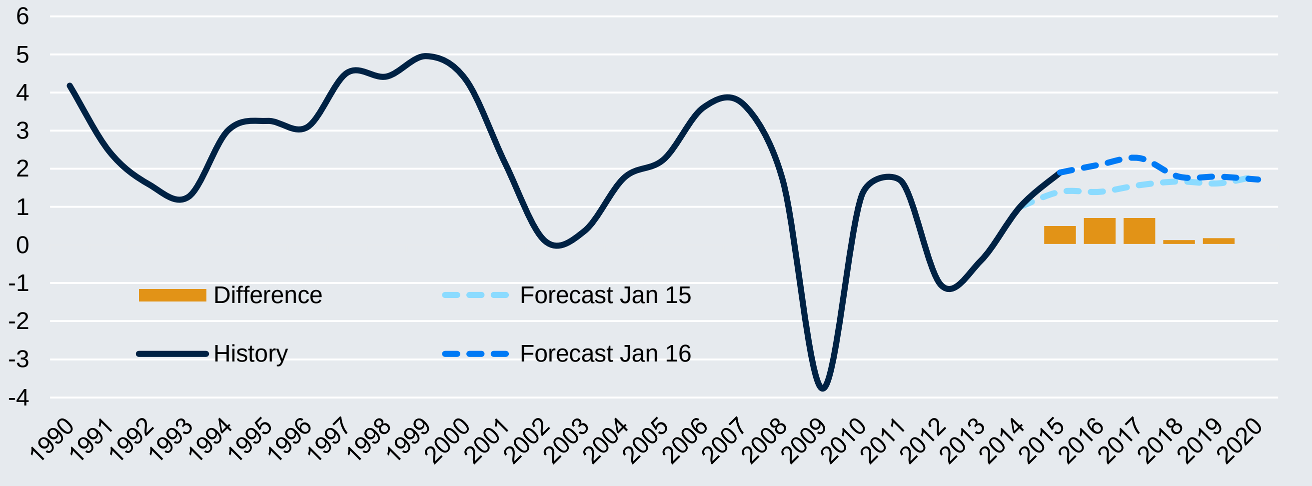
[46] PMA, November 2015.
[47] Oxford Economics, January 2016, Deutsche Asset Management, January 2016.

Strategic Outlook: Netherlands

In 2015 The Dutch economy has surprised to the upside. As a result, the forecast for 2016-2018 have been upgraded significantly. The Netherlands is now expected to be among the strongest growers in Core Europe over the next five years. After years gridlocked in recession, investors have come back strongly as yields dropped sharply over the past six month. Investors should seek opportunities in selected locations in the office and logistics segment, but should avoid simply buying into the market as consolidation in decentral and fringe locations will continue for the time being.

Occupier	▪ Take up has picked up gradually over the past 12 months but occupier activity remains below the long term average ▪ Vacancy rates have been declining nevertheless, also supported by low construction volumes and ongoing conversions into numerous Hotel and Residential properties ▪ There is still a great amount of polarisation in the market. Fundamentals have improved in well connected and central submarkets like Zuidas, IJ Overs and in the some parts of the South East which had a positive impact on rising effective rents as incentives declined. ▪ However, peripheral submarkets and pure play office parks without access to local amenities still struggle and some will need to cope with obsolescence for further years to come. ▪ The positive trend in the economy has supported demand for logistics space, although most demand is generated from retailers and 3PL's as global trade continued to be muted.
Investment	▪ ARA Research has been cautious about the Dutch office investment market for some time, given it was trapped in a prolonged recession but also due to its massive supply overhang. ▪ The situation has improved, albeit not all locations will benefit immediately from the recent up-swing. But pricing has reacted immediately as investors have rapidly pushed yields down be-low 5% in the office and below 6% in the logistics sector. ▪ Dutch target segments do certainly not look like a bargain anymore, but they should still offer opportunities and better relative value for long-term investors.

Netherlands GDP Forecast (%)



Sources: Oxford Economics, January 2016.
Note: There is no guarantee that the forecasts will materialize.

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