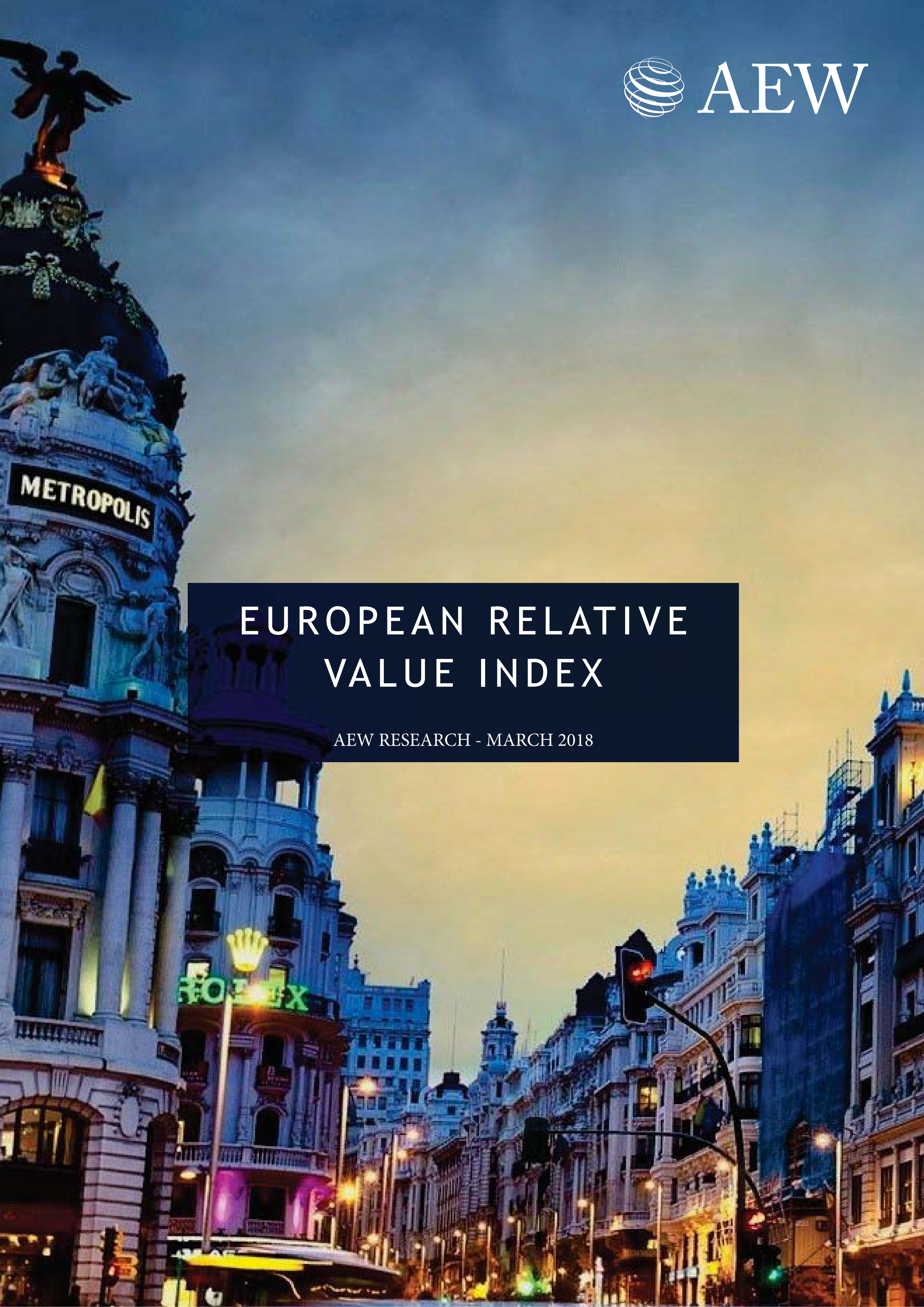

AEW

EUROPEAN RELATIVE VALUE INDEX

AEW RESEARCH - MARCH 2018

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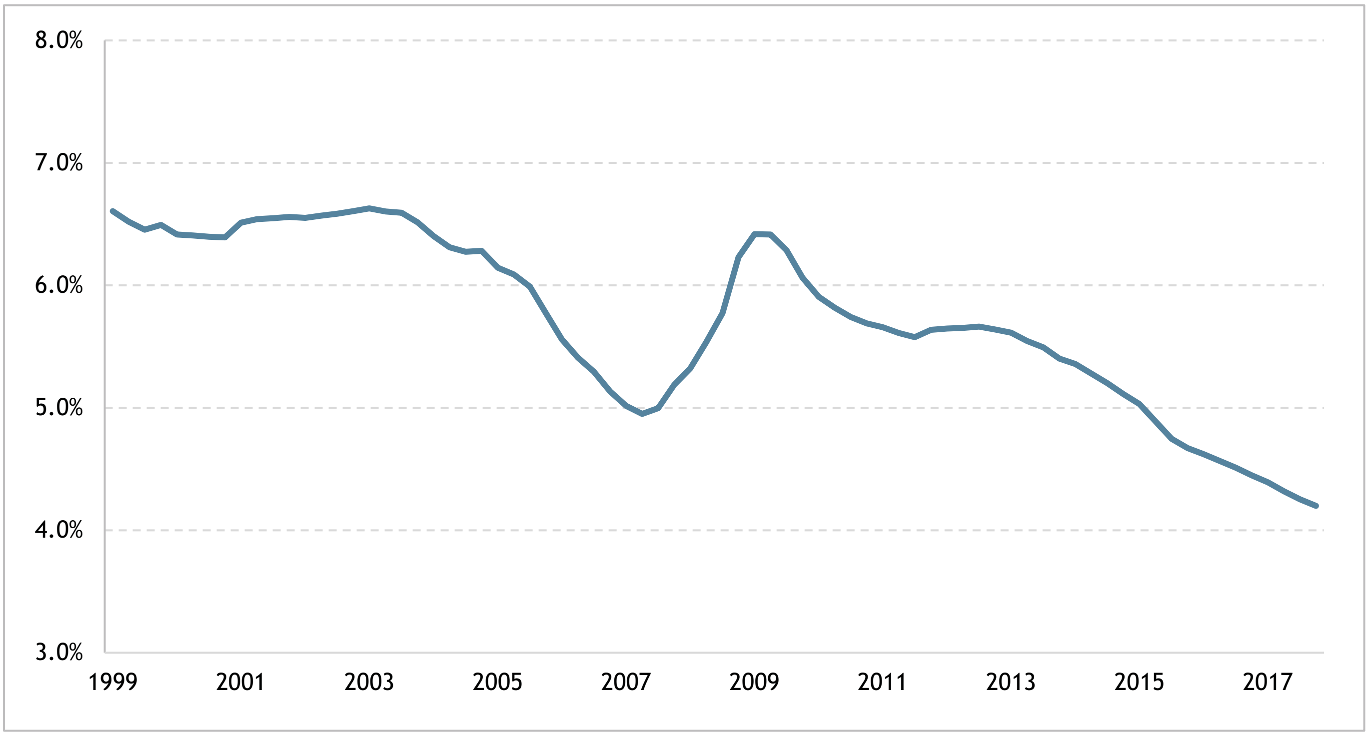
Is there still good value in European real estate?

In absolute terms, property appears expensive, as indicated by record low property yields (now just above 4%). However, to most investors values are *relative*. Therefore, we implement the '*Special theory of relativity*' introduced by our U.S. colleagues[1] for the main European markets.

EUROPEAN ALL PRIME PROPERTY YIELDS



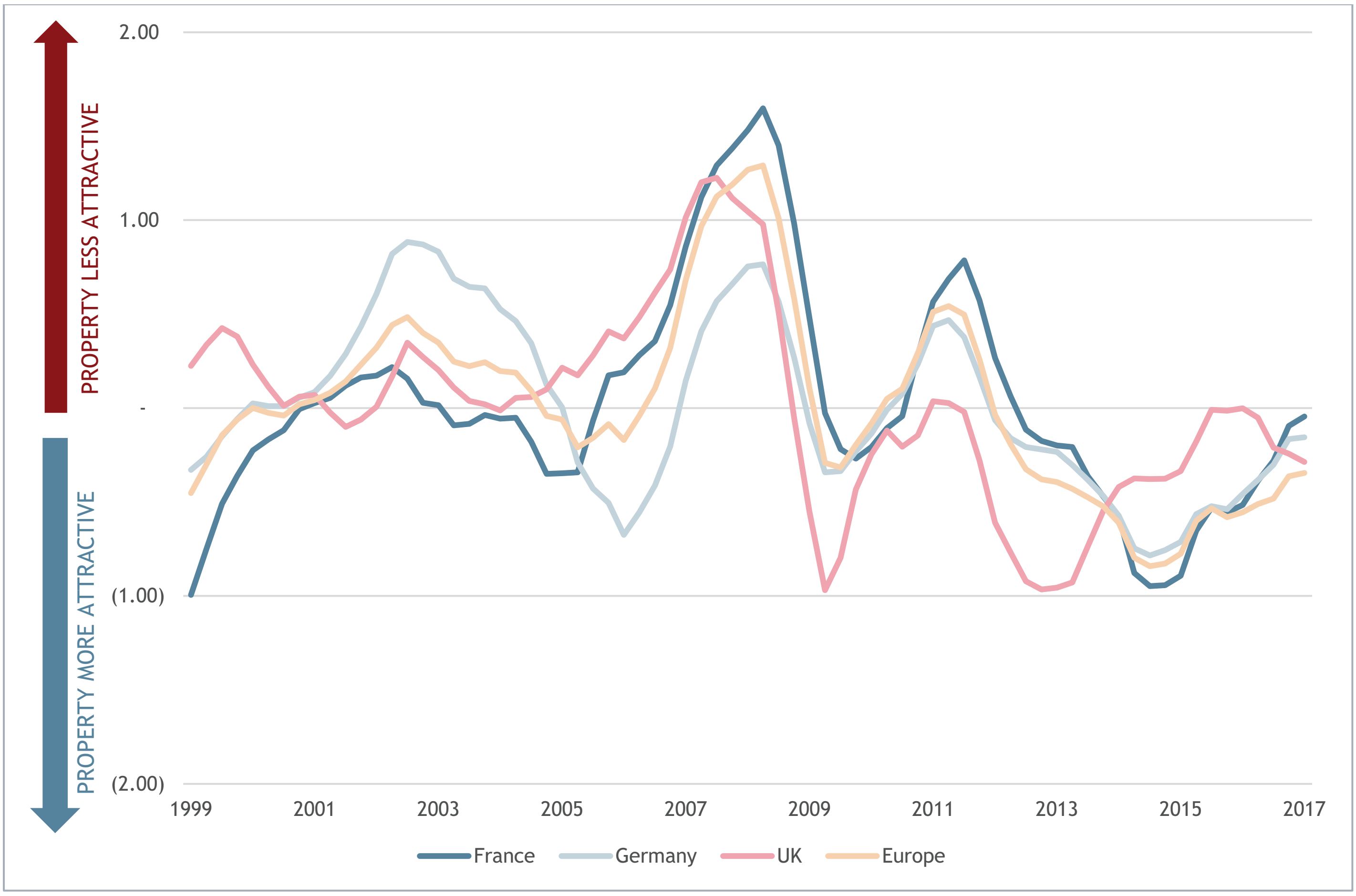
Sources: CBRE & AEW Research 2018

[1] AEW Research: A SPECIAL THEORY OF RELATIVITY (2018) http://www.aew.com/pdf/ASpecialTheoryofRelativity_Winter2018.pdf

EXECUTIVE SUMMARY: FAIR RELATIVE VALUE REMAINS IN PRIME

- As yields on European commercial real estate have tightened to record lows over the last two years, investors are fully justified to question whether direct real estate offers sufficiently attractive returns.
- Our newly launched European Relative Value Index (RVI) answers this question for the European market as a whole as well as for key individual markets such as the French, German and UK market.
- The RVI analyses show that fair relative value remains on offer in the prime European commercial real estate markets, with even better value available in secondary markets.
- Similar to our U.S. RVI, we compare direct real estate to three other assets, including stocks, bonds and REITs. But, data limitations force us to stick with prime (i.e., not average) property yields and government instead of corporate bonds.
- In our four step RVI approach we compare and calculate:
  - Property Net Operating Income (NOI) multiples to overall stock market earnings multiples (P/E ratio);
  - Prime property yields to 10-year government bond yields;
  - Premium or discount of REIT stock prices to their underlying Net Asset Values (NAVs);
  - Each comparison is normalised over its history using the Z-score and equal weighted in the RVI calculation.
- Our RVI methodology assumes current pricing across assets and a reversion to the historical mean of the ratio between the different asset pricings, similar to our U.S. RVI approach.
- Based on these RVI comparisons taking into account year-end 2017 pricing, prime UK property is slightly more attractive than other core European markets, such as France and Germany. As bond yields further normalise and other asset pricing changes this is likely to change in the next few years.
- However, non-core property remains even more attractive than core – offering investors a 150 bps yield pick-up across the main European markets.

COMPOSITE RELATIVE VALUE INDEX



Sources: CBRE, Oxford Economics, EPRA, Natixis & AEW Research 2018

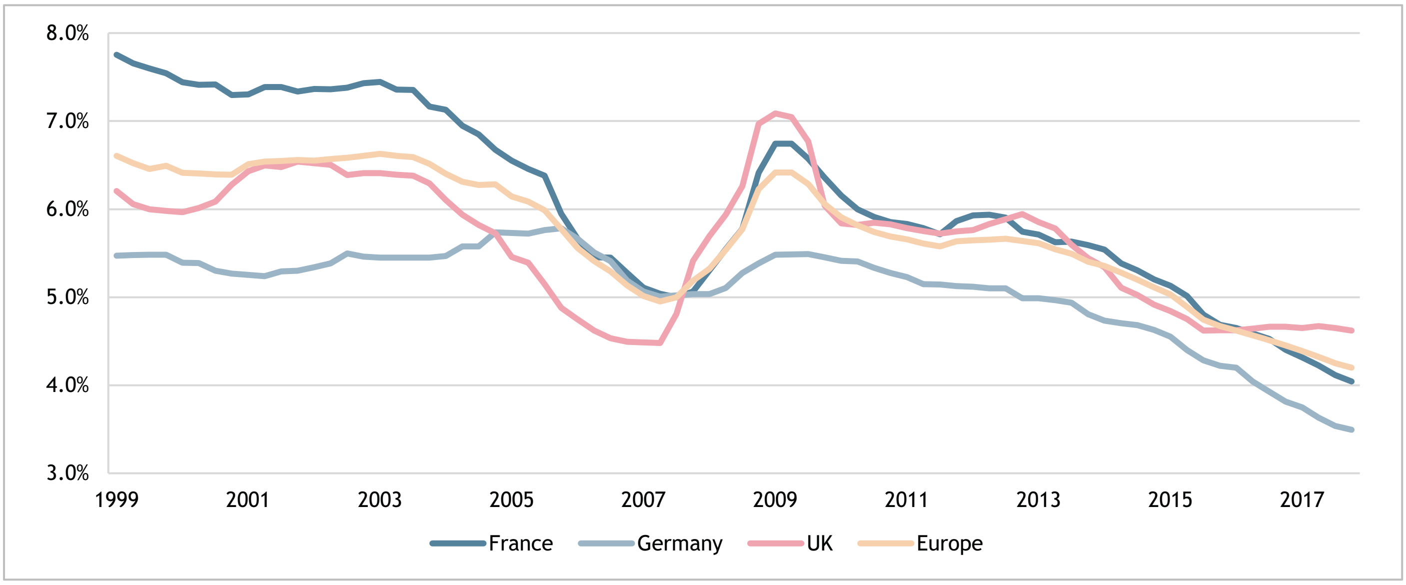
METHODOLOGY

As central banks have kept in place unprecedented quantitative easing policies after the global financial crisis, prime European real estate yields have tightened to record lows over the last two years. Based on this, we believe that investors are fully justified to question whether real estate offers sufficiently attractive returns. Our newly launched European Relative Value Index (RVI) answers this question. Our European RVI is as similar as the data allows to our U.S. RVI approach. In both cases, we compare direct real estate to three other assets, including stocks, bonds and REITs. Data limitations in Europe force us to stick with prime (i.e., not average) property yields and government bonds instead of corporate bonds. In our four step RVI approach we compare and calculate:

1. Compare Property Net Operating Income (NOI) multiples to overall stock market earnings multiples;
2. Contrast prime property yields to 10-year government bond yields;
3. Determine premium or discount of REIT stock prices to their underlying Net Asset Values (NAVs);
4. Normalise each comparison over its history using the Z-score and equal weight in the RVI calculation.

To create our European RVI, we have undertaken an extensive exercise in selecting data sources, coverage and time-period. We have selected France, Germany, the UK, Belgium and the Netherlands to construct a Core European aggregate for the time-period 1999-2017. In constructing this core European aggregate, we weight variables using each country's GDP in Purchasing Power Parity (PPP). Z-scores implicitly assume a reversion to their historical mean, similar to our U.S. methodology.

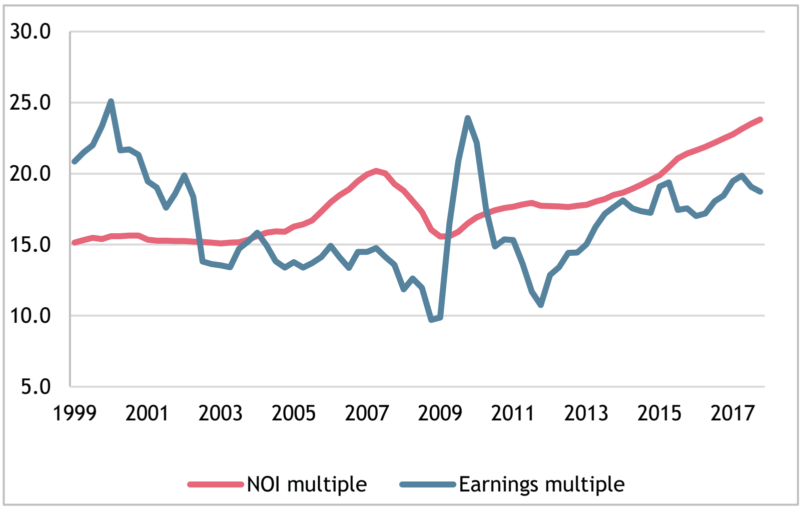
EUROPEAN ALL PROPERTY YIELDS



Sources: CBRE & AEW Research 2018

STEP 1 : COMPARE THE PROPERTY NOI MULTIPLE TO THE STOCK P/E MULTIPLE

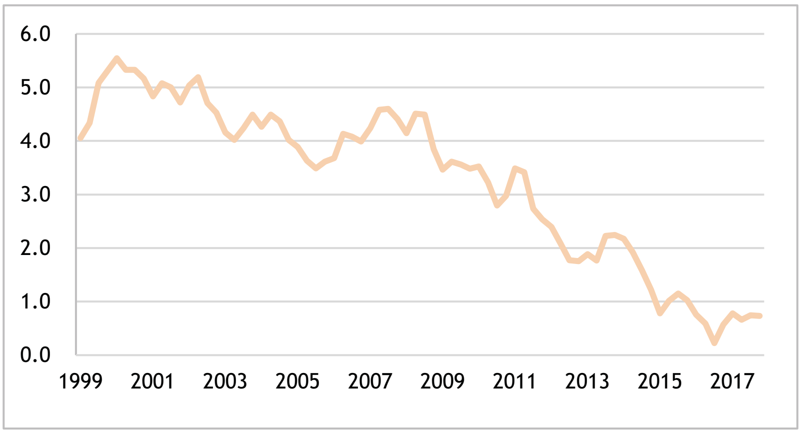
- For the property markets we use the ratio of property value to net operating income (NOI). This is the inverse of the prime initial yield (or cap rate). We therefore use the all property yield, which reflects the retail, office and logistics sectors.
- Corporate earnings multiple data are taken from the FTSE 250, CAC40, DAX30, AEX and BEL20. The earnings multiple is the stock-price over the last 12 months average earnings per share.
- In the next step, we calculate the ratio of the NOI over the PE multiples. A ratio of lower than one indicates that property is relatively cheap while a ratio of greater than one indicates that stocks are relatively cheap.



Source: Natixis, CBRE & AEW Research 2018

STEP 2 : AVERAGE 10-YEAR GOVERNMENT BOND YIELD PROVIDES CONTRAST FOR PROPERTY YIELDS

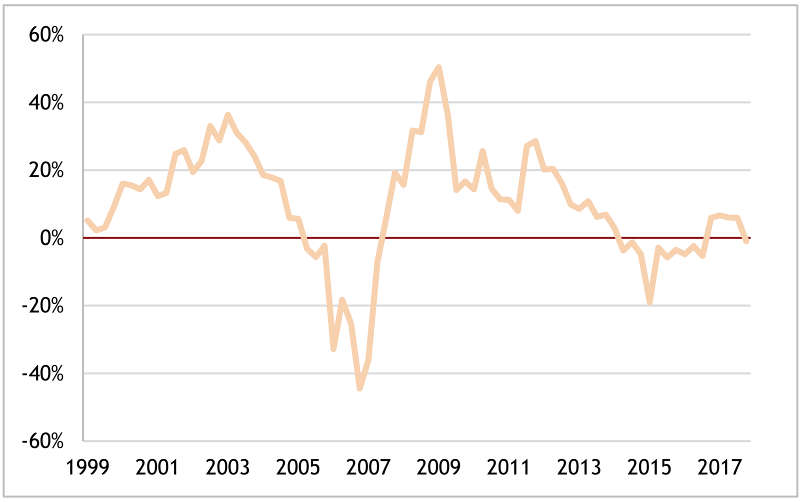
- Since no consistent corporate bond yield data is available for each of the key countries in Europe, we use 10-year government bond yield data from Oxford Economics (end of quarter notations) and contrast them with the all property yields.
- If the spread, calculated as the bond yield minus the prime all property yield, is below its long-term average, property is relatively cheap and vice versa.
- Since today's core European spread is 350bp compared to the average spread of 300bp, property is relatively attractive.



Sources: Oxford Economics & AEW Research 2018

STEP 3 : DETERMINE DISCOUNTS/PREMIUMS OF REIT SHARES TO UNDERLYING NET ASSET VALUES (NAV)

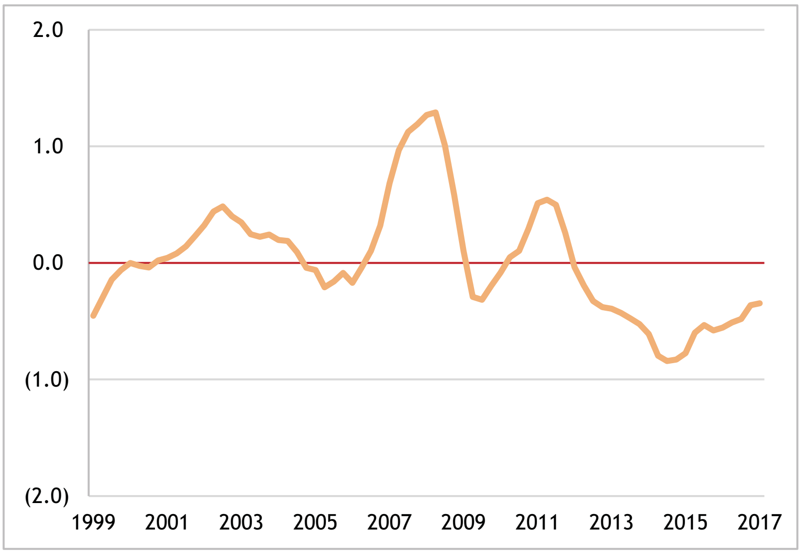
- Many REIT investors use premiums and discounts to Net Asset Value (NAV) to identify opportunities. If REIT stocks are trading at a discount to NAV, REIT shares offer good value. Based on this, we use the premium/discount of direct real estate as the inverse of EPRA's REIT premium/discount to NAV.
- This inverse allows us to indicate whether private property is more or less attractively priced compared to REIT stocks. To put it into context, a value above zero indicates that direct property is traded at a premium (and therefore unattractive relative to REIT shares) while a value below zero indicates that direct property is trading at a discount.



Sources: EPRA, Oxford Economics & AEW Research 2018

STEP 4: CALCULATE OUR EUROPEAN RELATIVE VALUE INDEX (RVI)

- The RVI is calculated by equally weighting each of the three comparisons described in the first three steps above.
- To normalise and avoid any bias in the calculation, we apply a process called Z-score standardisation, which allows us to transform each of the three time-series comparisons in terms of standard deviations around the long-term average. As a result, the Z-score has a mean of zero and a standard deviation of one.
- Please note that a lower score of the RVI implies that property is relatively more attractively priced compared to the historical period evaluated.
- As we use the same historical period for both core Europe as a whole and each of the three key markets, we can then also compare each market relative to the European average.

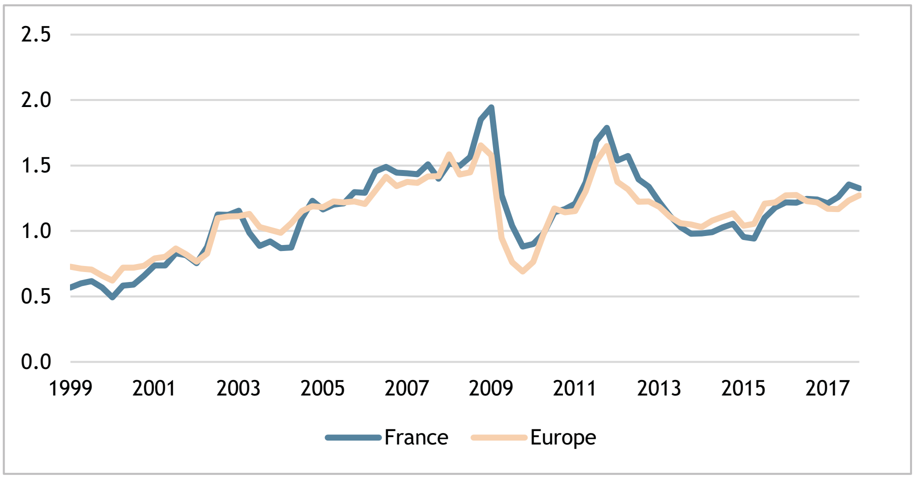


Sources: CBRE, Oxford Economics, EPRA, Natixis and AEW Research 2018

SECTION I : FRANCE

FRANCE PROPERTY NOI MULTIPLE OVER CAC40 P/E RATIO

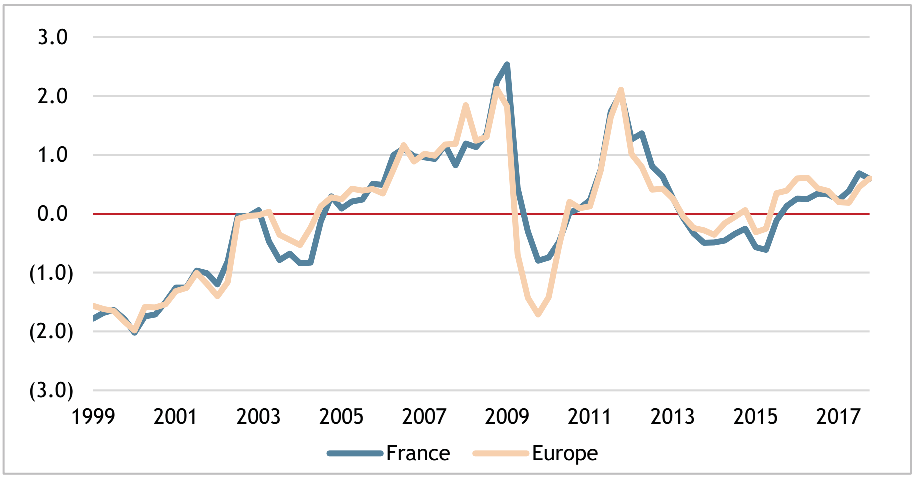
- The CAC40 corporate earnings multiple currently stands at 18.7x, indicating that investors are willing to pay 18.7x the income. For real estate, this multiple is currently around 24.7x, well above its historic average of 16.96x.
- The ratio of NOI to corporate earnings, which currently stands at 1.33, indicates that investors are willing to pay a higher price for real estate.
- In comparison, France is slightly above the European average but has seen a close correlation over the period.



Sources: Natixis, CBRE, Oxford Economics & AEW Research 2018

Z-SCORE OF NOI MULTIPLE OVER CAC40 P/E RATIO FRENCH PROPERTY IS RELATIVE HIGHLY PRICED

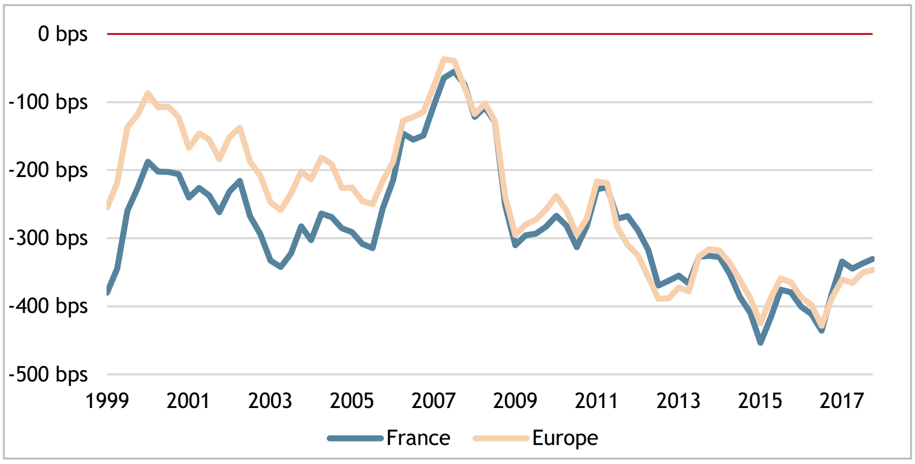
- The Z-score methodology that we applied to determine the relative price on the ratio between NOI and corporate earnings indicates that property is less favourably priced nowadays (a score above zero means that property is relatively highly priced).
- Historically, property has been more expensive for prolonged periods. It seems that opportunities to buy property relatively cheaply have been limited to before 2003, 2009/2010 and 2014/2015.



Sources: Natixis, CBRE, Oxford Economics & AEW Research 2018

GOVERNMENT BOND YIELDS OVER PROPERTY YIELDS SHOW THE RECENT UPTICK IN BOND YIELDS

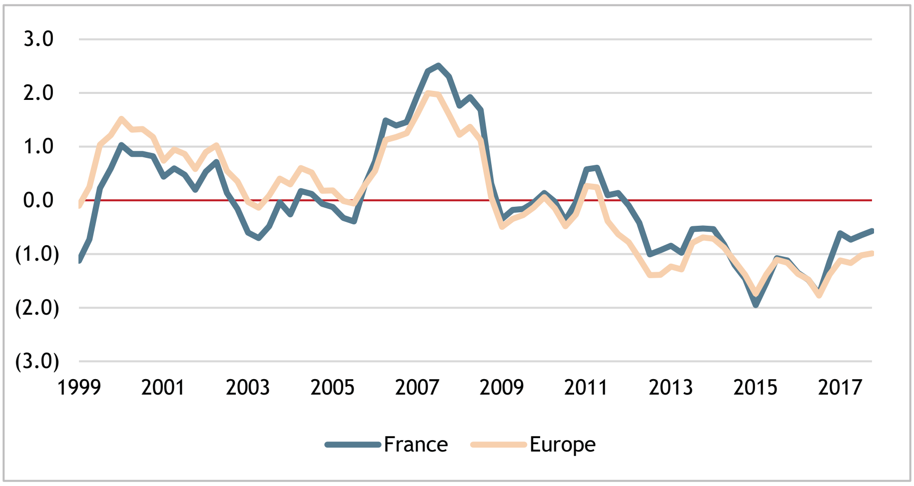
- The spread between government bond yields and property has increased significantly since the GFC from 100 bps in 2008 to over 300bps by 2017. This was mainly due to QE introduced by the ECB which resulted in a steep fall of bond yields.
- Currently, the spread between bonds and property equals 350 basis points, which is above the historical average of 300 basis points.
- The European yield spread is currently around 10 basis points lower than in France.



Sources: Oxford Economics, CBRE & AEW Research 2018

Z-SCORE YIELD SPREAD INDICATES THAT FRENCH PROPERTY IS PRICED ATTRACTIVELY

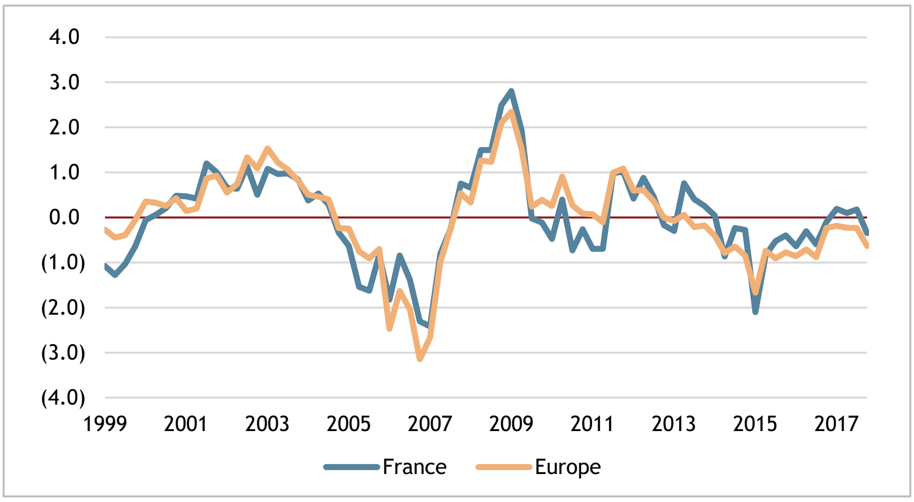
- French property is attractively priced nowadays due to an above average bond/property yield spread. This signal of attractiveness somewhat converged due to bond yield normalization.
- However, at historical standards, this spread has been high for the last 5 years. So, property has been relatively cheap compared to bonds for an extended period.
- In comparison, Europe has seen a similar path, although, property seems to be more attractively priced in Europe than in France on this metric.



Sources: Oxford Economics, CBRE & AEW Research 2018

Z-SCORE OF REITS TO NAV DISCOUNT SHOW ATTRACTIVE PRICING FOR DIRECT FRENCH PROPERTY

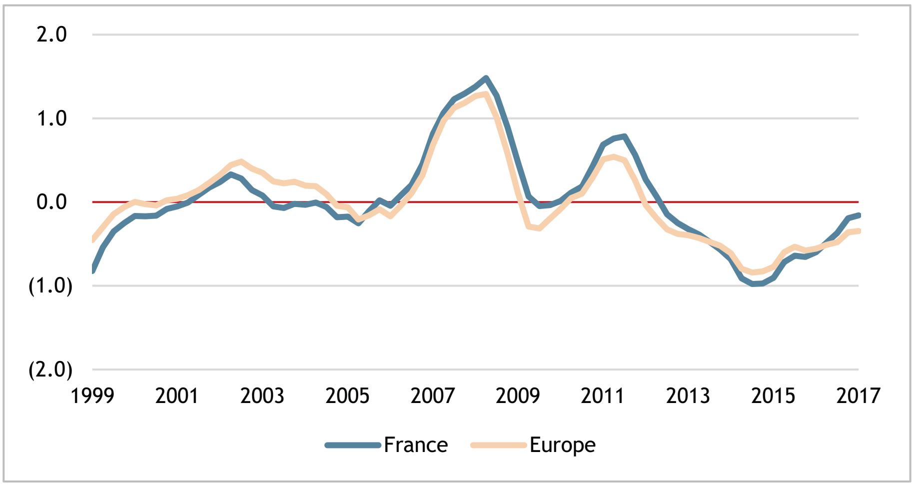
- The public market for real estate investment trusts indicates that direct property is traded at a small discount and thus attractively priced. It can be observed that property has been traded at or near discount over the last four years.
- The European aggregate shows an even a higher discount than France. This is confirmed by the line below the 0-axis which indicates that REITs are trading at a premium (direct property at a discount) while a line above the axis implies that REITs are trading at a discount (property at a premium).



Sources: EPRA, Oxford Economics & AEW Research 2018

FRANCE RELATIVE VALUE INDEX (RVI) INDICATES ATTRACTIVE PRICING

- When we put all three measures together in our RVI index, we see that French property is attractively priced. The degree of attractiveness has been diminishing, but is still positive. It is interesting to note that, pre GFC, property was highly priced and has since fallen.
- Since 2012 property has been attractively priced in France with the 2014/2015 period giving the best relative value (please note that we use a 12 month moving average to reduce the quarterly noise).

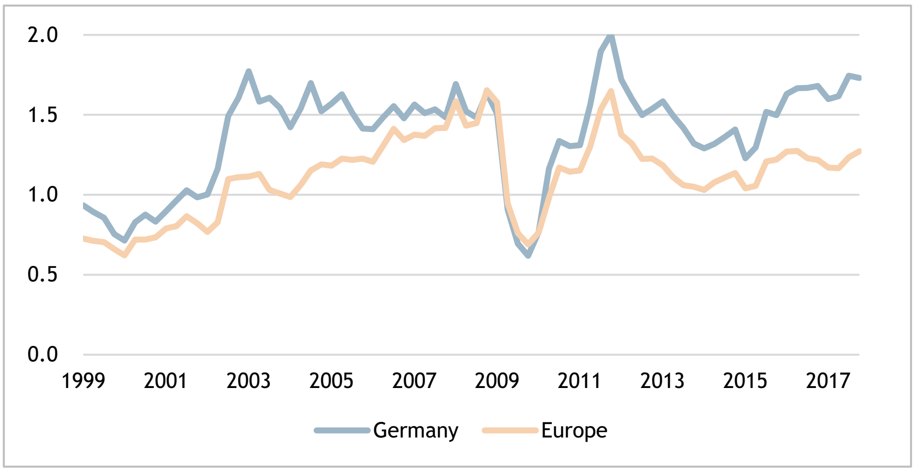


Sources: CBRE, Oxford Economics, EPRA, Natixis and AEW Research 2018

SECTION II : GERMANY

GERMANY PROPERTY NOI MULTIPLE OVER DAX30 P/E RATIO

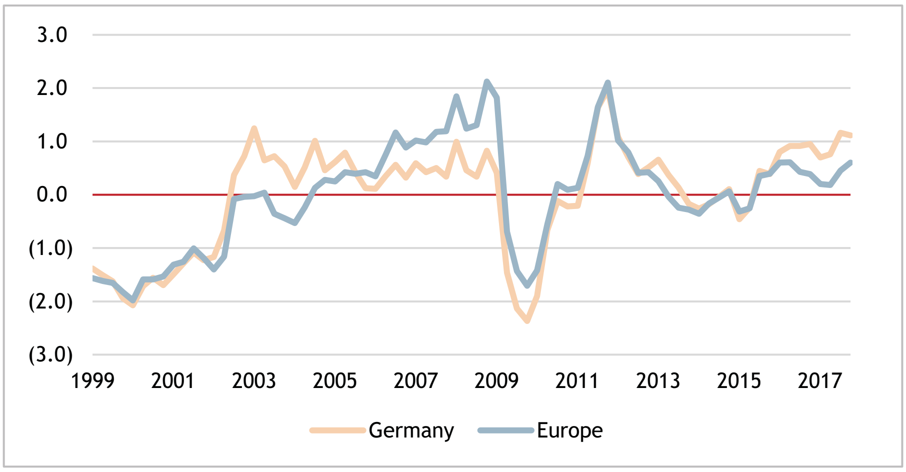
- The DAX30 corporate earnings multiple currently stands at 16.5x, indicating that investors are willing to pay 16.5 the income. This is the lowest earnings multiple for Europe. For real estate, this multiple is currently around 28.6x, the highest among the five European countries covered.
- Germany has seen a higher NOI to P/E ratio than core Europe since 2010. Nowadays this spread is near its highest point since 2010, a sign that property and stock valuations are diverging in Germany from Core Europe.



Sources: Sources: Natixis, CBRE, Oxford Economics & AEW Research 2018

Z-SCORE OF NOI MULTIPLE OVER DAX30 P/E RATIO IMPLIES GERMAN PROPERTY IS RELATIVE HIHGLY PRICED

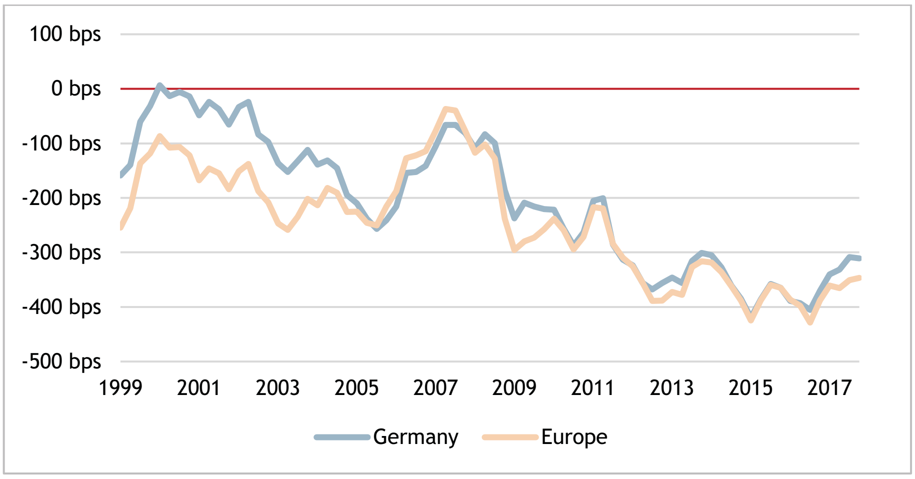
- The Z-score methodology that we applied to determine the relative price on the ratio between NOI and corporate earnings, indicates that property is less attractively priced in Germany.
- From a historic perspective, property has been getting more expensive over the last 12 months in Germany.
- In addition, it seems that property has been relatively cheap only during the GFC and in short periods in 2014 and 2015.



Sources: Sources: Natixis, CBRE, Oxford Economics & AEW Research 2018

GOVERNMENT BOND YIELDS OVER PROPERTY YIELDS SHOW RECENT UPTICK IN BOND YIELDS

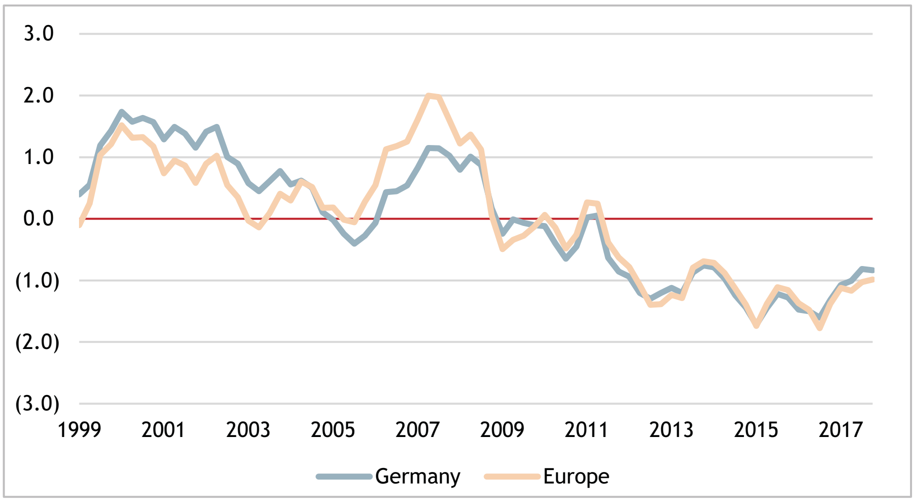
- Government bond yields have increased over the last year amid yield normalisation while property yields declined towards historical lows.
- As a result, the spread between government bond yields and property has declined to just over 300 bps from a high in 2016 of over 400 bps.
- In Europe, this spread is currently around 40 basis points lower (350 bps). Historically, the spread in Germany has been higher compared to Europe.



Sources: Sources: Oxford Economics, CBRE & AEW Research 2018

Z-SCORE YIELD SPREAD INDICATES THAT GERMAN PROPERTY IS PRICED ATTRACTIVELY

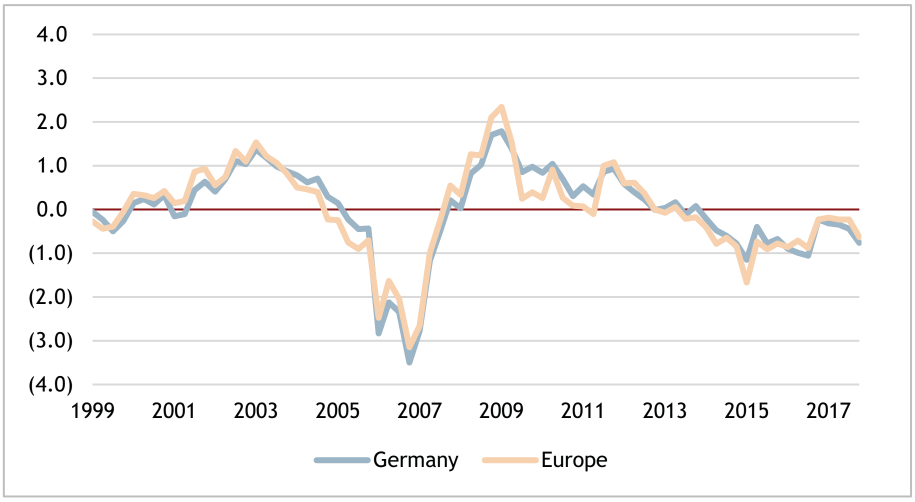
- Property is attractively priced in Germany nowadays due to an above average bond-property yield spread. This signal of attractiveness somewhat converged due to the aforementioned process of yield normalization.
- However, at historical standards, this spread has been high for the last 5 years. So, property has been relatively cheap for a prolonged period.
- In comparison, Europe has seen a similar path, although property seems to be somewhat more attractively priced in Europe.



Sources: Sources: Oxford Economics, CBRE & AEW Research 2018

Z-SCORE OF REITS TO NAV DISCOUNT SHOW ATTRACTIVE PRICING FOR GERMAN DIRECT PROPERTY

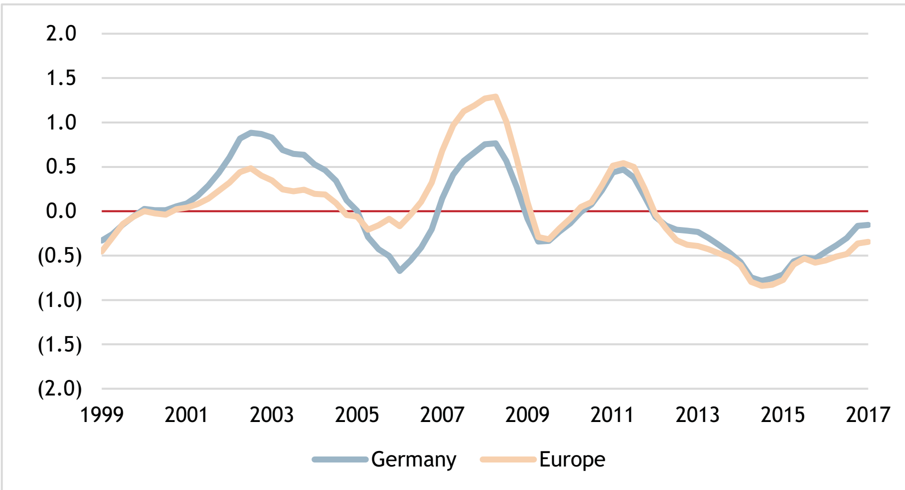
- The REITs market in Germany is trading at a small premium as property is relatively attractively priced (a score below the 0-axis indicates that property is attractive). This property discount is in a downward trend relative to its history.
- The European aggregate shows a similar trend over the time-period with property going from expensive in the aftermath of the GFC to attractive around 2013.



Sources: EPRA, Oxford Economics & AEW Research 2018

GERMAN RELATIVE VALUE INDEX (RVI) INDICATES ATTRACTIVE PRICING

- Again, when we put all three measures together in our RVI index, we see that property is attractively priced in Germany. However, the degree of attractiveness is slightly diminishing but still positive. It is interesting to note that property has been attractively priced for over the last 5 years.
- However, Europe is slightly more attractively priced than Germany. The correlation of both is similar with a slight divergence in the last 24 months (not that we use a 12 month moving average to reduce the quarterly noise).

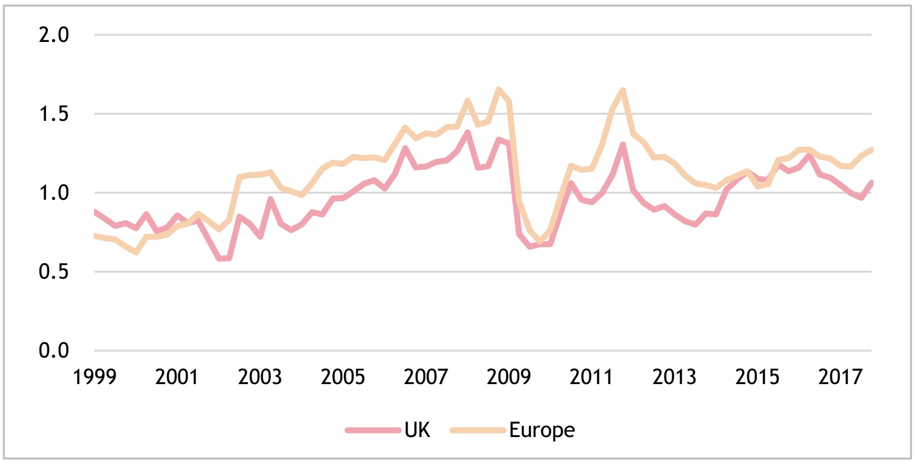


Sources: CBRE, Oxford Economics, EPRA, Natixis and AEW Research 2018

SECTION III : UNITED KINGDOM

UK PROPERTY NOI MULTIPLE OVER FTSE250 P/E RATIO

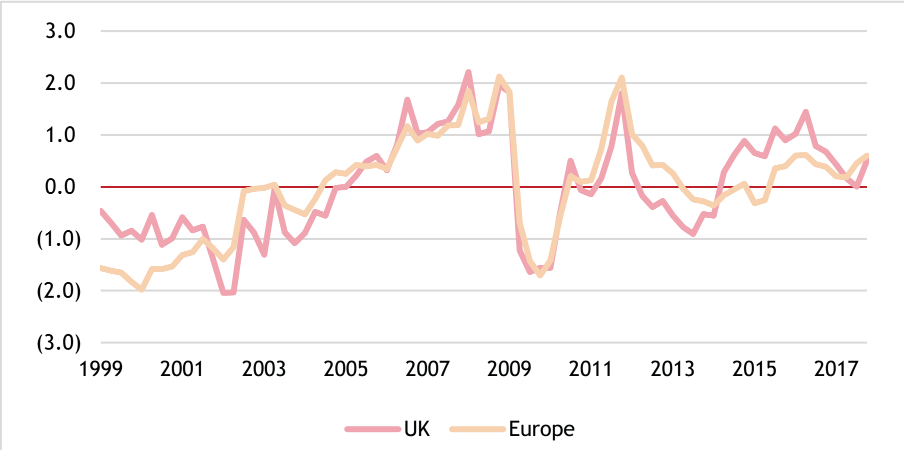
- The FTSE250 corporate earnings multiple currently stands at 20.4x, indicating that investors are willing to pay 20.4x income for stocks. For real estate, this multiple is currently around 21.6x, the lowest among our five European countries covered.
- The UK has seen a lower NOI to P/E ratio than core Europe since 2010. This is mainly due to the observed property yield stabilisation after the Brexit referendum.



Sources: Sources: Natixis, CBRE, Oxford Economics & AEW Research 2018

Z-SCORE OF NOI MULTIPLE OVER FTSE250 P/E RATIO SHOWS UK PROPERTY IS RELATIVELY HIGHLY PRICED

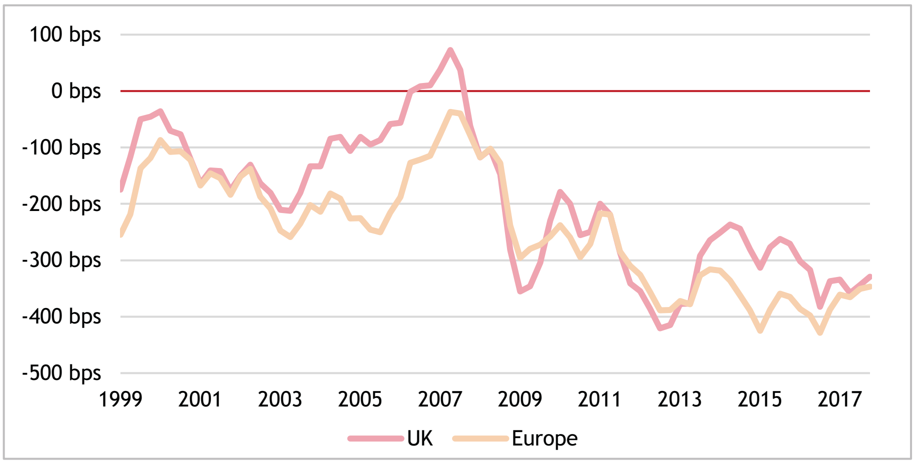
- The UK is relatively (measured by the NOI over P/E ratio) highly priced to stocks on a historical basis.
- However, compared to Europe, the UK has seen a period of relatively high pricing before the Brexit referendum whereas property was relatively more attractive priced in Europe.
- Therefore, property has been getting less expensive compared to stocks since June 2016 (the FTSE250 increased in the aftermath of the Brexit-referendum while property yields stabilised).



Sources: Sources: Natixis, CBRE, Oxford Economics & AEW Research 2018

GOVERNMENT BOND YIELDS OVER PROPERTY YIELDS SHOW RECENT UPTICK IN BOND YIELDS

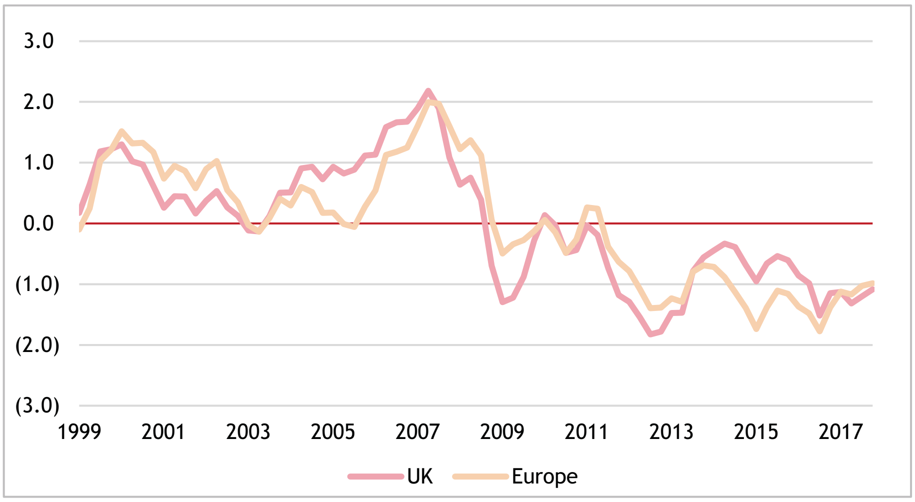
- The UK has seen its first interest rate increase in over a decade last year. This has triggered a slight increase in government bond yields which resulted in a tightening of the spread between bond and property yields.
- As a result, the spread between government bond yields and property is currently around 330 bps from a high in 2016 of just under 400 bps.
- In Europe, this spread is currently around 20 basis points lower (350 bps). Historically, the spread in the UK has been higher compared to Europe.



Sources: Sources: Oxford Economics, CBRE & AEW Research 2018

Z-SCORE YIELD SPREAD INDICATES THAT UK PROPERTY IS PRICED ATTRACTIVELY

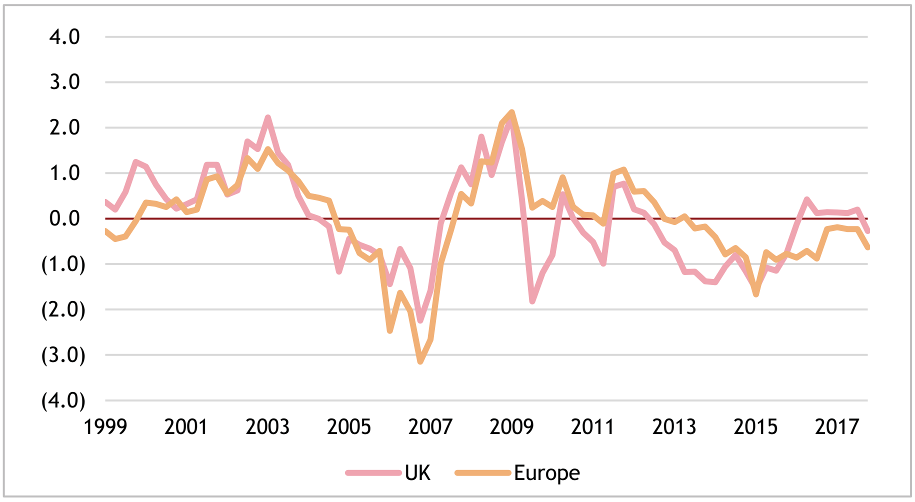
- In the UK, property is attractively priced due to a bond-property spread that is above its historical average. This signal of attractiveness converged due to the increase in bond yields together with a stabilisation of property yields.
- However, at historical standards, this spread has been high for the last 5 years. So therefore, property has been relatively cheap for a prolonged period.
- In comparison, Europe has seen a similar path, although property seems to be slightly less attractively priced in Europe at the moment.



Sources: Sources: Oxford Economics, CBRE & AEW Research 2018

Z-SCORE OF REITS TO NAV DISCOUNT SHOW ATTRACTIVE PRICING FOR UK DIRECT PROPERTY

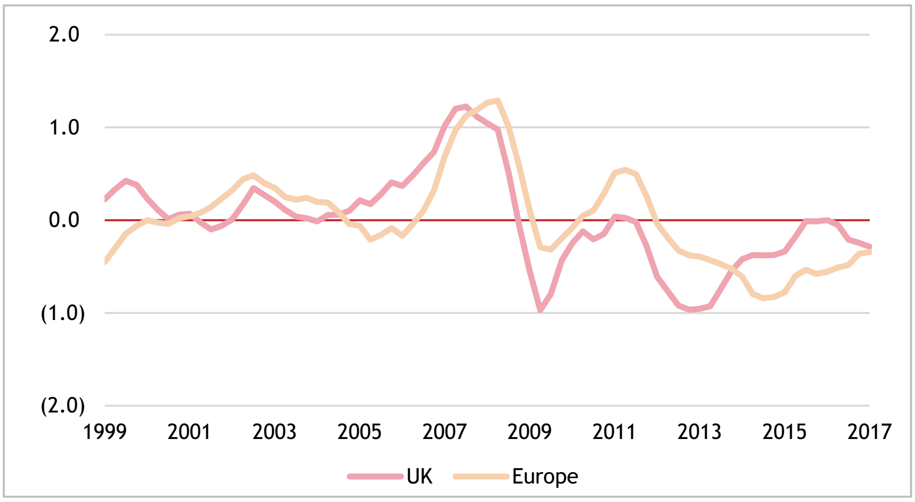
- The REITs market in the UK is the only core European market that trades at a discount of 12% for REITs to NAV. On that basis, direct property is currently less attractive than REITs.
- However, if we compare the current discount/premium to its long term average (Z-score methodology), we see that UK direct property is priced at a small discount.
- The European aggregate shows a somewhat different trend over the last three years with direct property being a bit more attractively priced.



Sources: EPRA, Oxford Economics & AEW Research 2018

UK RELATIVE VALUE INDEX (RVI) INDICATES ATTRACTIVE PRICING

- If we put all three measures together in our RVI index, we see that property in the UK is attractively priced. In contrast to Europe the direction of the trend is different. Whereas the trend in Europe is diminishing, the UK is becoming more attractively priced compared to 2016.
- UK property was fairly priced in parts of 2015 and 2016. Afterwards, property became more attractive amid property yield stabilisation.
- Historically, UK direct property has been attractive since the GFC.

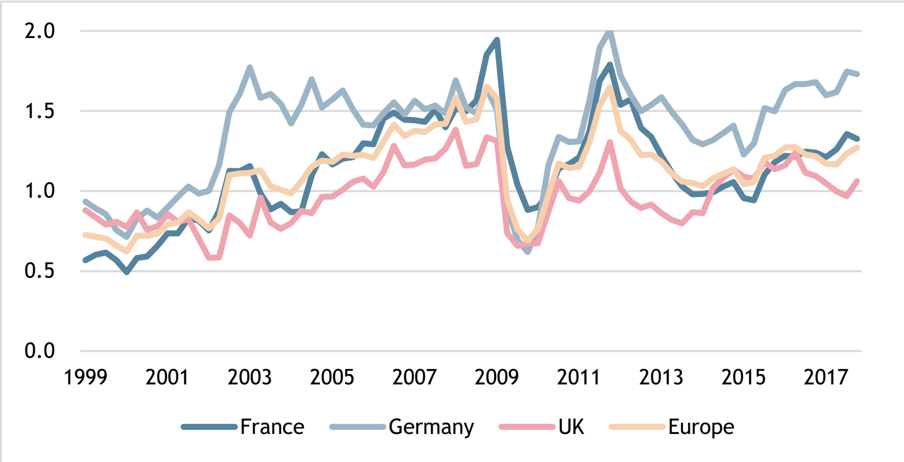


Sources: CBRE, Oxford Economics, EPRA, Natixis and AEW Research 2018

SECTION IV: EUROPE

EUROPEAN PROPERTY NOI MULTIPLE OVER STOCKS P/E RATIO

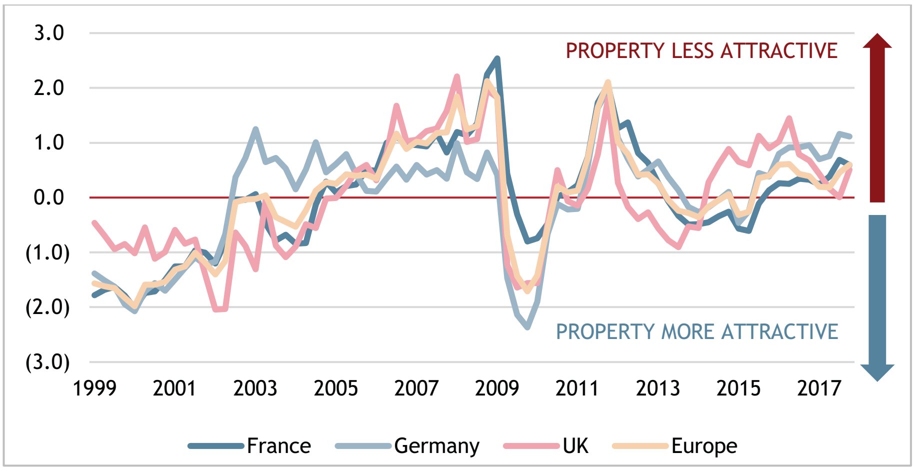
- The European corporate earnings multiple currently stands at 18.7x, indicating that investors are willing to pay 18.7x income. For real estate, this multiple is currently higher at 23.8x.
- The ratio of NOI over earnings multiple in Europe currently stands at 1.27, slightly above its long-term average of 1.12. The latter indicates that the NOI multiple has been higher over the 1999-2017 period than the earnings multiple.
- The European average ratio is centered with Germany on the high end and the UK on the bottom.



Sources: CBRE, Natixis & AEW Research 2018

EUROPEAN Z-SCORE OF PROPERTY NOI MULTIPLE OVER STOCK EARNINGS MULTIPLE RATIO

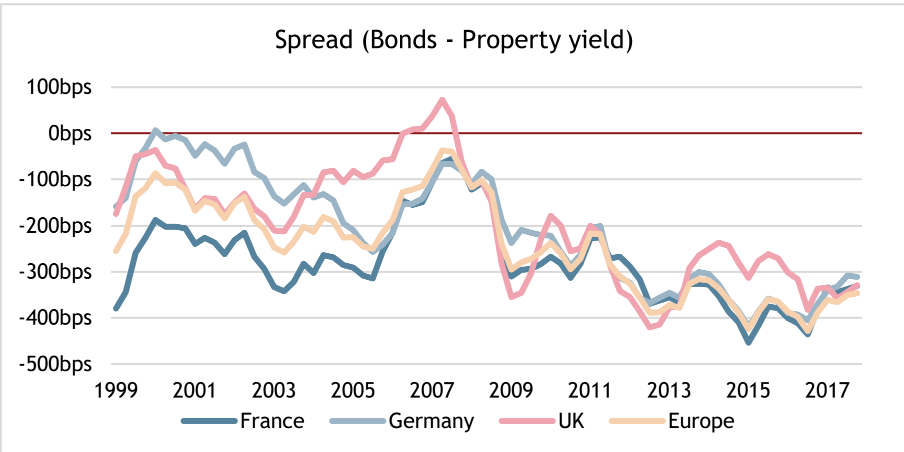
- Compared to their respective stock markets, all property markets are relatively expensive. But, German property looks most expensive on this metric.
- Please note that only ratio scores below the line indicate that property is attractively priced relative to stock market multiples when compared to historical averages.
- The trend of the Z-score is upwards, indicating that property is less attractive over the last 12 months compared to stocks.



Sources: CBRE, Oxford Economics & AEW Research 2018

EUROPEAN GOVERNMENT BOND YIELDS OVER PROPERTY YIELDS SHOW CONVERGENCE

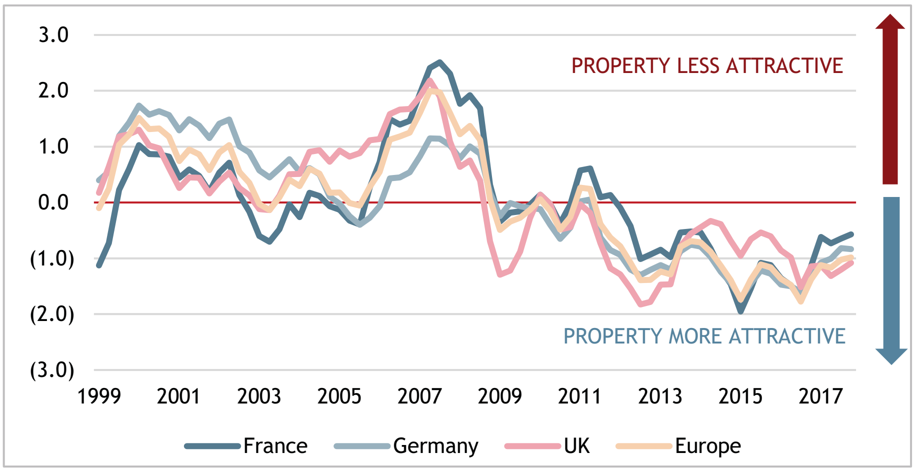
- European bond yields have come down in the aftermath of the GFC (German bond yields even traded in negative territory for a short period of time).
- Nowadays, with interest rates going up and the ECB downgrading its QE buying program, bond yields have moved up. This can be seen in the recent drop of the yield spread from trading around 400 bps in the end of 2016 to around 300/325bps today.
- Despite German bonds trading significantly below the other countries, the current spread in the other countries is higher than in Germany.



Sources: EPRA, Oxford Economics & AEW Research 2018

EUROPEAN Z-SCORE OF 10-YEAR GOV'T BONDS YIELDS OVER PRIME PROPERTY YIELDS SPREAD

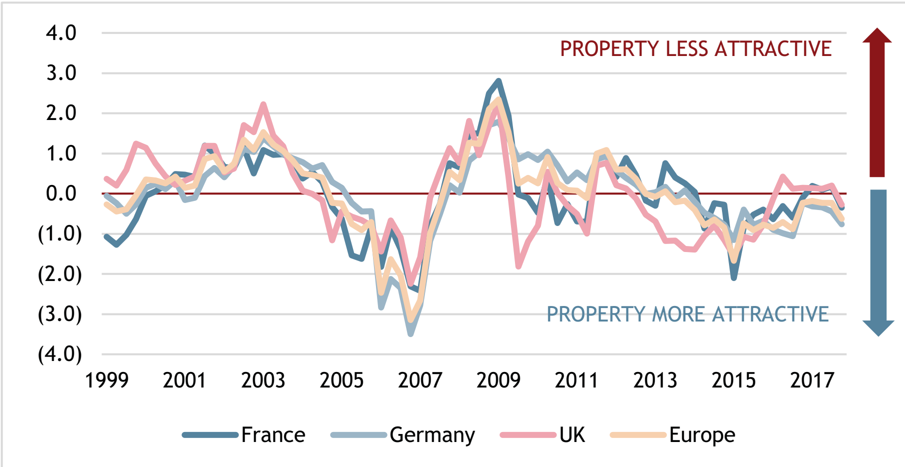
- Relative to each of their respective government bond yields, all property markets are priced attractively. UK property looks most attractive in this respect.
- Again, we note that only a ratio score below the line indicates that property is attractively priced relative to government bond yields compared to historical averages.
- Property has been attractive in all markets since 2012 with an upward trend due to bond-spread convergence.



Sources: Sources: Oxford Economics, CBRE & AEW Research 2018

EUROPEAN Z-SCORE OF REITS DISCOUNT/PREMIUM TO UNDERLYING PROPERTY NAV

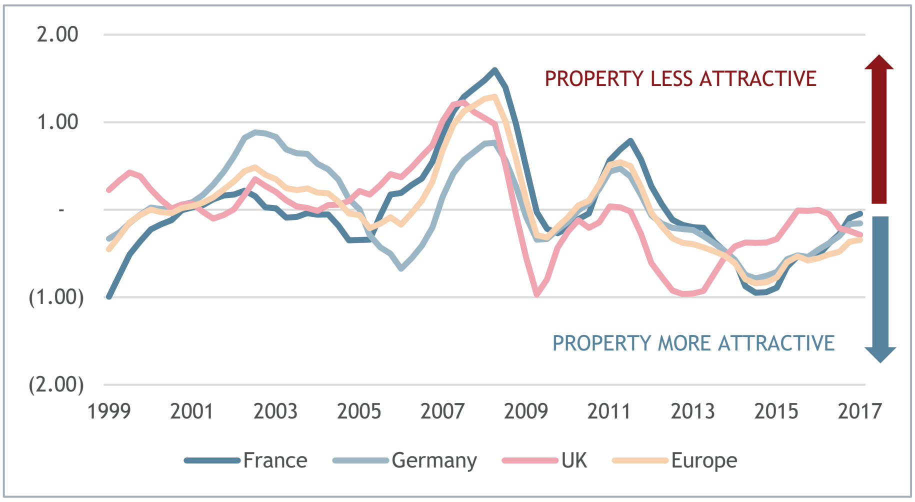
- When considering REITs discounts to NAV, all three direct property markets are deemed attractive.
- But, German direct property ranks most attractive on this comparison basis.
- As before, we highlight that only ratio scores below the line indicate that direct property is attractively priced relative to REITs compared to historical averages.



Sources: EPRA, Oxford Economics & AEW Research 2018

EUROPEAN RELATIVE VALUE INDEX (RVI) INDICATES FAIR PRICING

- Finally, if we put all three measures together in our RVI index, we see that property in Europe is attractively valued.
- The UK's direction of the trend is different to France and Germany. Where the trend in Europe is diminishing, the UK is becoming more attractively priced compared to 2016.
- Historically, property has been attractive in Europe since 2012.

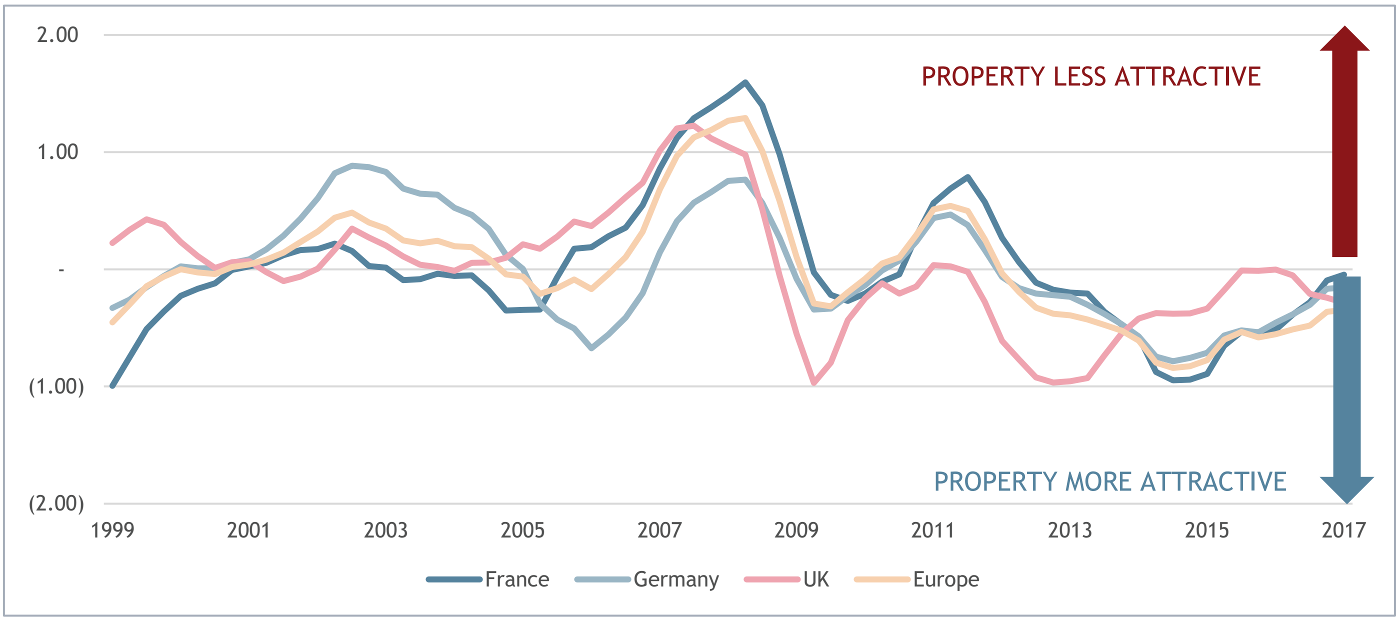


Sources: CBRE, Oxford Economics, EPRA, Natixis and AEW Research 2018

Section V: Conclusion

With our European Relative Value Index (RVI) we have tried to answer the question: *Is there real estate still good value in European real estate?* Based on our RVI we can say that all markets offer fair relative value when compared to market pricing in each of their respective national l stocks, government bonds and REITs.

RELATIVE VALUE INDEX - EUROPE VS KEY COUNTRIES



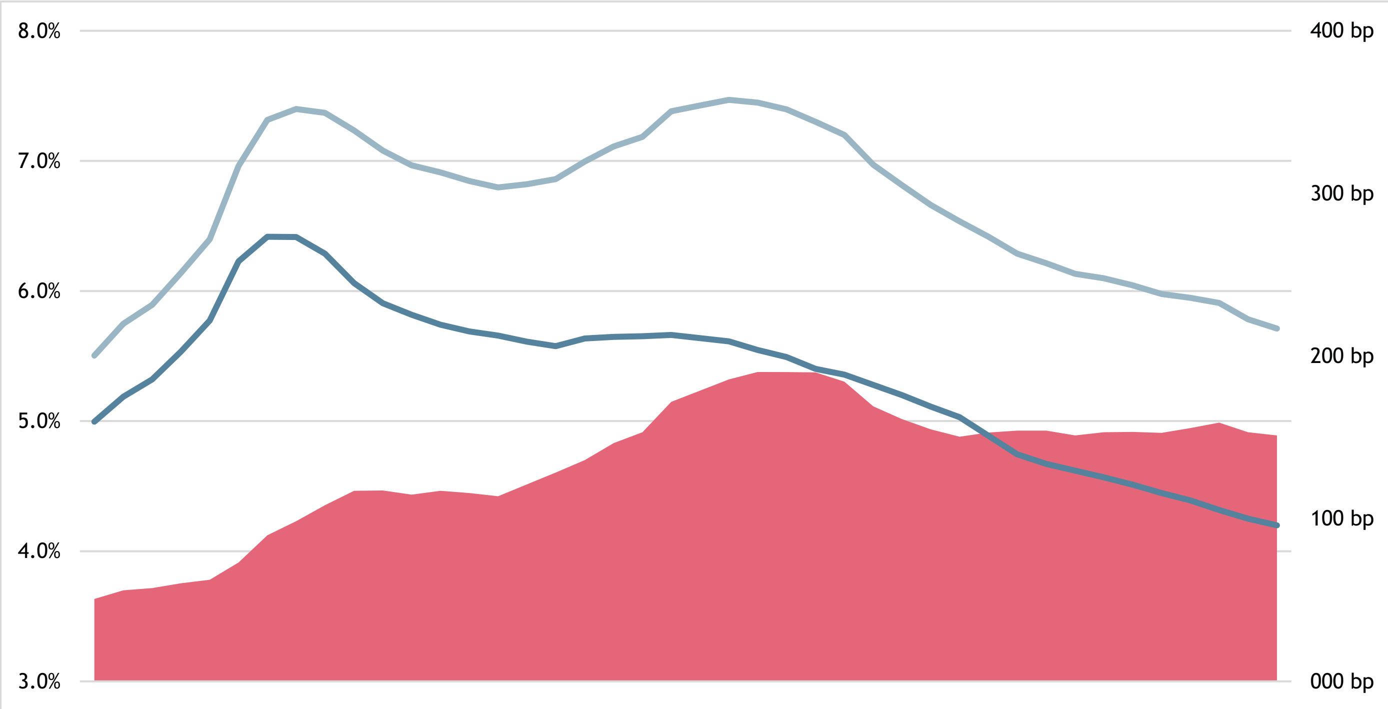
Sources: CBRE, Oxford Economics, EPRA, Natixis and AEW Research 2018

- First, as shown in the figure above, markets all offer fair relative value but the pattern varies as the UK, after its recent adjustment, is marginally more attractive than France and Germany. However, the European average offers marginally better value compared to the three main countries as Belgium and the Netherlands offer good relative value.
- As we look ahead, we think that property market fundamentals remain positive. We see that there is less risk on new supply compared to the previous cycle as supply has been subdued and way below its unprecedented levels of 2007.
- Also, we see that the amount of leverage (LTV) in real estate investment is below its previous peak with an average LTV of just below 50%. In comparison, the average LTV in 2007 was just above 70%.
- We summarize our RVI index by market and indicate if a market shows fair relative value or not and whether the recent trend is moving up (i.e., becoming more attractive) or down (i.e., becoming less attractive).

	Stocks		Bonds		REITs		Overall RVI	
	Value	*Trend*	*Value*	*Trend*	*Value*	*Trend*	*Value*	*Trend*
France	Expensive	→	Fair	↘	Fair	↗	Fair	↘
Germany	Expensive	→	Fair	↘	Fair	↗	Fair	↘
UK	Expensive	↘	Fair	↘	Fair	↗	Fair	↗
Core Europe	Expensive	↘	Fair	↘	Fair	↗	Fair	↘

So, with core property giving fair relative value, non-core property, with a current yield spread of 150 bps (as shown in the figure below), remains more attractive. Therefore, investors could consider adjusting their focus for the medium term to a broader range of European Markets (as implied in our European Property Market Outlook[2]) and focus on income returns as capital value upside is projected to be limited

PRIMARY VS. SECONDARY PROPERTY YIELDS



Sources: CBRE & AEW Research 2018

[2] AEW European Property Market Outlook - 2018: http://hub.im.natixis.com/en/articles/AEW-12-17.shtml

ABOUT AEW

AEW is one of the world's largest real estate asset managers, with €58.6bn of assets under management as at 31 December 2017. AEW has over 660 employees, with its main offices located in Boston, London, Paris and Hong Kong and offers a wide range of real estate investment products including comingled funds, separate accounts and securities mandates across the full spectrum of investment strategies. AEW represents the real estate asset management platform of Natixis Investment Managers, one of the largest asset managers in the world.

As at 31 December 2017, AEW managed €28.4bn of real estate assets in Europe on behalf of a number of funds and separate accounts. AEW has close to 400 employees based in 10 offices across Europe and has a long track record of successfully implementing core, value-add and opportunistic investment strategies on behalf of its clients. In the last six years, AEW has invested and divested a total volume of over €19.4bn of real estate across European markets.

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