

January 2010

# European Property Cycle Monitor

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## Executive Summary

The global economic crisis squeezed 1.1% out of the world's output in 2009, but it could have been worse. In July, forecasters had braced for a 1.5% contraction as the dire first quarter GDP numbers rolled in from across the world. Six months later, in early 2010, a guarded optimism prevails in Europe despite lingering worries about a sputtering recovery. The upside lies in a global economy poised for 4.0% growth in 2010, but the downside is that Europe may claim only a small slice of that expansion. Deutsche Bank's 2010 GDP forecast calls for a 1.5% expansion in the Eurozone, the UK, and Sweden. At its first meeting of 2010, the European Central Bank (ECB) maintained its cautious commitment to consistent monetary policy for the near term, while echoing its ongoing concern about uneven drivers of the economic recovery.

Rents in Europe's **office markets** have not yet rebounded, but that did not deter a turnaround in real estate capital markets beginning in the latter half of 2009. Over the next couple of years, headline rents will remain sluggish in European office markets until incentives have finally been cast off and leasing activity can support sustained net absorption free of subsidy. This long wait for lasting recovery bears unwelcome implications for existing owners and lenders who can expect rising vacancies and falling net operating incomes (NOIs) during this period. Massive overhangs of supply do not haunt the office markets this time as in past cycles. Instead, the waiting game focuses on the revival of demand and its timing across markets. Our forecasting period extends only through 2014, and during this window we expect few markets to match their previous peak rent level. At this point in the cycle, the keenest attention falls on the core markets. The more volatile core markets (London, Paris, Madrid) have good upside potential but timing and downside risks vary significantly. The more stable core office markets (Frankfurt, Munich, Hamburg, Brussels, and Amsterdam) will produce flatter cycles with varying degrees of upside potential.

Europe's **shopping centre markets** have moved into a period of readjustment in 2009 and most markets will spend the remainder of 2010 in this phase. Retail sales will continue falling during 2010 in most markets, with about half showing signs of rebound, or at least stabilisation, by year-end. Investors can expect a flatter cycle for shopping centres relative to office properties, as higher cash flows cushion retail returns through this period. The retail supply cycle is also responding accordingly. Europe completed a record 5 million sqm of new shopping centres in 2008 but the annual pipeline is likely to fall to just 2 million sqm by 2011, its lowest level in nearly 20 years. Volatile markets with significant rent disruption (Spain, Ireland, Portugal, Poland and Czech Republic) will hold better prospects for rental growth later in the recovery. Others with good prospects for moderate ramp-up in the outer years of the forecast include Sweden and the UK, although UK rents are unlikely to recovery all of their lost ground until beyond the 2014 scope of this forecast. Rental recovery prospects for Germany are modest overall but Munich's fundamentals position it for longer-term outperformance compared with its German peers. City centre rents have held up relatively well in Munich, as they have in other major cities such as Milan, Paris and London.

Rents fell in all of Europe's **industrial markets** in 2009, a pattern that is expected to be repeated in 2010. By year-end, rents in most markets will stabilise, but we expect uneven performance during recovery. Volatile markets, which suffered steep peak-to-trough rent declines will rebound at an above-average pace. These include London, Madrid, and Barcelona primarily, and more loosely, the CEE markets of Warsaw and Prague. Moderate recoveries can be expected in the hub and gateway markets with extensive distribution infrastructures, either by sea (Hamburg and Rotterdam primarily, but also Copenhagen), by air (Paris, Amsterdam, Frankfurt), or by rail/road (Lyon). The weaker markets (Munich, Brussels, Helsinki, Stockholm) will mount flat recoveries with rents falling short of 3% p.a. in the outer forecast years.

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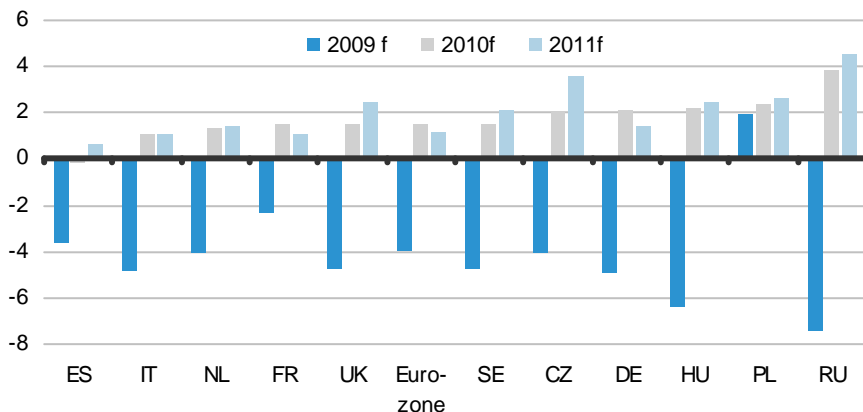
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## 1. Economic Context

Global output contracted 1.1% over the course of 2009, but this turned out to be better news than first anticipated. Just six months earlier, forecasters had braced for a 1.5% contraction, but as the final months of 2009 drew down, confidence strengthened as it appeared that Keynesian stimulus efforts in the world's major economies had proven reasonably effective. Concerns persist in early 2010 of an uneven recovery, but overall, the mood of investors has improved dramatically from the dark days of early 2009. The global economy is now expected to expand by 4.0% in 2010, led not by the major industrial countries, but rather by emerging markets. Europe's outlook for 2010 lacks the robust dynamism anticipated for much of the developing world. Deutsche Bank's 2010 forecast for the Eurozone calls for a 1.5% expansion of GDP. Similar economic growth rates are forecast outside the Eurozone in Sweden and the UK.

At its first meeting of 2010, the ECB maintained its cautious commitment to consistent monetary policy for the near term, while echoing its ongoing concern about uneven drivers of the economic recovery. This implies that interest rates will remain low, at least for a while, much to the delight of capital markets. Improved investor sentiment and outlook reached real estate capital markets in the latter half of 2009. Property fundamentals, on the other hand, have yet to turn, and strong recovery is still not anticipated until 2012. In the meantime, recent re-pricing has spurred more attractive investment opportunities for some markets and property types in the short term. But the "uneven" nature of recovery that worries central banks also implies risks for investors. The uncertain environment surrounding interest rates, liquidity, credit markets, and economic growth in Asia and the US, together cast a faint shadow of risk over the outlook for European property.

*Exhibit 1: Real GDP Growth (%)*



Source: DB Global Markets Research, "Focus Europe" 22 January 2010, and "Global Economic Perspective" 20 January 2010;

"f": forecast

The 2009 recession in Western Europe exposed an unwelcome economic rift between the region's core and peripheral countries. Many of the core economies, including Germany, the UK, the Netherlands, Italy, and all of the Nordics except Norway contracted by 4% or more over the course of the year, yet all are poised for modest recoveries in 2010. In the more peripheral economies of Spain, Ireland, Greece, and Portugal, however, a more tenuous near-term outlook prevails. In 2009, consumer price deflation swept through three of these countries (Ireland, Portugal, and Spain), and the throes of recession will also linger through 2010 in three of the four (Spain, Ireland, and Greece). All four of these countries struggle with some of Western Europe's worst fiscal imbalances and current account deficits. The ongoing debt crisis in Greece is of immediate concern because of the implications it poses for the rest of the EU and Eurozone countries.

For the moment, it is Germany that leads Western Europe's recovery since it is the only large economy in the region expected to break above the 2% threshold of growth in 2010. This is a remarkable bounceback from 2009 when recession downsized the German economy by nearly 5%. An unexpected benefit for Germany was that the

thrust of its downturn came heavily front-loaded, paving the way for a speedier recovery. Stimulus spending among the countries that buy German-made machinery (especially China) has at last brought an uptick in the manufacturing sector, and this is reflected in January's business expectations survey (Ifo) that rose above 100 for the first time since September 2007. German consumers, however, continue to fret over an anticipated spread of unemployment during 2010.

Much of the rest of Western Europe will follow Germany's lead in 2010, turning in growth rates of 1-2%. Deutsche Bank economists expect 1.5% GDP growth in the UK, France, and Sweden in 2010, very much in line with the Eurozone average. The UK was relatively slow to recover in 2009, with its recession lingering into the third quarter, but its consumers have shown signs of life as they pushed retail sales upward in the latter half of the year. The economic downturn in France proved mild relative to its Western European peers. This was thanks largely to the French government's generous stimulus measures, which included targeted VAT cuts and motor vehicle rebates. Double-digit unemployment, however, may keep French consumers restrained in the year ahead.

Economic performance in Central and Eastern Europe (CEE) varies significantly across countries. The Baltics and Russia suffered swift economic downturns in 2009. Among its CEE peers, Poland held up much better, with preliminary GDP estimates for 2009 showing positive growth of 1.9%. Poland's industrial production is once again growing robustly, but double-digit unemployment remains a blemish on an otherwise remarkable soft landing. Poland's cycle contrasts with the Czech Republic which took a substantial economic hit in 2009. Leading Czech indicators now point toward strengthening economic momentum for 2010 and 2011 and Deutsche Bank economists forecast 2.0% economic growth in the Czech Republic in 2010 followed by 3.6% growth the following year. Hungary continued to be one of the CEE region's economic laggards in 2009, with its economy shrinking by more than 6%. For years the Hungarian government has struggled to reform its fiscal house to conform to IMF guidelines. While the debt-burdened country faces a long, arduous process of slimming down its public obligations, external attention on Hungary's domestic problems have eased somewhat as Europe's fiscal spotlight has re-focused on Greece. Meanwhile Hungary appears positioned to turn in moderate growth of 2.2-2.5% over the next two years.

## 2. Office

The turnaround in the real estate capital markets in the latter half of 2009 has not been matched by a similar rebound in rents. Over the next couple of years, headline rents will remain sluggish in European office markets until incentives have finally been cast off and leasing activity can support sustained net absorption free of subsidy. This long wait for lasting recovery bears unwelcome implications for existing owners and lenders who can expect rising vacancies and falling net operating incomes (NOIs) during this period.

The fundamentals of supply and demand vary with each property cycle. The overhang of office construction in the early 1990s and 2000s cast a long shadow over the market but in this cycle, Europe has experienced nothing quite like that. In general, this downturn is driven more by weak demand rather than by an overactive pipeline of construction. By 2012, the current supply tap will have slowed to a drip in most of the core office markets. This timing should coincide well with a sustained revival in rent growth across most of Europe, but this turning point is still many quarters away. Our forecasting period extends only through 2014, and few markets are likely to see rents match their past peaks during this window.

At this point in the cycle, the keenest attention falls on the core markets. In Europe these include the major cities of the northwest (London, Paris, Brussels, Amsterdam, Frankfurt, Munich, Hamburg and Stockholm) as well as Madrid and Milan in the south. But these core markets clearly do not perform uniformly as a group. Dynamic, globally engaged cities like London and Paris often produce volatile cycles, but the cities underpinned by steadier histories – frequently German-speaking cities or provincial cities – tend toward flatter cycles, even though they too were impacted by the downturn.

The European office markets segment neatly into four risk groups based on the prospects for further rent decline and the recovery through 2014. This is based on the rent change expected from the end of 2009, and not for the full cycle as certain markets, such as London, suffered severed downturns in the two years to the end of 2009. Readers will note that the core office markets (identified above) stretch into each of these risk categories.

### **Low Downside / High Upside**

Markets with high upsides and low downsides – the blue chips – attract attention. These include London's three main submarkets (West End, City, M25 West) plus the Paris CBD, and they will be Europe's first office markets to gain rental traction. As demand recovers and new supply declines, there is scope for these markets to experience a spell of double-digit annual rent growth within the forecast period. While the London submarkets should resume growth by 2011, with pockets potentially even seeing growth in 2010, the subsequent years are likely to see the strongest annual gains. Paris is expected to lag London with strong growth in the latter years of the forecast period. Supply poses a degree of risk in all these markets. The City and West End together have about 5 million sqf still under construction. While the pipeline has declined through 2009, there are tentative signs of developers looking to move new projects forward. The pipeline for the Paris CBD is much lighter, although new supply in La Defense and the western suburbs could still put rents in the centre city under pressure. Vacancies in London have moved into double-digits across all submarkets and are currently peaking. In Paris, economic conditions unravelled more slowly and the effects took longer to reverberate, so the full impact on office rents is likely to be felt in 2010. The Paris CDB vacancy rate is still moving up, but is likely to top out below 10%.

On the demand side, both London and Paris benefit from their global profiles, which allow them to draw cross-border tenants. Paris CBD and London's M25 West draw tenants from a broader base while Central London's base relies more on financial and professional services firms. Rising unemployment and sputtering global growth could impact the timing of the recoveries in each of these markets, but overall they should still lead Europe out of its rental slump.

### High Downside / High Upside

Other European office markets also hold the necessary volatility to present strong upside potential, but with a greater return per unit of risk. The core markets in this group include **Paris La Defense** and **Madrid**. Other markets that fit this profile are **Barcelona** and **Dublin**. The latter three cities in this group – Madrid, Barcelona, and Dublin – are likely to give back more than 40% of their peak rental levels during this correction. With one in five of its workers now unemployed, Spain's economy is still shrinking, leaving little opportunity for near-term stimulation of new office demand. A supply overhang in Madrid's suburbs and in Barcelona further complicates fundamentals. We expect significant corrections to rents in Madrid and Barcelona to continue well into 2011, but by the outer years of the forecast, both markets should be positioned for a vigorous rebound as Spain's economy and its labour markets recover.

A shuffling of occupiers is underway in Paris as both La Defense and the CBD face competitive pressures from the western suburbs. This puts the fundamentals of La Defense, in particular, at risk, and this is expected to push its vacancy rate into the teens, a level higher than most other forecasters outside of RREEF have projected. Complicating the long-term outlook further, the French president's vision for La Defense includes an extensive amount of new office space although it is not yet clear how the implementation of that vision might coincide with market demand.

### Moderate Downside / Moderate Upside

The next tier includes those European office markets where solid but less dynamic economic bases generally produce less volatile property cycles. This can limit downside risk to some degree, but it also means trading away return potential as well. Markets that fall in this group tend to lie either in Germany (**Hamburg, Frankfurt**) or relatively close by (**Warsaw, Helsinki, Lyon, Milan**). Warsaw is the only market from the CEE region that falls into this tier.

At the geographic centre of this group, Germany is recovering from its worst recession since World War II. In Frankfurt, the country's financial centre, the vacancy rate stayed surprisingly stable through the downturn, though relocations in 2010 and ongoing mergers may cause some shifts among submarkets. A moderate amount of new space is planned for the CBD and Airport submarkets, but with at least 75% of it already committed, market disruption will come mainly in the form of backfill. As the market's fundamentals rebalance, rental levels will continue to lose ground through 2011. We expect a solid recovery in this market by 2012 with moderate rental growth of 5-7% beginning in 2013. The timeline for Hamburg's rental recovery looks similar, although the arc of its recovery may hold slightly more potential for incremental acceleration.

Milan also will experience a relatively moderate downturn, although it will still lose up to 30% of its peak rent across the cycle. Like most of the markets with mid-range prospects, Milan's rents are expected to recover in 2012 with growth of 5-8% p.a. A resilient Polish economy worked to Warsaw's benefit. The city's office rents are likely to give back only 20-25% of their peak levels, somewhat less than Milan, but we expect the recovery to kick in a little later. The market should stabilise by 2012, but the rental potential in the years beyond is quite strong, perhaps upward of 10% p.a. As the Warsaw office market matures its yield spread has tightened. Over the forecast period, we expect the yield spread to stay well below its historical average.

### Moderate Downside / Low Upside

The remainder of Europe's office markets hold little upside potential for significant rental growth despite moderate downside risk. Four core markets fall within this group: **Munich, Stockholm, Amsterdam** and **Brussels**. The remainder of the group includes non-core European capitals (Berlin, Rome, Budapest, Lisbon, Prague, Vienna) as well as regional cities in the UK (Manchester, Birmingham, Glasgow, Edinburgh) and France (Marseille, Lille), plus Dusseldorf, Germany.

Office rents in Munich have held steadier than any other European market, but this shallow downturn will give it only marginal spring to its recovery cycle. Munich's diversified economy holds promise for stimulating demand during the recovery, but the market will need to absorb a moderate amount of speculative construction in the near term. We expect Munich to stabilise as early as 2011, but from 2012 onward rental growth is unlikely to exceed 4% p.a.

Despite a past history of volatility, Stockholm's performance in this cycle has been more restrained. The construction pipeline winds down in 2010, and the challenge will be filling that space during the recovery. New space in the CBD and western fringes will compete for tenants and thus hold back the rental recovery. Add to this a high degree of international exposure focused in the Baltic region. The result is that Stockholm's fundamentals will take longer to rebalance than Munich's. Rental growth will be held back until 2013, but the annual growth rate is likely to be in the 3-6% p.a. range – solid, though not spectacular.

### **Key Real Estate Risks**

RREEF's office forecast carries certain risks which extend across the European markets, but with very different implications for market fundamentals. The first is overheating. If the weight of capital moves too quickly to real estate whilst the current lack of investment supply remains, cap rates will compress significantly during 2010. This could pave the way for yield decompression in 2011-2012. This risk of short term overheating followed by decompression in 2011-2012 would, in fact, have a relatively positive impact on market fundamentals. Despite compression in 2011, the credit and occupier markets remain sufficiently weak that there is little prospect of a new wave of construction activity. The decompression of 2011-2012 would be a further barrier to new construction. This scenario of short term overheating could well lead to lower levels of supply and this would boost rental prospects in the years beyond 2011.

An alternative risk, that of sustained cap rate compression, could have more of an adverse effect on market fundamentals. Such compression could result from an ongoing environment of low interest rates across markets or sustained investor demand for real estate. The compression would likely lead to an earlier resumption of the development cycle which, in turn, would dampen rent growth prospects in the mid-years of this decade.

Another risk is that cap rates move in the opposite direction. Spikes in inflation, interest rates, or bond yields could push cap rates up over the period 2012-2014. As for the first set of risks, this increase in cap rates should lead to a slowing of construction activity. As such, it could be associated with stronger rent growth, especially if accompanied by more widespread inflationary pressures.

Finally, we do not rule out the upside risk of a stronger-than-expected economic recovery. This would boost demand in the short-term, allowing fundamentals to stabilise faster than outlined in this paper, but also providing an earlier spur to construction activity.

Given these risks, and with markets changing so rapidly, there is a clear need to monitor and review the economic outlook and its implications for demand and supply on an even more frequent basis than usual.

## Exhibit 2: European Office Rental Cycle

### Office Market Cycle

#### Western European and Nordic Cities

#### Forecast Years

	YE 09	YE10	YE11	YE12	YE13	YE14
	GRW					GRW
	PGW					
	REC	CON	CON	REC	REC	
Office Job Growth	-3.1%	-1.2%	1.1%	1.8%	2.4%	2.7%
GDP Growth	-4.1%	1.0%	1.4%	1.8%	2.1%	2.2%
% Vacant	11.5%	13.2%	12.9%	11.9%	10.8%	9.8%
Rent Momentum	Decrease+	Decrease+	Decrease	Increase	Increase	Increase+

#### Central and Eastern European Cities

#### Forecast Years

	YE 09	YE10	YE11	YE12	YE13	YE14
	GRW					GRW
	PGW					
	REC	CON	CON	REC	REC	
Office Job Growth	-1.2%	-0.9%	0.5%	1.6%	1.8%	1.8%
GDP Growth	-1.5%	0.9%	2.9%	4.4%	3.9%	3.8%
% Vacant	13.6%	15.7%	13.6%	10.3%	7.5%	4.8%
Rent Momentum	Decrease+	Decrease	Decrease	None	Increase	Increase+

Key: REC = Recovery GRW = Growth PGW = Post-Growth CON = Contraction

Source: RREEF Real Estate Research and Global Insight, January 2010

## Office Sector Outlook

### Drivers

- Relatively low rent levels by historic standards increases affordability for occupiers and spurs demand.
- Consolidation in some sectors forces a shakeout, benefiting some office markets at the expense of others during recovery.

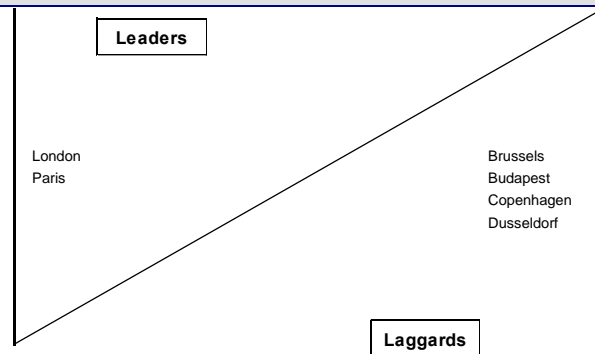
### Constraints

- Rising unemployment limits office market recovery even more than expected.
- Construction resumes too quickly in some markets.

### Implications: Timing of changes

- Global economy recovers quickly, causing fundamentals to rebalance ahead of the forecast.
- Volatile office markets (London, Paris, Madrid, Barcelona) likely to experience relatively strong recoveries.

### Exhibit 3: European Office Markets through the Current Rental Cycle



Source: RREEF Real Estate Research, January 2010

### Exhibit 4: European Office Market Cycle

		YE 2009	2010	2011	2012	2013	2014
Western Europe incl Nordic	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	11.5	13.2	12.9	11.9	10.8	9.8
	Rent Momentum	Decrease+	Decrease+	Decrease	Increase	Increase	Increase+
London: West End	Stage	Contraction	Recovery	Recovery	Growth	Growth	Growth
	Vacancy	10.8	10.5	8.5	7.3	6.4	4.6
	Rent Momentum	Decrease+	None	Increase	Increase	Increase+	Increase+
London: City	Stage	Contraction	Recovery	Recovery	Growth	Growth	Growth
	Vacancy	16.0	15.8	11.6	9.5	7.8	7.2
	Rent Momentum	Decrease+	Increase	Increase	Increase	Increase+	Increase+
Paris: CBD	Stage	Contraction	Contraction	Recovery	Growth	Growth	Growth
	Vacancy	6.3	7.3	6.7	5.9	5.1	4.0
	Rent Momentum	Decrease+	Decrease	None	Increase	Increase+	Increase+
Paris: La Defense	Stage	Contraction	Contraction	Contraction	Recovery	Growth	Growth
	Vacancy	7.0	14.0	14.7	13.0	8.7	5.0
	Rent Momentum	Decrease+	Decrease+	Decrease	Increase	Increase	Increase+
Frankfurt	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	17.9	20.2	20.8	19.7	18.2	17.2
	Rent Momentum	Decrease+	Decrease+	Decrease	Increase	Increase	Increase+
Berlin	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	10.7	11.5	12.0	11.5	10.9	10.8
	Rent Momentum	Decrease	Decrease	None	Increase	Increase	Increase
Munich	Stage	Contraction	Contraction	Contraction	Recovery	Growth	Growth
	Vacancy	9.2	11.3	11.4	10.1	8.6	7.8
	Rent Momentum	None	Decrease	None	Increase	Increase	Increase
Hamburg	Stage	Contraction	Contraction	Contraction	Recovery	Growth	Growth
	Vacancy	9.9	12.1	12.5	11.0	9.5	8.2
	Rent Momentum	Decrease	Decrease+	Decrease	Increase	Increase	Increase
Brussels	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	12.5	13.4	13.1	12.2	11.6	11.0
	Rent Momentum	Decrease	Decrease	Decrease	None	None	Increase
Amsterdam	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	19.3	21.6	21.3	20.4	19.6	18.3
	Rent Momentum	Decrease	Decrease	Decrease	None	None	Increase
Stockholm	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	15.2	16.4	16.0	15.3	14.5	13.6
	Rent Momentum	Decrease+	Decrease+	Decrease	None	Increase	Increase
Copenhagen	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Recovery
	Vacancy	10.3	13.1	12.9	12.1	11.0	9.7
	Rent Momentum	Decrease	Decrease+	Decrease	None	None	Increase
Helsinki	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	12.2	14.2	14.1	13.3	12.1	10.7
	Rent Momentum	Decrease+	Decrease+	Decrease	None	Increase	Increase+
Milan	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	11.2	12.9	13.1	12.7	12.1	11.3
	Rent Momentum	Decrease+	Decrease+	Decrease	Increase	Increase	Increase
Madrid	Stage	Contraction	Contraction	Contraction	Recovery	Growth	Growth
	Vacancy	9.6	10.5	11.0	9.9	8.7	6.8
	Rent Momentum	Decrease+	Decrease+	Decrease+	None	Increase+	Increase+
Barcelona	Stage	Contraction	Contraction	Contraction	Recovery	Growth	Growth
	Vacancy	11.5	14.7	14.5	14.0	12.8	11.2
	Rent Momentum	Decrease+	Decrease+	Decrease+	None	Increase+	Increase+
Lisbon	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	10.9	13.2	13.1	12.6	11.7	11.3
	Rent Momentum	Decrease	Decrease	None	None	Increase	Increase
Dublin	Stage	Contraction	Contraction	Contraction	Recovery	Growth	Growth
	Vacancy	20.3	21.8	16.9	14.8	12.2	10.4
	Rent Momentum	Decrease+	Decrease+	Decrease	None	Increase+	Increase+
Vienna	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	5.3	7.5	7.2	6.6	6.4	6.2
	Rent Momentum	Decrease	Decrease	None	None	None	Increase
Central and Eastern Europe	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	13.6	15.7	13.6	10.3	7.5	4.8
	Rent Momentum	Decrease+	Decrease	Decrease	None	Increase	Increase+
Prague	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Vacancy	13.4	14.3	12.9	11.0	9.3	7.9
	Rent Momentum	Decrease	Decrease	None	Increase	Increase	Increase
Warsaw	Stage	Contraction	Contraction	Contraction	Recovery	Growth	Growth
	Vacancy	9.1	10.8	9.0	5.5	3.4	3.0
	Rent Momentum	Decrease+	Decrease+	Decrease	None	Increase+	Increase+
Budapest	Stage	Contraction	Contraction	Contraction	Contraction	Recovery	Growth
	Vacancy	19.6	23.5	20.2	15.8	11.3	5.8
	Rent Momentum	Decrease	Decrease+	Decrease	Decrease	None	Increase

Source: RREEF Real Estate Research, January 2010

### 3. Shopping Centres

Europe's shopping centre markets have moved into a period of readjustment in 2009 and most markets will spend the remainder of 2010 in this phase. The severity of this economic recession has dragged down income levels as well as consumer confidence and has created a retail cycle that is worse than previous downturns. Retail sales will continue falling during 2010 in most European markets, with about half showing signs of rebound, or at least stabilisation, by year-end. Some of the worst slumps in retail sales are currently in those markets with crippling debt burdens at either the household (Spain, Ireland) or the government level (Hungary, Greece).

Despite the headline statistics, the fortunes of Europe's shopping centres are comparatively less dire than one might expect. The office sector cycle, for example, holds more latent volatility since companies and industries come and go, merge and acquire, consolidate and decentralise, expand and contract with unbridled exuberance. Meanwhile, households must still consume the basic necessities of life – food, drink, clothing, home accessories – even if they do so more strategically during hard times. This can tip the shopping centre cycle toward a comparatively flatter shape in some markets, especially during a recession, with higher cash flows cushioning retail returns for owners. The retail supply cycle is also responding accordingly. PMA estimate that Europe completed a record 5 million sqm of new shopping centres in 2008 but the annual pipeline is expected to fall to just 2 million sqm by 2011, its lowest level in nearly 20 years<sup>1</sup>.

The shopping centres of **Western Europe** show less overall volatility than offices, but they can still be differentiated broadly by certain fundamental characteristics. Spain, Portugal, and Ireland, for example, will share significant rental declines over this cycle and their relatively high cap rates (among Western European markets) imply their higher levels of risk. Spain and Portugal were among the first of the region's shopping centre markets to stumble in 2008. By the time it stabilises, Spain's market will likely end up losing more than a third of its peak rental level – the largest decline of any market in Europe. Rents in Ireland and Portugal by comparison will lose close to 20% and 10%, respectively. The cyclical timing of these markets varies as well. Ireland's retail market stumbled after Iberia faltered and persistent recession in Ireland will postpone its recovery as well. A more manageable supply pipeline will aid Madrid's recovery, as will more restrictive planning laws recently enacted in Lisbon. Dublin's eventual retail recovery, however, is unlikely to look anything like the heady boom years of the past 20 or so years.

Current cap rates in the other 10 major Western European shopping centre markets fall well below Ireland and Iberia. These markets can be further differentiated by the strength and timing of their cycles. Four markets – the UK, France, Italy, and Denmark – are experiencing severe peak-to-trough losses on the order of 10-20%. All should return to rental growth by 2012 except for the UK which may take a bit longer to recover. None of these four markets is expected to recover its previous cyclical peak by the end of the forecast window in 2014. However, the scale of the rental decline implies perhaps more room for market improvement in the years ahead. Centre city rents in Paris and Milan continue to hold up well relative to their overall catchment areas. Although headline rents are holding up well in these cities, the reductions in various incentives such as "key money" means that the headline rents conceal the true impact of the cyclical downturn. Another market that has performed relatively well is the high streets of Central London (especially Oxford, Bond, and Regent Streets). Rents in these locations have been held up by the surge of tourist spend from visitors enjoying the benefit of the weak British Sterling.

Accumulated peak-to-trough rental losses in the remaining markets – Germany, Sweden, the Netherlands, Belgium, Finland, and Austria – will total 5% or less. The bounce will be smaller in most of these markets. Of the six, Sweden's rebound is likely to be strongest, with rents resuming a 3-4% p.a. pace of growth by 2013. Throughout the downturn, retailer demand has held up in Stockholm as cross-border retailers continue to expand. The city centre vacancy rate remains relatively low and construction has been primarily focused on modernisation and improvement, which should produce higher rents over time. While Germany's retail rent recovery appears

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<sup>1</sup> PMA "European Shopping Centre Forecasts", Winter 2009

muted, key differences exist across the main cities. Centre city rents in Hamburg, for example, will struggle during the recovery period as the Hafen City infill redevelopment scheme brings competitive new space to the market. German retail rents are highest in Munich, which also holds the best prospects for growth since its established centre city retailers lack formidable competition from the surrounding region.

Rising levels of affluence in **Central and Eastern Europe** boosted the region's shopping centre markets in recent years, but global recession has warped the trendline, at least in the short term. Retail spending continues to inch forward in Poland, and in the Czech Republic only a minor dent is anticipated, but in Hungary, weak economic conditions have dealt a greater setback to retail sales. The downturn has reigned in aggressive demand-side drivers in these countries to varying degrees. Meanwhile, a moderate supply pipeline has been enough to disrupt fundamentals and take some of the zip out of rent growth. Peak-to-trough adjustments will be in excess of 20% in Poland, but single digits in the Czech Republic and Hungary. Poland's rental market stumbled early, so its recovery will lead the other CEE markets. By 2012, both Poland and the Czech Republic should be positioned for 3-5% p.a. rental growth. Hungary will follow, moving into recovery in 2012 as well, but the sputtering Hungarian economy will leave it less room for improvement. Hungary's shopping centre rents are set to grow at a more modest 2-3% p.a. during the recovery.

## Exhibit 5: European Retail Rental Cycle

Retail Market Cycle							
Western European and Nordic Countries				Forecast Years			
	YE 09		YE10	YE11	YE12	YE13	YE14
	GRW	PGW				GRW	
	STA	REA		REA	STA		
Retail Sales Growth	-1.9%		-0.4%	0.8%	1.0%	0.9%	0.8%
GDP per capita	34,511		34,775	35,189	35,755	36,444	37,187
Rent Momentum	Decrease+		Decrease+	None	None	Increase	Increase
Central European Countries				Forecast Years			
	YE 09		YE10	YE11	YE12	YE13	YE14
	GRW	PGW			GRW		
	STA	REA		STA		GRW	
Retail Sales Growth	-3.5%		-0.1%	1.7%	4.9%	3.9%	3.9%
GDP per capita	10,733		10,852	11,192	11,720	12,245	12,802
Rent Momentum	Decrease+		None	None	Increase+	Increase+	Increase+

Key: GRW = Growth PGW = Post-Growth REA = Re-adjustment STA = Stable

Source: RREEF Real Estate Research and Global Insight, January 2010

## Retail Sector Outlook

### Drivers

- Development pipeline slows quickly, allowing rental recovery by 2011.
- Consumer spending holding up better in some countries (Poland, France) than others (Spain, Ireland, Hungary).
- Cross-border retailers continue to show interest across several markets (Sweden, CEE).

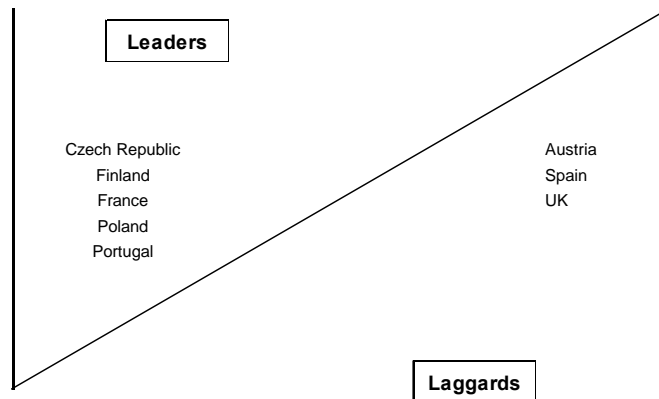
### Constraints

- Persistent worries of pending joblessness stifle consumer spending (France, Germany).
- Retailer bankruptcies, reorganizations and consolidations impact timing and patterns of tenant demand.

### Implications: Timing of changes

- Relatively strong, but lagging, retail recoveries in markets where housing wealth was erased (Spain, Ireland, UK).
- Solid, early rebounds with upward momentum as cycle is restored (Poland, Czech Republic.)

### Exhibit 6: European Retail Markets through the Current Rental Cycle



Note: Classification based upon rental growth through the current cycle

Source: RREEF Real Estate Research, January 2010

### Exhibit 7: European Retail Market Cycle

		Forecast					
		2009	2010	2011	2012	2013	2014
Western Europe and Nordic	Stage	Re-adjustment	Re-adjustment	Stable	Stable	Growth	Growth
	Rent Momentum	Decrease+	Decrease+	None	None	Increase	Increase
UK	Stage	Re-adjustment	Re-adjustment	Re-adjustment	Stable	Growth	Growth
	Rent Momentum	Decrease+	Decrease+	Decrease+	None	Increase+	Increase+
France	Stage	Re-adjustment	Re-adjustment	Stable	Growth	Growth	Growth
	Rent Momentum	Decrease+	Decrease+	None	Increase	Increase	Increase
Germany	Stage	Re-adjustment	Re-adjustment	Stable	Stable	Growth	Growth
	Rent Momentum	None	Decrease	None	None	Increase	Increase
Netherlands	Stage	Re-adjustment	Re-adjustment	Stable	Stable	Stable	Growth
	Rent Momentum	Decrease	Decrease	None	None	None	Increase
Sweden	Stage	Re-adjustment	Re-adjustment	Stable	Growth	Growth	Growth
	Rent Momentum	Decrease	Decrease	None	Increase	Increase+	Increase+
Italy	Stage	Re-adjustment	Re-adjustment	Stable	Stable	Growth	Growth
	Rent Momentum	Decrease+	Decrease+	None	None	Increase	Increase
Spain	Stage	Re-adjustment	Re-adjustment	Re-adjustment	Stable	Stable	Stable
	Rent Momentum	Decrease+	Decrease+	Decrease	None	None	None
Austria	Stage	Post Growth	Re-adjustment	Stable	Stable	Growth	Growth
	Rent Momentum	None	Decrease	None	None	Increase	Increase
Belgium	Stage	Post Growth	Re-adjustment	Stable	Growth	Growth	Growth
	Rent Momentum	None	Decrease+	None	Increase	Increase	Increase
Central and Eastern Europe		Stage	Re-adjustment	Stable	Growth	Growth	Growth
		Rent Momentum	Decrease+	None	Increase+	Increase+	Increase+
Czech Republic	Stage	Re-adjustment	Re-adjustment	Stable	Growth	Growth	Growth
	Rent Momentum	Decrease+	Decrease	None	Increase+	Increase+	Increase+
Poland	Stage	Re-adjustment	Stable	Growth	Growth	Growth	Growth
	Rent Momentum	Decrease+	None	Increase	Increase+	Increase+	Increase+
Hungary	Stage	Re-adjustment	Re-adjustment	Stable	Growth	Growth	Growth
	Rent Momentum	Decrease	Decrease	None	Increase	Increase	Increase

Source: RREEF Real Estate Research, January 2010

## 4. Industrial

Rents fell in all of Europe's industrial markets in 2009, a pattern which is expected to continue in 2010. The downward momentum, however, will ease as the year progresses and by year-end 2010, rents in most markets should stabilise. The effects of this downturn have been spread unevenly across European markets, and we expect varying performance over the course of the recovery. Three broad groups of markets can be distinguished based on their rent performance characteristics. First are the volatile markets, which suffered steep peak-to-trough rent declines, but will rebound at an above-average pace. These primarily include London, Madrid, and Barcelona, but in a broader sense, they extend to the CEE markets of Warsaw and Prague as well. Second are the hub markets, with extensive distribution infrastructures, either by sea (Hamburg and Rotterdam primarily, but also Copenhagen), by air (Paris, Amsterdam, Frankfurt), and by rail/road (Lyon). The third group includes the weaker markets which will mount flatter recoveries (Munich, Brussels, Helsinki, Stockholm, Milan).

The most volatile industrial markets of this cycle lie on Europe's outer edges – London, Madrid, and Barcelona to the west, Prague and Warsaw to the east. Those markets to the west hold the most upside promise. London, Madrid, and Barcelona are the only three markets in this forecast with the potential to reach annual rental growth of 4% by 2014. Moreover, these markets are among the most backloaded in the forecast. Even though speculative construction has wound down quickly, all three markets have a surplus of vacant space to absorb before rents can stabilise. In London, the gap between headline and effective rents remains wide, as incentives remain prevalent. London and Madrid are unlikely to see positive movement in rents until 2012, and Barcelona may not get an uptick until 2013. When these markets do turn, however, the rebound should be swift, at least relative to other markets in the forecast. On Europe's eastern side, both Warsaw and Prague are positioned for above-average rebounds beginning in 2012, though rents will lack the same accelerating momentum expected in London and Spain. The CEE markets avoided a severe disruption of fundamentals in this cycle. As demand dried up, speculative supply shut down quickly before the markets could destabilise. With Poland avoiding recession entirely and with the a solid rebound forecast for the Czech Republic, industrial rents may lose only about 10% of their peak – perhaps a little less in Warsaw, a little more in Prague. Rather than the sharper rebound expected in London and Spain, the recovery in Prague and Warsaw should bring gradually accelerating rental growth in both markets of 1-3% p.a.

Of the remaining markets in Europe, those expected to resume at least 3% annual rental growth by the close of the forecast in 2014 are mostly gateway or hub markets with specialised infrastructures for goods distribution by air, sea, or land. These markets skirt the western edge of German-speaking Europe, following a line starting at Copenhagen, then arcing along the North Sea coastline and continuing as far west as northern France. Rising levels of international trade in recent years kept these distribution markets humming with pass-through activity. The global crisis that erupted in 2008 not only slowed down the flow of goods, it also put the brakes on demand for distribution space as manufacturers, wholesalers, chain retailers, freight forwarders, and other logistics providers all took a step back from any expansion plans. As global economic conditions firm up again, these European gateways and hubs will recover, but the timing will differ from one market to the next. Among the seaports, we expect industrial rents to pick up first in Hamburg in 2011 with Rotterdam to follow in 2012 and Copenhagen holding back until 2013. Congestion has plagued Hamburg and Rotterdam for years, so the slowdown in global trade provided these markets some temporary breathing room that resulted in only a modest impact on rents. Hamburg plans to spend €1 billion on port upgrades over the next five years in order to maintain its competitiveness. Rotterdam World Gateway, a 4 million TEU terminal now under way at Maasvlakte 2, remains on schedule for a 2013 completion. While these investments raise the possibility of short-term terminal overcapacity at quayside, they also stimulate ancillary logistics and distribution demand in constrained surrounding regions. Despite its ambitions, Copenhagen lacks the gateway status of its counterparts, and will benefit less from the first wave of demand during the upturn, thus pushing its recovery later. Still, all three markets are well positioned to regain 3% p.a. rent growth by the end of the forecast window in 2014.

Amsterdam, Paris and Lyon function as important European hubs for air or land-based distribution. Amsterdam in particular has struggled in this cycle. Schiphol Airport was forced to lower fees in an effort to raise its competitive profile. In 2009, it announced plans to forego an IPO, then later in the year it delayed a planned €1 billion terminal expansion until at least 2014 when demand conditions improve. Industrial rents in Amsterdam are expected to continue to weaken through 2010, before staging a moderate rebound in 2012. Rental growth should resume sooner in Paris and Lyon. Both markets should experience rental growth of 1-3% from 2011 onward. The supply pipeline has pulled back in both markets. Upward momentum will be solid in Paris and Lyon, with perhaps a slightly better bounce in Paris. With the French economy holding up reasonably well, the diversified Paris industrial market will shave only 5% or so from peak rents. By 2014, Paris should be one of the few industrial markets in Europe to surpass its previous cyclical peak rents. Another one is Frankfurt. The recovery is likely to be weaker there but follow a very mild downturn. A proposed ban on night flights at Frankfurt Airport in exchange for a new, fourth runway has triggered clashes between local officials and cargo carriers and created an air of uncertainty about the Frankfurt area's infrastructure for industrial expansion.

Most other major markets will experience slower rebounds with rental growth still falling short of 3% p.a. by the end of the forecast period in 2014. These weaker markets mostly lie along a north-south axis that cuts through the heart of the continent from Lombardy through German-speaking Europe and up to Scandinavia. This group includes Milan, Munich, Brussels, Stockholm and Helsinki. Like Frankfurt, the industrial market of Munich has seen a relatively modest downturn to date, with peak-to-trough rent decline of less than 5%, but soft demand conditions will limit opportunities for a strong bounce. Still, because the downturn has been so mild, Munich rents should surpass the previous peak by 2014. Rents in Milan and Helsinki have suffered much more, with peak-to-trough declines expected to be 10-20%. Finnish trade ties with Russia and Eastern Europe have worn heavily on Helsinki's industrial market. The downturn in demand also coincided closely with the 2008 opening of the new Vuosaari harbour, which created a new strategic location for local distribution activity. It also gave the market ample new supply with relatively high prime rents to boot, thus the market is still giving back some of these rents gains as fundamentals stabilise. This pushes Helsinki's recovery back until 2013. In Milan, where recent developments focused on the City's ring road and along the A1, A4, and A7 motorways, the bounce will come much sooner. For now, developers have postponed most speculative schemes, paving the way for a quick, albeit mild recovery. Rents should turn positive again by 2011, but despite a gradual escalation, are still not likely to reach 3% p.a. before the end of the forecast period.

## Exhibit 8: European Industrial Rental Cycle

### Industrial Market Cycle

#### Western European incl Nordic Cities

#### Forecast Years

	YE 09	YE10	YE11	YE12	YE13	YE14																								
	<table border="1"> <tr><td>GRW</td><td>PGW</td></tr> <tr><td>REC</td><td>CON</td></tr> </table>	GRW	PGW	REC	CON	<table border="1"> <tr><td></td><td></td></tr> <tr><td></td><td>CON</td></tr> </table>				CON	<table border="1"> <tr><td></td><td></td></tr> <tr><td></td><td>CON</td></tr> </table>				CON	<table border="1"> <tr><td></td><td></td></tr> <tr><td>REC</td><td></td></tr> </table>			REC		<table border="1"> <tr><td></td><td></td></tr> <tr><td>REC</td><td></td></tr> </table>			REC		<table border="1"> <tr><td>GRW</td><td></td></tr> <tr><td></td><td></td></tr> </table>	GRW			
GRW	PGW																													
REC	CON																													
	CON																													
	CON																													
REC																														
REC																														
GRW																														
Industrial Production	-13.3%	3.7%	2.5%	2.2%	2.1%	1.9%																								
GDP Growth	-4.1%	1.0%	1.4%	1.8%	2.1%	2.2%																								
Rent Momentum	Decrease+	Decrease	Decrease	None	Increase	Increase																								

#### Central and Eastern European Cities

#### Forecast Years

	YE 09	YE10	YE11	YE12	YE13	YE14																								
	<table border="1"> <tr><td>GRW</td><td>PGW</td></tr> <tr><td>REC</td><td>CON</td></tr> </table>	GRW	PGW	REC	CON	<table border="1"> <tr><td></td><td></td></tr> <tr><td></td><td>CON</td></tr> </table>				CON	<table border="1"> <tr><td></td><td></td></tr> <tr><td>REC</td><td></td></tr> </table>			REC		<table border="1"> <tr><td></td><td></td></tr> <tr><td>REC</td><td></td></tr> </table>			REC		<table border="1"> <tr><td></td><td></td></tr> <tr><td>REC</td><td></td></tr> </table>			REC		<table border="1"> <tr><td>GRW</td><td></td></tr> <tr><td></td><td></td></tr> </table>	GRW			
GRW	PGW																													
REC	CON																													
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REC																														
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Industrial Production	-7.2%	1.8%	5.0%	5.8%	5.0%	4.8%																								
GDP Growth	-0.5%	1.0%	2.9%	4.5%	3.9%	3.8%																								
Rent Momentum	Decrease+	Decrease	None	Increase	Increase	Increase																								

Key: REC = Recovery GRW = Growth PGW = Post-Growth CON = Contraction

Source: RREEF Real Estate Research and Global Insight, January 2010

## Industrial Sector Outlook

### Drivers

- Because industrial buildings have the shortest construction schedules of all major property types, speculative construction has wound down abruptly in most markets.
- Limited supplies of modern logistics buildings in many markets.
- Continued economic growth in Asia re-ignites demand for German industrial machinery and provides a catalyst for market recovery.
- International trade volumes recover faster than expected as inventories are re-stocked and consumers and businesses unleash pent-up demand.

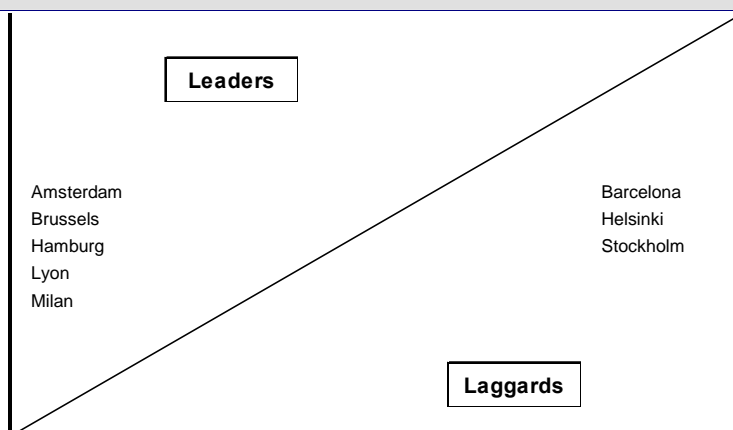
### Constraints

- Unfavourable exchange rates hamper exporters.
- Reluctant consumers stay home.
- Auto industry consolidation and realignment impacts newer manufacturing supply chains in CEE markets (Slovakia, Czech Republic) as well as more established production chains in Western Europe.

### Implications: Timing of changes

- Volatile markets like London, Madrid and Barcelona stage relatively strong recoveries.
- Soft landing for the French economy cushions Paris and Lyon, paving the way for relatively early recovery.
- Markets with airports or seaports tied to global trade hold a competitive advantage during recovery.

### Exhibit 9: European Industrial Market through the Current Rental Cycle



Note: Classification based upon rental growth through the current cycle

Source: RREEF Real Estate Research, January 2010

### Exhibit 10: European Industrial Market Cycle

		2009	2010	2011	2012	2013	2014
Western Europe incl Nordic	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease	Decrease	None	Increase	Increase
London	Stage	Contraction	Contraction	Recovery	Recovery	Growth	Growth
	Rent Momentum	Decrease+	Decrease	None	Increase	Increase+	Increase+
Paris	Stage	Contraction	Contraction	Recovery	Recovery	Growth	Growth
	Rent Momentum	Decrease	Decrease	None	None	Increase	Increase
Lyon	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease	None	None	Increase	Increase
Frankfurt	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease	Decrease	None	None	Increase	Increase
Munich	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease	Decrease	None	None	Increase	Increase
Hamburg	Stage	Contraction	Contraction	Recovery	Recovery	Growth	Growth
	Rent Momentum	Decrease+	Decrease	None	Increase	Increase	Increase
Brussels	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease	None	None	None	Increase
Amsterdam	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease	None	Increase	Increase	Increase
Rotterdam	Stage	Contraction	Contraction	Recovery	Recovery	Growth	Growth
	Rent Momentum	Decrease+	Decrease	None	Increase	Increase	Increase
Stockholm	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease	None	None	None	Increase
Copenhagen	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease+	None	None	Increase	Increase
Helsinki	Stage	Contraction	Contraction	Contraction	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease	Decrease	None	None	Increase
Milan	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease	None	None	Increase	Increase
Madrid	Stage	Contraction	Contraction	Contraction	Recovery	Growth	Growth
	Rent Momentum	Decrease+	Decrease+	Decrease	Increase	Increase	Increase+
Barcelona	Stage	Contraction	Contraction	Contraction	Recovery	Growth	Growth
	Rent Momentum	Decrease+	Decrease+	Decrease	None	Increase	Increase+
Central and Eastern Europe	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease	None	Increase	Increase	Increase
Prague	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease+	Decrease	None	Increase	Increase	Increase
Warsaw	Stage	Contraction	Contraction	Recovery	Recovery	Recovery	Growth
	Rent Momentum	Decrease	Decrease	None	Increase	Increase	Increase

Source: RREEF Real Estate Research, January 2010

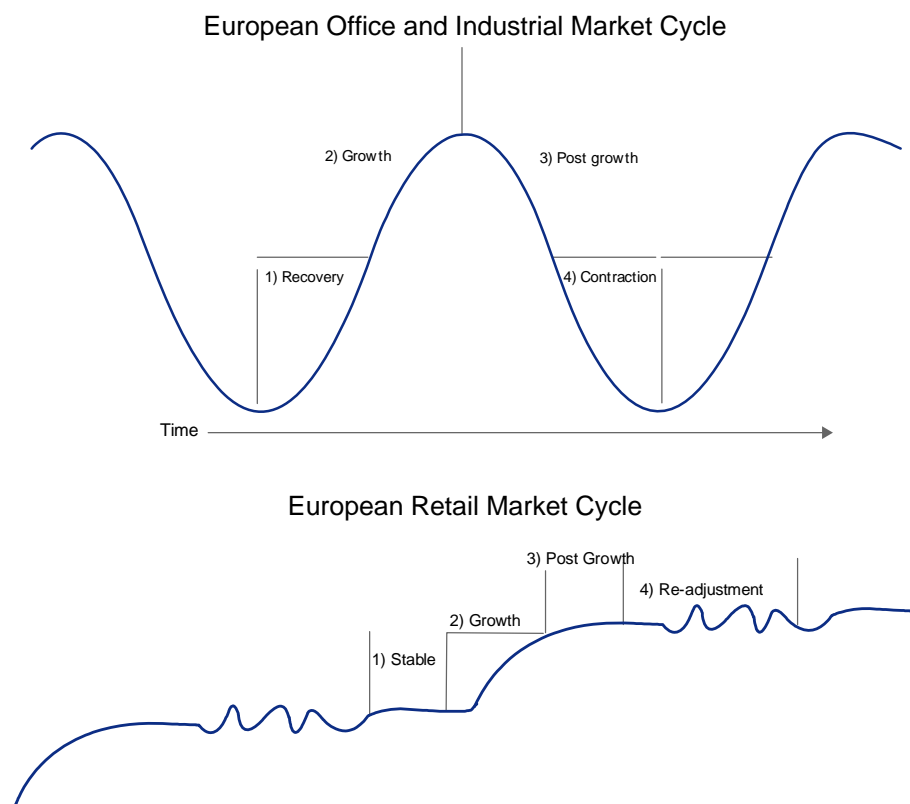
## 5. Appendix

### Classifying the markets

Each property sector has a clearly identifiable cycle. While the office market has the greatest volatility, it shares a similar pattern and is characterised by the same phases as the industrial market cycle. In contrast, the shopping centre market cycle has lower downside risk and tends to take the form of progressive steps. This reflects supply constraints which creates excess demand for limited space, reducing the risk of vacancy.

The property market cycles are considered in four distinct stages shown in Exhibit 11.

#### Exhibit 11: Property Market Cycle



Source: RREEF Real Estate Research

### Office and industrial market cycle

Stages	General conditions
1) Recovery	High but declining vacancy rates – stable to rising rents
2) Growth	Low and declining vacancy rates – rising rents supportive of construction
3) Post Growth	Low but increasing vacancy rates – rising/flattening rents
4) Contraction	High or increasing vacancy rates – falling rents

The position in the cycle is based on a combination of factors including change in vacancy rates and rental growth. It is important to recognise that the analysis is based on 'headline' or 'face' prime rents. In general terms, effective rents will lead the recovery of headlines, as the reduction in incentives tends to occur before any movements in headlines.

## Retail market cycle

In mature European markets, supply tends to be relatively constrained and, as developing markets mature, supply restrictions tend to be introduced. As a result vacancy rates tend to be very low. Although there is a clear cyclical pattern, the contraction phase, characterised by rising vacancy rates and falling rents, is neither significant nor prolonged. Rather, demand softens while rents plateau or they may even decline. This is reflected in the different stages in our specific retail market cycle:

<b>Stages</b>	<b>General conditions</b>
1) Stable	Stable rents, up turn in consumer spending
2) Growth	Rising rents, strong consumer spending and/or retailer demand
3) Post Growth	Rents stabilising, slowed consumption growth
4) Re-adjustment	Rents stable or declining, slowed or declining consumer spending

## Rental momentum

A rent category is assigned to each of the markets for every year of the forecast period. This rent momentum, which helps establish the rate of growth at different stages of recovery, is based on the typology displayed in Exhibit 12. It is intended to show the general momentum behind potential changes in rent, not an absolute variation in rates.

### Exhibit 12: Rent Categories and the Property Cycle

#### European Office and Industrial Market Cycle

<b>Momentum Category</b>	<b>Cycle Stage</b>			
	<b>Contraction</b>	<b>Recovery</b>	<b>Growth</b>	<b>Post Growth</b>
Increase+			√	
Increase		√	√	√
Stable	√	√	√	√
Decrease	√			√
Decrease+	√			

#### European Retail Cycle

<b>Momentum Category</b>	<b>Cycle Stage</b>			
	<b>Re-adjustment</b>	<b>Stable</b>	<b>Growth</b>	<b>Post Growth</b>
Increase+			√	
Increase		√	√	√
Stable	√	√	√	√
Decrease	√			√
Decrease+	√			

Source: RREEF Real Estate Research

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