

European Real Estate Market Report

Q3 2010



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Real estate market review and outlook

Recent market movements

- Despite the turmoil in wider financial markets, conditions in prime real estate markets continued to improve over the course of Q2, both in investor and to a lesser degree occupier markets. Yields were stable in most markets over the quarter with compression recorded in a minority and outward movement very rare. Investment volumes rose relative to Q1. Stability is also becoming increasingly common in rental markets across the continent, particularly in the core markets, suggesting that we are close to the trough for occupier markets. With income risks still elevated, particularly for secondary stock, investor demand remains heavily focused on prime property and it remains too soon to talk of significant recovery for secondary assets.

Prime investment and markets tended to strengthen in Q2 despite wider financial upheaval

Offices

- Q2 brought further evidence that the recovery phase for prime office markets is moving closer. The improved economic backdrop is beginning to show up in a stronger labour market and a pick-up in office demand. Prime rents were stable in most markets over the course of the quarter, though Paris saw rental uplift for the second consecutive quarter on the back of declining vacancy. Sluggish economic recovery means that a rapid pick-up in rents is not likely in most markets in the near term, however, though low development levels do provide considerable support in most markets. Prime office yields moved lower in a number of markets over Q2.

Office rental recovery moving closer though rapid turnaround not expected

Retail

- In aggregate, unemployment appears to have stabilised across the Euro-zone as a whole, though this masks wide variations at a national level. Germany, in particular, stands out for its robust labour market performance, boosting the defensive qualities of this market. In Spain, meanwhile, labour market conditions are particularly weak. Most markets saw stable rents over the course of Q2, though some of the markets in Europe's troubled periphery saw decline and downward rental pressure is likely to remain a feature of some of these markets in the near term. The credit crunch and occupier downturn have led to a sharp decline in retail completions and this should support an eventual recovery in rental values.

Retail rents stabilising in "core", still falling in parts of "periphery"

Industrial

- Industrial production continues to recover from the extreme downturn of 2008-9, particularly in Germany and to a lesser degree across most of the rest of Europe. This improvement is feeding through to a pick-up in demand in Germany. Headline rents were unchanged in most major markets during the second quarter and have not declined as significantly as expected during this downturn. Whilst leasing conditions are improving, robust rental growth does not yet appear imminent in most markets.

European industrial activity recovering, led by Germany

Summary

- The financial turbulence of Q2 highlighted the fragility of the European economic recovery and, whilst our central expectation remains for an extended period of sub-trend growth rather than anything worse, downside risks have increased. Extremely low interest rates have generated favourable relative pricing conditions for real estate and recovery in prime pricing is ongoing. Occupier markets, though still weak, are showing signs of bottoming out, and rental recovery is probably moving closer, though it is likely to be relatively muted in most markets when it comes. Given the increased economic downside risks, particularly on Europe's periphery, our preference for the core markets of Germany, France, Benelux and Nordics has increased.

Strengthening return profile expected but downside risks have increased

Summary statistics

IPD All-property returns in local currency

| Total return % | 2006 | 2007 | 2008 | 2009 |
|------------------|------|------|-------|-------|
| Denmark 17.8 | | 10.2 | 3.1 | 3.9 |
| Finland 10.1 | | 11.3 | 5.1 | 3.8 |
| Norway 17.6 | | 18.3 | -4.6 | 4.8 |
| Sweden 16.2 | | 14.9 | -3.3 | 1.4 |
| France 21.7 | | 17.8 | -0.9 | -1.4 |
| Germany 1.3 | | 4.5 | 3.5 | 2.5 |
| Netherlands 12.5 | | 11.3 | 3.3 | -0.2 |
| Belgium 8.9 | | 9.9 | 4.3 | 3.4 |
| Austria 6.7 | | 6.8 | 3.7 | 3.9 |
| Portugal 12.0 | | 12.4 | 2.6 | 0.0 |
| Spain 17.4 | | 12.9 | -2.8 | -9.4 |
| Ireland 27.2 | | 9.9 | -34.5 | -23.3 |
| UK 18.1 | | -3.4 | -22.1 | 3.5 |
| Switzerland 5.9 | | 7.1 | 6.1 | 5.5 |
| Italy 8.1 | | 9.1 | 2.3 | 0.8 |
| IPD Euro-zone | 10.1 | 9.9 | 1.5 | 0.2 |
| All IPD Europe* | 13.3 | 5.9 | -4.0 | 1.4 |

*Uses Euro-denominated weights

Source: IPD

European prime rents and yields as at Q2 2010

| | Offices | | Shops | | Industrial | |
|-------------------|----------------------|---------|----------------------|---------|----------------------|---------|
| | Rent €m ² | Yield % | Rent €m ² | Yield % | Rent €m ² | Yield % |
| Amsterdam 330 | | 5.65 | 2700 | 4.25 | 67 | 7.80 |
| Barcelona 246 | | 6.00 | 2040 | 5.75 | 78 | 8.25 |
| Berlin 240 | | 5.40 | 2940 | 4.90 | 55.2 | 7.50 |
| Brussels 265 | | 6.25 | 1600 | 5.00 | 44 | 7.50 |
| Budapest 240 | | 7.75 | 1080 | 7.25 | 54 | 9.25 |
| Dublin 376 | | 7.50 | 2468 | 6.25 | 82 | 9.00 |
| Frankfurt 456 | | 5.30 | 3240 | 4.60 | 70.8 | 7.25 |
| London (City) 658 | | 5.50 | 1450 | 5.75 | 164* | 6.50* |
| Madrid 348 | | 6.00 | 2796 | 5.75 | 78 | 8.00 |
| Milan 520 | | 5.75 | 3700 | 5.50 | 57 | 7.75 |
| Munich 354 | | 4.90 | 3600 | 4.50 | 76.8 | 7.25 |
| Paris 770 | | 5.10 | 6300 | 4.90 | 80 | 7.25 |
| Praque 252 | | 6.85 | 2040 | 6.75 | 57 | 8.75 |
| Stockholm 431 | | 5.25 | 1208 | 5.25 | 52.5 | 7.50 |
| Warsaw 276 | | 6.60 | 960 | 6.50 | 60 | 8.25 |

Source: CBRE, Aviva Investors, Q2-10

Rents are Euro per square metre per year, * Figure is for London Heathrow

Economic overview

- Whilst economic recovery is continuing in the Euro-zone, it remains somewhat sluggish overall. The Euro-zone recorded real GDP growth of just 0.1% q-o-q in Q4 2009 and 0.2% in Q1 2010. The manufacturing sector, particularly in Germany, has recovered robustly, aided by a strong turnaround in the global trade and manufacturing cycle. However domestic demand remains weak across the monetary union, particularly in the troubled “peripheral” countries. In a global context, the Euro-zone is proving something of a weak spot, even in the context of sub-par recoveries in many developed economies. Growth in the US, for example, though not currently sufficient to bring a pronounced turn in the labour market, has been considerably stronger in recent quarters; and although recent cyclical indicators have tended to ease back from strong levels in the region, growth is very much stronger in developing Asia. We expect GDP growth of 1% in 2010 and 1.4% in 2011 in the Euro-zone, compared to 3% and 2.6% in the US.
- In addition, the recent tensions within the Euro-zone remain a considerable risk to the durability of the global recovery. Whilst the emergency measures of the European Central Bank (ECB) and the International Monetary Fund (IMF) in May have helped to reduce the risk of sovereign default in the region, notably in Greece, the outlook remains highly uncertain. In particular, the assistance provided to Greece is conditional on the implementation of considerable fiscal reform and it is too soon to say that such reform will be possible. Other peripheral zone members, notably Spain, Portugal and Ireland, are also in the process of radical retrenchment in order to maintain bond markets’ faith in their fiscal sustainability. Likewise in these countries, it remains a considerable risk that this retrenchment cannot be achieved and that a further bout of bond market upheaval follows. Contagion to other current-account deficit economies outside of the Euro-zone, notably the US and UK would be a considerable risk under such a scenario. Rising bond yields, elevated risk aversion and further banking stress could easily then derail the growth recovery.
- Whilst, in aggregate, growth in the Euro-zone is expected to be subdued in the next couple of years, this masks an expectation of considerable growth divergence at a national level. Broadly, the “core” Northern countries are expected to fare considerably better than the “peripheral” Southern and Western members. Germany, in particular, exemplifies the core. The manufacturing and exporting sectors of its economy have recovered strongly in recent quarters, aided by the strong recovery in the Far East and its competitiveness in capital equipment and high-tech sectors. Indicators such as the IFO (issued by one of Germany’s largest think-tanks) suggest that this strength should persist in the near term. In contrast, the troubled peripheral countries, even if the spectre of sovereign default/restructuring can be avoided, appear set for an extended period of economic weakness. Ireland, in many respects, exemplifies the difficulties facing these economies. Whilst it has taken considerable steps towards fiscal retrenchment, it remains mired in difficulties. This retrenchment continues to weigh on activity in the economy and, combined with the ongoing bursting of the domestic housing bubble, is generating significant deflationary pressures. This combination of falling output and deflation makes achieving further fiscal adjustment all the more difficult.
- These tensions and the likely divergence in performance across the Euro-zone make it difficult for the ECB in attempting to devise a single monetary policy for such a spectrum of conditions. Whilst recovery in Germany argues for some tightening now, recession and fiscal retrenchment in the periphery argue for a continuation of extremely loose monetary policy. Overall, we believe that weak growth, relatively muted inflation and the considerable downside risks implied by the tensions within the region mean that the ECB is likely to be very slow to raise interest rates. We expect the ECB Refi rate to remain at 1% through 2010 and to rise only to 1.75% by the end of 2011.

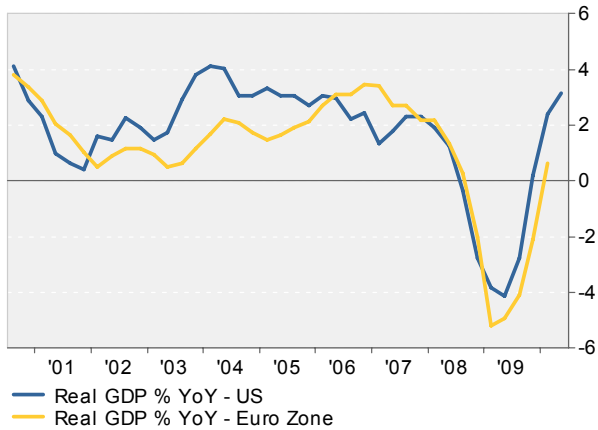
Euro-zone proving something of weak spot in global recovery

Sovereign issues are a risk to the durability of that recovery

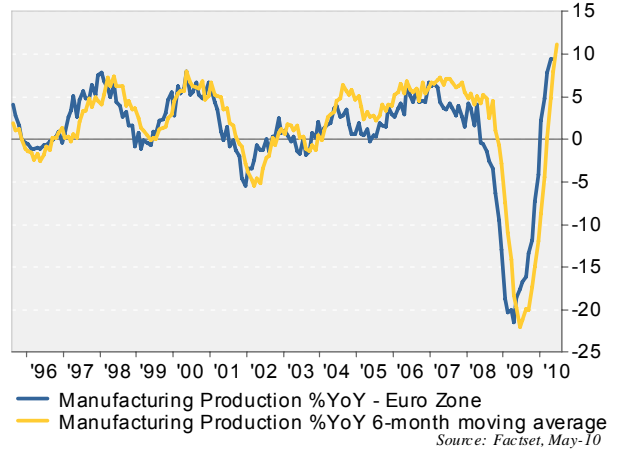
Divergence in growth amongst Euro-zone economies expected

Making life difficult for the ECB; monetary policy to remain loose

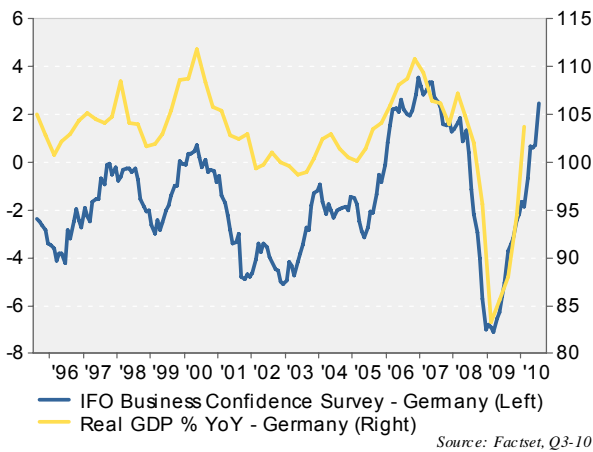
GDP - US and Eurozone



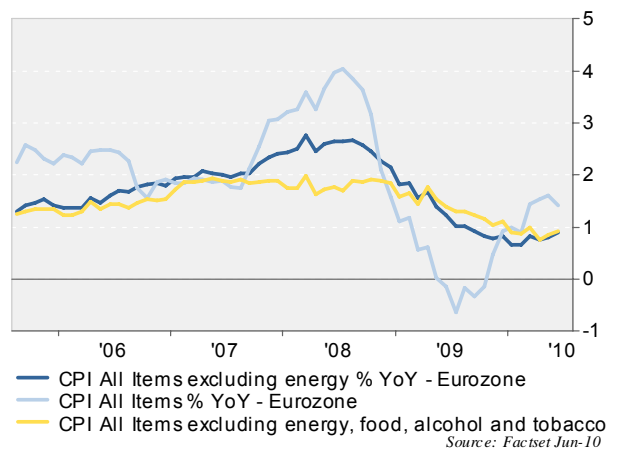
Euro-Zone and German Manufacturing Production



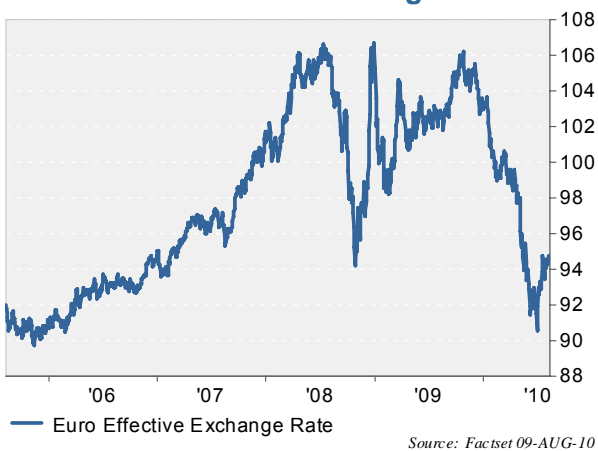
German IFO Index and GDP Growth



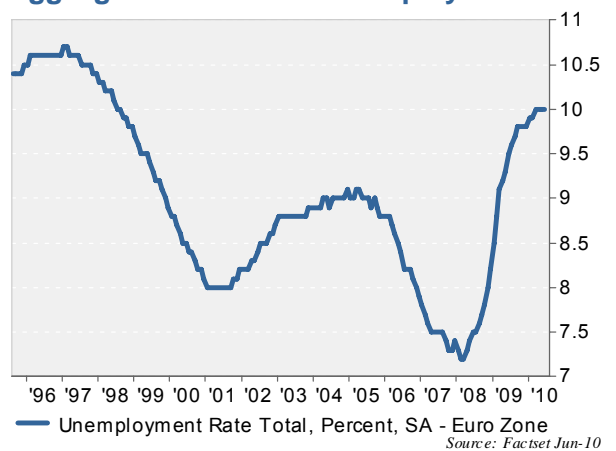
Eurozone Core and Headline CPI



Effective Euro Exchange Rate



Aggregate Euro-zone Unemployment Rate



Bond and equity markets

| | 31 Dec 07 | 31 Dec 08 | 31 Dec 09 | 2 Aug 10 |
|---|-----------|-----------|-----------|----------|
| Nominal 10yr Bond Yield (US) | 4.0 | 2.4 | 3.8 | 2.9 |
| Nominal 10yr Bond Yield (GER) | 4.3 | 2.9 | 3.4 | 2.7 |
| Yield Spread (GER-US) (bps) | 29 | 52 | -43 | -24 |
| MSCI Europe Ex UK - Price Index (Local) | 1347 | 743 | 920 | 913 |
| MSCI Europe Ex UK – PE Ratio | 13.6 | 9.0 | 23.6 | 16.0 |
| S&P 500 Composite – Price Index | 1468 | 903 | 1,115 | 1,121 |

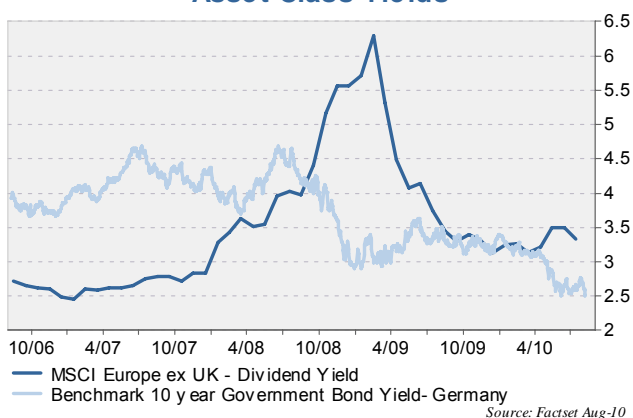
Source: Factset, August, 2010

- Bond yields across the Euro-zone and elsewhere have tended to move lower in recent months. In fact, with the exception of a small number of countries over which bond markets still have considerable worries, bond yields remain remarkably low given the backdrop of widespread large fiscal deficits. The German 10-year bond yield, for instance, at c2.7% on 2 August, is c10bps lower than three months earlier and c70bps lower than at the beginning of the year. Greek bond yields have also declined following the support measures put in place in early May by the ECB and IMF. However, at c10.4% for a 10-year bond on 2 August, they remain elevated due to uncertainty over the Greek government's ability to implement the austerity measures that were necessary to secure the support package. Bond yields in Spain and Portugal, other countries whose fiscal dynamics have caused some concern for bond markets recently, remain considerably lower, at c4.2% and c5.2% respectively.
- Global equity markets tended to recover in July from the Q2 weakness that was induced by the turmoil in Euro-zone bond markets. By the end of July, for instance, the MSCI Europe index had risen by almost 10% in local price terms from its low point at the beginning of the month – though it was still c5% below its end-Q1 level. This rally has been helped by the Greek support package, but also by solid earnings numbers and generally favourable economic data. We continue to expect that, with corporate profits beginning to benefit from the recovery in economic activity, further moderate gains are possible for equities.

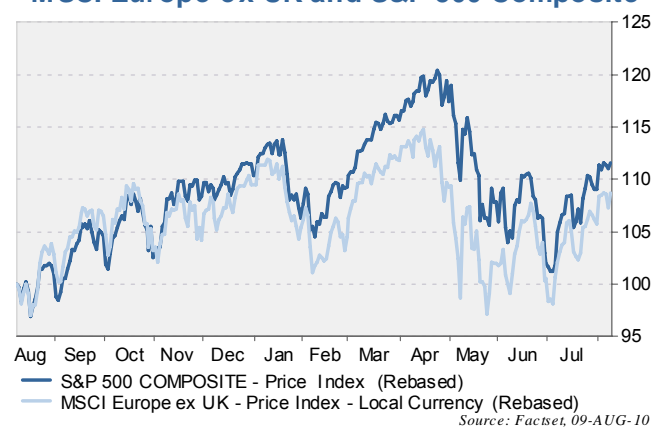
Bond yields have tended to move lower in recent months

Equity markets recovered much of Q2's losses in July

Asset Class Yields



MSCI Europe ex UK and S&P 500 Composite



Real estate equities

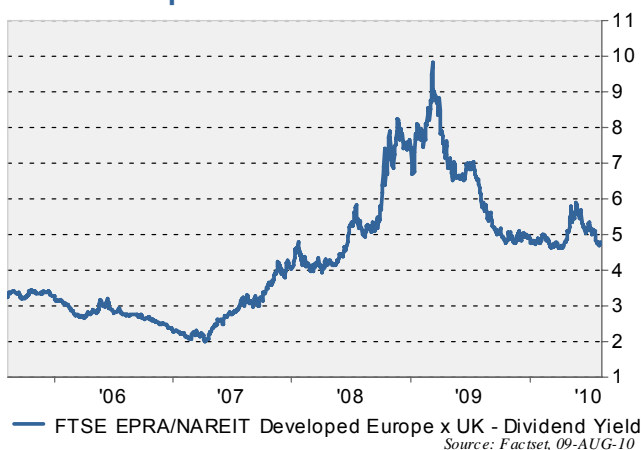
| European Majors | | | | | | | | |
|---------------------|----------|-------------|-------------------------------|------------------------|----------------|-----|----------------------|---------------------|
| Company | Country | Sector | Market Cap (local currency m) | Discount to NAV (Spot) | Dividend Yield | LTV | 3 month price return | 1 year price return |
| UNIBAIL-RODAMCO Pan | Euro | Retail | 13.8 (15%) | | 5.5% | 38% | 12.7% | 31.0% |
| KLEPIERRE Pan | Euro | Retail | 4.5 (34%) |) | 2.3% | 53% | -6.0% | 22.1% |
| ICADE France | | Diversified | 3.8 (8%) | | 4.4% | 70% | -0.5% | 18.8% |
| GECINA SA | France | Office | 4.9 (14%) |) | 5.5% | 45% | 7.9% | 44.7% |
| CORIO NV | Pan Euro | Retail | 4.1 (5%) | | 5.8% | 41% | 3.0% | 15.8% |

Source: Bloomberg, Aviva Investors, July-09

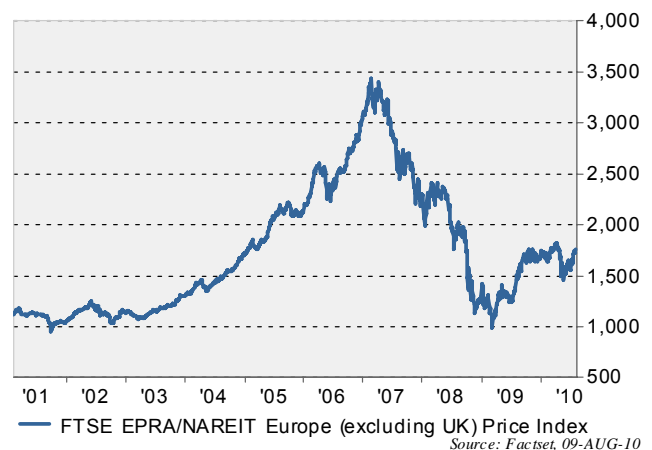
- European REIT pricing has tended to broadly follow the pattern of wider equity markets in recent months, weakening during April and May before recovering much of those losses during June and July. The FTSE EPRA/NAREIT Europe index fell by over 16% in local price terms between the end of March and late May but its subsequent rally left it only c2% lower at the end of July than at the end of March. Following a strong Q1, the financial market turmoil of Q2 also dealt a blow to capital markets activity in the sector. This was most clearly demonstrated by the last minute cancellation of two IPOs (Initial Public Offerings) in Germany, those of Berlin residential owner GSW and Berlin developer Chamartin Merman, with weak investor demand cited. We continue to believe that it is difficult to envisage a significant upward move in REIT pricing from here given our expectation that the economy and occupier markets across the region will be slow to recover. On the other hand, however, improvements in the companies' balance sheets mean downside risks should be relatively limited.

REIT pricing recovered in June and July

European REITs Dividend Yield



FTSE EPRA/NAREIT Price Index



Real estate investment markets

- Despite the increased volatility in broader financial conditions during the quarter, Q2 overall saw a continuation of the firming in prime real estate pricing that has been taking place in recent quarters. In fact, there were signs of improving conditions beginning to extend beyond the core Western European markets that have been the main beneficiaries to date with CBRE recording inward yield movement in a number of the emerging Central European markets for the first time. In the office sector, for instance, CBRE recorded inward movement in the three most developed of these markets, -25 basis points (bps) in Budapest and -15 bps in both Prague and Warsaw. For most other office markets, CBRE recorded stable yields in Q2, notable exceptions being the four Dutch centres that it covers, where inward yield movement of between 20 bps and 35bps was recorded during Q2. Paris saw a continuation of yield compression in all sectors, by 15bps for offices, 10bps in the retail sector and by 50bps in the industrial sector. CBRE estimates that prime office yields have moved in to 5.1% in this key market, 90bps lower than a year earlier – though still 150bps higher than at the peak of the market. Of the continental markets, only in Greece are yields recorded as moving higher as pricing responded to the deteriorating domestic economic picture for the second consecutive quarter. Real estate pricing continues to be supported by low cash returns and low bond yields in core European countries, as well as signs that stability in rental conditions is moving closer.
- Q2 also saw a pick-up in investment volumes, continuing the recovery from the very depressed levels of early 2009; the period of maximum financial market dislocation. DTZ estimates that European (including UK) investment volumes were €21.4bn in Q2 2010, up from €19.3bn in Q1. For the first half of the year as a whole, it recorded transactions worth €40.7bn, an 85% increase on the same period in 2009, though volumes remain a long way below the long-run quarterly average of €31bn. In our experience, investor demand remains focused on prime assets as investors act with an awareness of elevated income risks, avoiding secondary stock.
- Whilst DTZ recorded that German Open Ended Funds (OEFs) were net investors in European real estate in Q2 to the tune of €1.5bn, potential legislative changes (the German government's proposed New German Investment Act) are causing uncertainty for this sector. Investor inflows had been slowing since the beginning of the year and in May the sector saw net investor outflows of €1.4bn. The OEFs are very significant investors on a pan-European and indeed global basis, with a bias towards prime assets, and the lack of clarity over their future investment strategies adds to market uncertainty.
- Whilst we expect some further inward movement in prime yields in the near term, we continue to believe that there is little scope for significant movement from here as factors including the weak growth outlook and ongoing debt financing constraints bear down on the market. And the downside risks to this relatively benign outlook have probably increased since last quarter's report with, in particular, the risk of a recurrence of bond market and wider financial turmoil. Given that some markets appear more vulnerable than others, and that this is yet to be fully reflected in relative pricing, our preference for the core markets of Germany, France, Benelux and the Nordics has strengthened. It is worth noting that investment conditions have cooled somewhat in recent months in the UK, Europe's most liquid market. This market has tended to be something of a lead indicator for the rest of Europe through the boom, bust and recovery stages of this cycle and we expect the cooling in the UK to be repeated across continental Europe in coming months.

Further yield compression for prime assets in Q2

Investment activity recovering but still somewhat muted

Potential legislative changes clouding the outlook for German OEFs

Scope for further rally in yields appears limited

Office markets

- The economic recovery of recent quarters, though far from stellar, is beginning to become apparent in conditions across European office occupier markets. The turn in output growth is showing up in improved labour market conditions and hence stronger demand for office space. At an aggregate Euro-zone level, unemployment was steady at 10% in June for the third consecutive month, and the employment component of the Euro-zone Services Purchasing Managers' Index (PMI) rose a point in July to 51.7, above the 50 mark that is consistent with employment growth. JLL reports that office take-up across Europe was 2.6 million m² in the second quarter, 6% higher than in Q1 and 34% up on Q2 2009's level. For the first half of 2010 as a whole, take-up is 38% higher than in H1 2009, with improvement recorded in both Western Europe (+32%) and Central & Eastern Europe (+73%).

Economic recovery starting to show up in labour and office occupier markets
- As a result, prime rents in aggregate appear to be stabilising. According to CBRE, rents in most developed European markets were flat in Q2, with only Lyons seeing downward movement (-6.5% q-o-q). Its pan-European EU15 office rental index actually rose by 0.5% over the course of the quarter, though this was heavily influenced by a 6.4% rise in the City of London. In continental Europe, German rents were generally flat over the quarter, with only Dusseldorf seeing growth (+2.2% q-o-q). Prime rents in Germany have generally been relatively defensive through this downturn, however, with only Berlin, a market that has long had struggled with issues of inadequate demand, seeing a large decline; though rents in Berlin were flat over the course of Q2, they were c11% below their peak according to CBRE. Rents have also been relatively stable in the major Italian centres. CBRE estimates that rents in Q2 in both Milan and Rome were unchanged and have only declined c5% from the peak. Rents were unchanged in both Barcelona and Madrid for the first time in quite a few quarters in Q2, though they remain down almost 30% in each case from the peak rents recorded. Rents in Dublin and Warsaw, two other markets that have suffered very badly in this downturn, with rents down c44% and c34% respectively from peak, were flat for the second consecutive quarter. Paris (+2.7% q-o-q) and Stockholm (+2.5%) were notable for seeing rising rents.

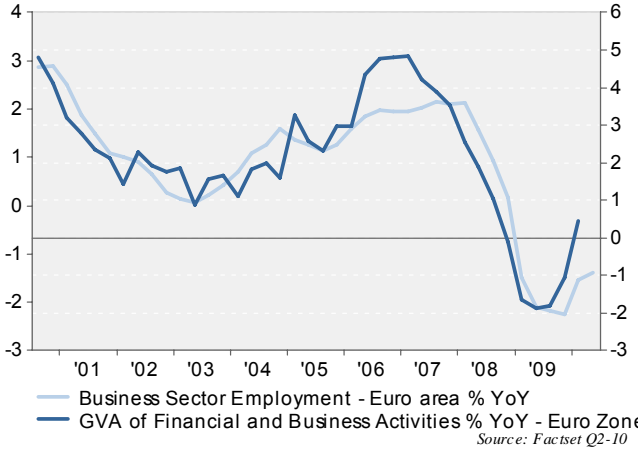
Prime rents close to stabilisation in aggregate
- This is the second consecutive quarter that prime rental growth has been recorded in Paris. At present, however, rental growth appears to be largely confined to the relatively narrow prime CBD part of the Paris market. Outside of this segment of the market, rents appear to be static or under downward pressure, often through the agreement of more generous incentives. Vacancy continued to decline in Paris in Q2, down to 6.8% from 7% a quarter earlier according to JLL. At this level, Paris has one of the lowest levels of vacancy in Europe, underlining the relative health of conditions in continental Europe's largest office market.

Rents rising in Paris CBD on declining vacancy
- In many other markets, vacancy appears to be still drifting higher, though some notable markets appear to have reached a peak. Amongst the latter is Frankfurt where JLL recorded a modest decline in Q2, to 13.7% from 13.8% a quarter earlier, reversing a long trend of rising vacancy. However, in Amsterdam, another of Western Europe's high vacancy markets, vacancy rose further in Q2, up to 17.6% from 17.3% in Q1. Vacancy also rose further in Madrid and Barcelona, in particular in the latter, where vacancy is now estimated at 13% on the back of weak demand and plentiful new supply. Dublin saw a further increase in vacancy in Q2, up to 22.5%, reflecting the ongoing tribulations of the Irish economy.

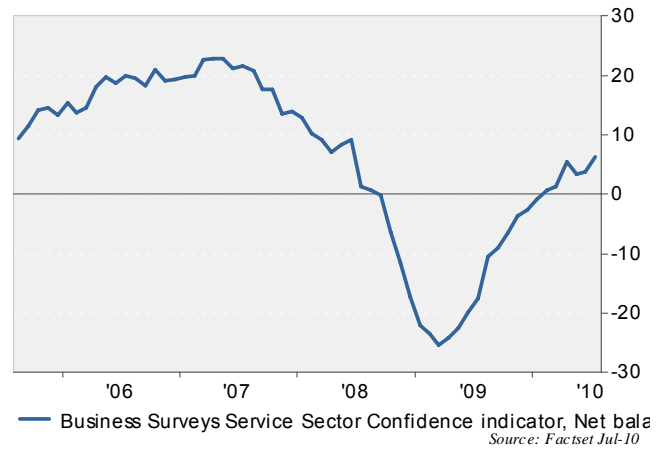
Vacancy still drifting higher in many other markets
- In broad terms, the improving demand picture, allied with a constrained development cycle in most markets, is moving rental recovery closer for Europe's office markets. However there is likely to be significant variation in the timing and pace of recovery, with office markets in Europe's troubled periphery, such as Spain and Ireland, likely to fare worst in the near term. In contrast, core Northern markets such as Germany and France are likely to enjoy recovery sooner.

Rental recovery moving closer

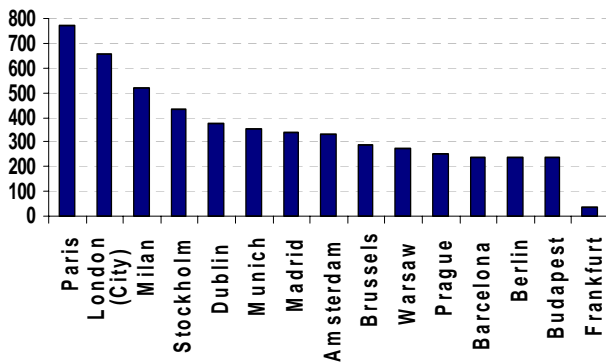
Business Sector Output & Employment Growth



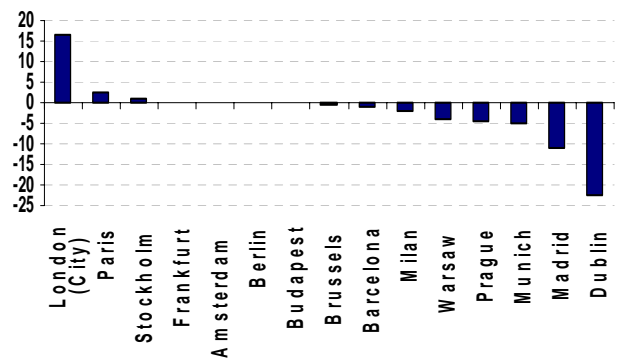
EC Service Sector Confidence



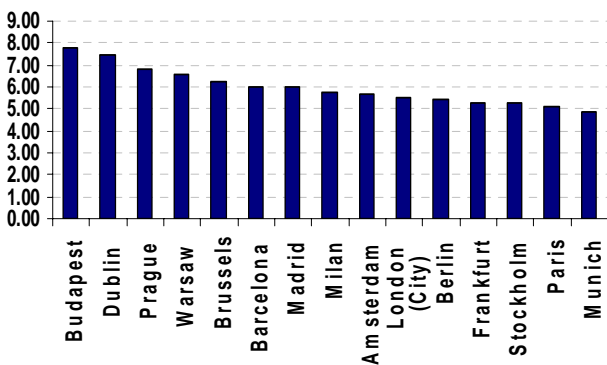
Office Markets Prime Rent (€/sq m)



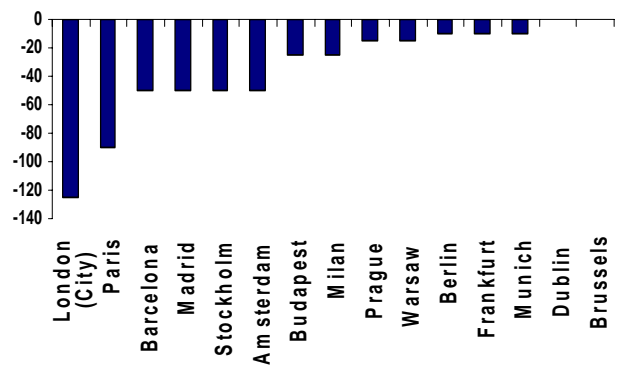
Office Market Prime Rental Growth y-o-y (%)



Office Markets Prime Yields (%)



Office Markets Yield Shift y-o-y (bps)



Source: CBRE, Aviva Investors, Q2 2010

Retail markets

- The growing divergence in economic performance within the Euro-zone is already apparent in labour market conditions, a key determinant of the health of the retail sector. The aggregate 10% unemployment rate for the Euro area as a whole masks a broad divergence in conditions at a national level. In particular, Germany's recent labour market performance stands out as particularly buoyant. The rise in unemployment was relatively muted during the downturn, helped by a formal government short-time working scheme (Kurzarbeit). Subsequently, the recovery in activity in the country has led to a robust turnaround in hiring. June's labour market data saw a further increase in employment to take the level of employment within 25k of its pre-recession peak, while the unemployment measure declined further, to 7.6%. In contrast, Spain's labour market stands out for its extreme weakness. Here, the unemployment rate hit 20% in June and, with activity in the economy still very weak and the impact of pronounced fiscal contraction yet to be felt, unemployment is likely to drift even higher in the near term. Whilst some of this weakness is cyclical, Spain's labour market undoubtedly suffers from structural deficiencies (even during the boom years up to 2008, unemployment didn't drop below 7.9%) and the government has recently introduced legislation that aims to tackle these rigidities. Elsewhere, unemployment remained elevated in Ireland in June, at 13.3% and lower in France and Italy, at 10% and 8.5% respectively.

Wide divergence in labour market conditions within the Euro-zone with Germany out-performing
- Despite the signs of improvement in the labour market, Germany's retail sales performance remains relatively muted. An annualised increase of 1.4% in sales volumes over the course of Q2 merely reverses the decline of Q1 and broadly continues Germany's near decade-long trend of stagnant sales. Nonetheless, there has been some improvement in consumer confidence in recent months and, given the labour market improvement, it is likely that sales can enjoy modest strengthening from here. At the very least, German retail appears to offer relatively limited downside.

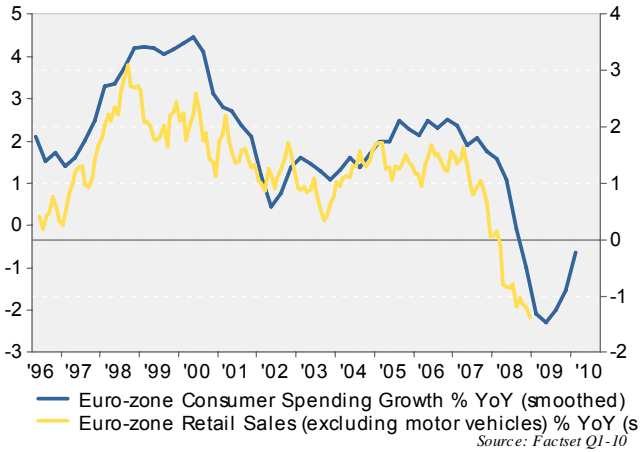
Though not yet showing up in German retail sales performance
- Prime rents in most major European cities were stable over the course of Q2 according to CBRE, with rental decline recorded only in some of the troubled peripheral countries. CBRE estimates that prime rents in Athens fell by 10% over the quarter, to be down 25% year-on-year and over 35% from their peak. But once again, it was Ireland's performance that stood out for all the wrong reasons. CBRE estimates that prime rents in Dublin fell by 19% over the course of Q2, to be down 38% y-o-y and almost 50% from their peak. Elsewhere, rental decline was also recorded for some smaller Eastern European markets, Sofia (-11% q-o-q), Bucharest (-3.5%) and Belgrade (-5.9%). No major market saw rental uplift over the course of Q2.

Prime rents stable in most markets in Q2
- The muted domestic demand environment, as well as the lack of development finance, is showing up in a decline in development levels. Cushman and Wakefield (C&W) estimates that 2009 saw the sharpest decline in European (including UK) shopping centre completions in almost fifteen years, with 7.4m m² opened, c19% lower than in 2008. For the period ahead, new supply is heavily focused on CEE markets. C&W records Russia and Turkey, Europe's two most populous countries, as the markets with most space in the pipeline. Poland, Bulgaria and Romania are also expected to see considerable new space relative to their populations. In Western Europe, Italy, France and Spain are expected to see most new shopping centre space. In Italy's case, though the consumer spending outlook is far from buoyant, many parts of the country, particularly the South, have a shortage of modern retail space raising the possibility that the new space can be absorbed.

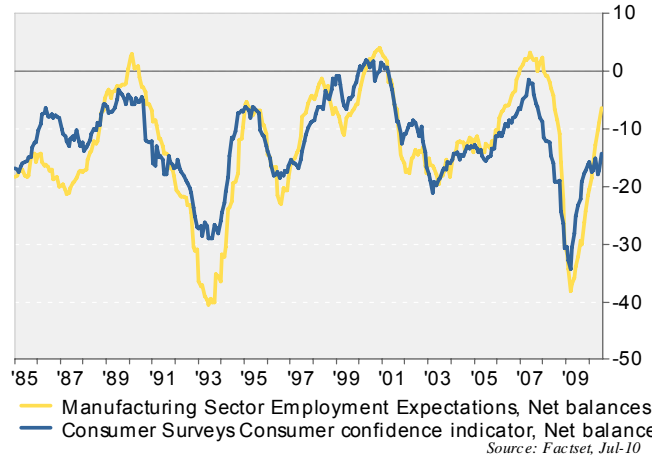
Shopping centre supply growth has declined
- Although the retail sector has proved resilient so far in this downturn, both supply and demand conditions continue to offer tenants considerable bargaining power; we expect rents to remain under pressure in 2010 and do not expect rental growth in the majority of markets until next year.

Rental outlook muted in near term

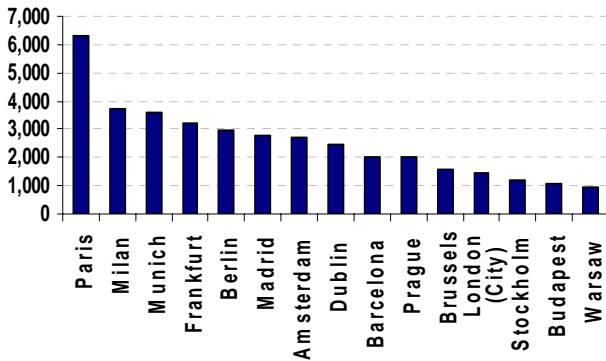
Euro-zone Consumer Spending & Retail Sales



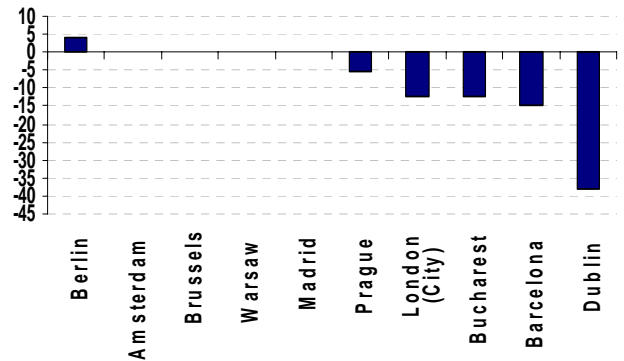
Euro-zone Consumer Confidence & Employment Expectations



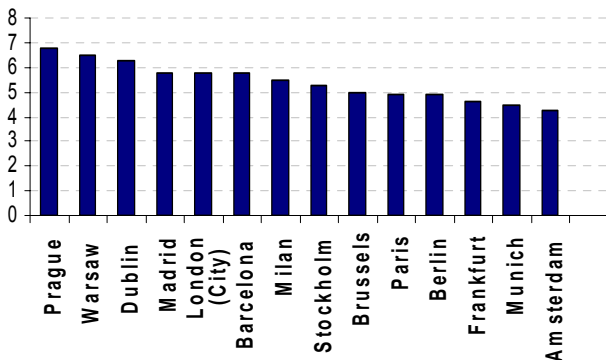
Retail Markets Prime Rent (€/sq m)



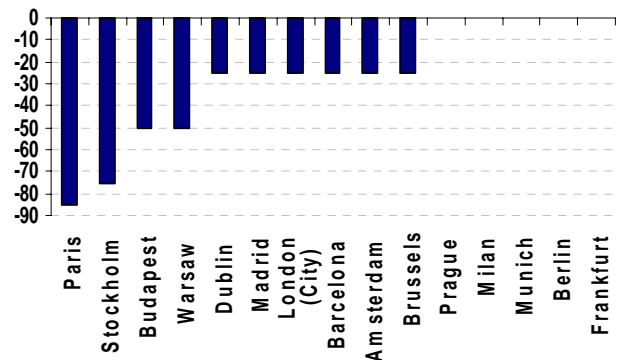
Retail Market Rental Prime Rental Growth y-o-y (%)



Retail Markets Prime Yields (%)



Retail Markets Yield Shift y-o-y (bps)



Source: CBRE, Aviva Investors, - Q2 2010

Industrial markets

- Activity in the industrial sector is something of a relative hotspot across much of Europe, particularly in Germany, neighbouring Austria and Sweden. In Germany, the manufacturing Purchasing Managers' Index (PMI) survey rose to 61.2 in July, close to a record high for the series and well above the 50 level that is consistent with expanding output. Austria's survey reading came in just a little lower at 58.9 whilst Sweden's is even higher at 64.2. Other significant German indicators are also suggestive of robust growth in the sector. For instance the headline balance of the July monthly IFO survey saw its biggest jump since re-unification, up 4.4 points to 106.2, well above its long-run average. Meanwhile capacity utilisation component of the survey moved to close to its long-run average. Whilst Germany is the strongest industrial performer of late, the rest of the Euro-zone is also seeing recovery, even in the troubled periphery. Spain's PMI reading, at 51.6 in July, and Ireland's, at 51.4, are both consistent with modest output growth. Greece's reading remains suggestive of recession, however, at 45.3 in July, though even this represented a marked improvement on the 42.2 reading of the prior month. The PMIs for France and Italy meanwhile, at 53.9 and 54.3 respectively, are consistent with robust, if unspectacular, growth in the sector.

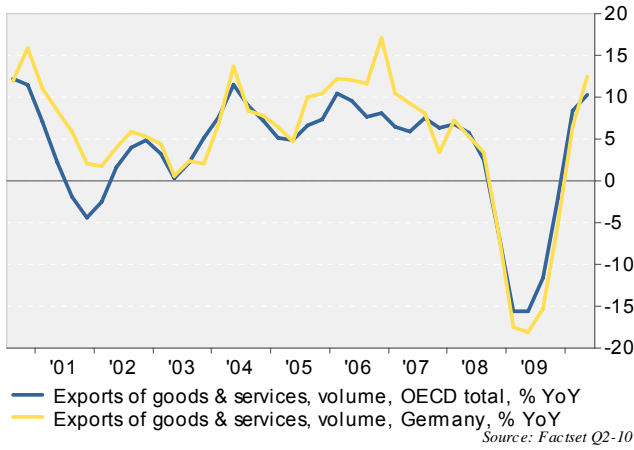
Industrial activity recovering robustly led by Germany
- The strong recovery in German activity is beginning to show up in leasing conditions in this market. JLL reports that logistics take-up in the first half of 2010 was up 11% compared to the same period a year earlier to c2 million m². JLL expects total take-up for 2010 to exceed 3.5 million m², the kind of level last achieved in 2007 and 2008, prior to the global downturn. The improvement in Germany's five major regions (Berlin, Dusseldorf, Frankfurt/Wiesbaden/Mainz, Hamburg and Munich) was even more impressive in the first half, with take-up rising by almost 25% in comparison to H1 2009.

Feeding through to German leasing conditions
- As in the other sectors, there are signs that rental decline is easing. CBRE estimates that prime rents in most European industrial city markets were flat over the course of Q2. Dublin saw a further substantial decline, -4.7% on the quarter, and CBRE estimates that prime rental values in this market have declined by almost 40% from their peak. Athens also saw a 4% rental decline over the quarter, but the overall decline from the peak has been far less here at -7.7%. The industrial sector probably demonstrates better than the other sectors the relative resilience of the core versus the periphery during the downturn. For instance, CBRE estimates that prime rents in the Ile de France have not declined at all during the downturn. This is also the case in three of the five major German markets that it covers, the other two seeing decline of less than 2%. It also estimates that rents in two major Dutch centres, Rotterdam and Utrecht, actually managed to rise despite the economic downturn, with rents in both up almost 8% in this period. Meanwhile many peripheral markets have seen very significant decline. Dublin's performance, noted above, is amongst the worst, with only Kiev, at c-44% from peak, faring worse. Elsewhere in the CEE region, CBRE estimates that prime rents have declined by over 30% from peak in Budapest, by over 20% in Warsaw and by almost 15% in Prague, though rents in all were flat in Q2. Prime rents in Barcelona and Madrid declined by c20% and c25% from peak, though rents in both were flat in Q2.

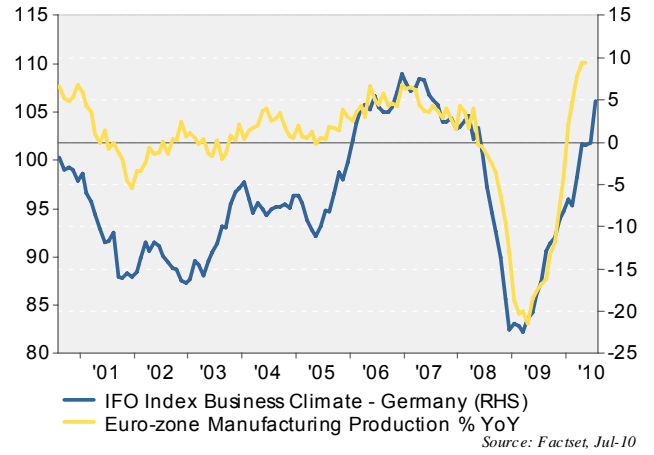
Prime rents steady in most markets in Q2
- We continue to expect some further weakness in industrial rents in the near term and that recovery thereafter will be muted. On a positive note, recent supply side trends have been favourable to rental recovery as new development responded rapidly to weaker demand and financing constraints; for instance, JLL recorded a decline of c40% in completions in 2009 compared to the year before. But the sector has long struggled to generate significant rental growth, held back by the flexibility of new supply and extremely cost-conscious occupiers – in Germany, for instance, IPD estimates that sustainable rental values have declined in the sector in eight of the past thirteen years. And with much of the recent improvement in occupier demand being attributed to occupiers' efforts to rationalise their operations, it does not appear likely that a change in rental dynamics is imminent. Nonetheless, yields in the sector have moved a long way to reflect these weak fundamentals and we believe that the sector can deliver robust returns over the medium term across Europe. In fact, the yield rally in the industrial sector has arguably been less pronounced than in the office and retail sectors of late. CBRE's pan-European industrial yield index records an aggregate decline of 34bps year-on-year in Q2 compared to 50bps for the office sector. Whilst the retail sector has seen less yield compression in terms of basis points, at 31bps y-o-y, given the significantly lower yields in the retail sector (CBRE's pan-European average retail yield was 5.2% in Q2 compared to an average 7.76% for industrials) this yield shift will have had a greater impact on capital values.

Rental recovery expected to be modest

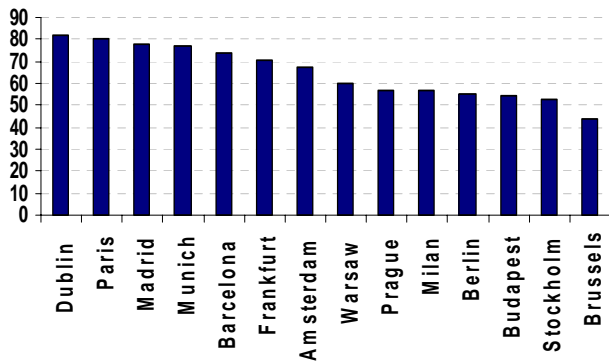
German and OECD Export Growth



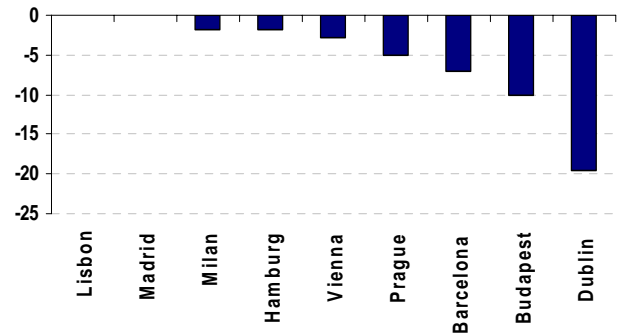
IFO Index & Eurozone Manufacturing Production



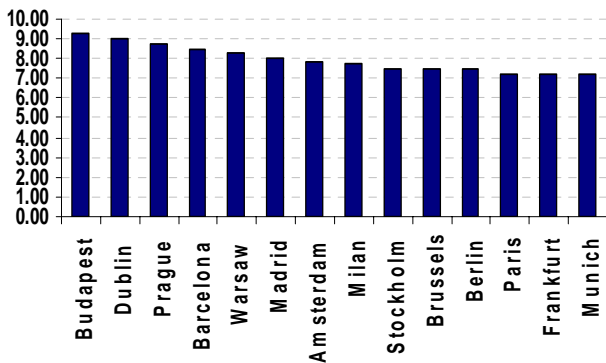
Industrial Markets Prime Rent (€/sq m)



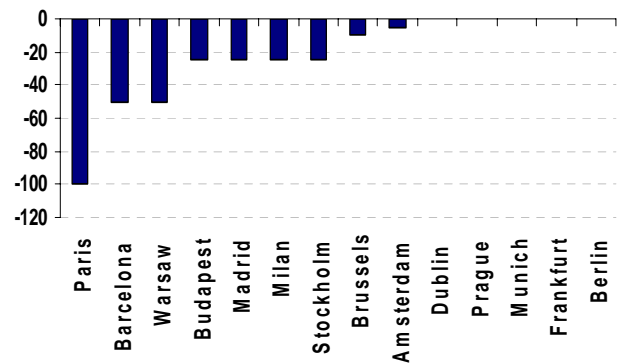
Industrial Markets Prime Rental Growth y-o-y (%)



Industrial Markets Prime Yields (%)



Industrial Markets Yield Shift y-o-y (bps)



Source: CBRE, Aviva Investors, Q2 2010

Important notes

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