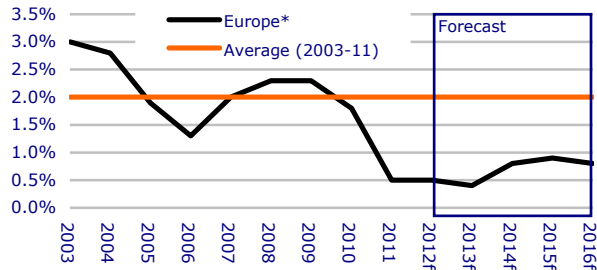


In our autumn 2011 house view we stressed that there remains diverse economic performance both across countries in Europe and also within individual countries. Key centres are continuing to show stronger growth than the national levels would imply. Real estate asset performance is driven by local factors and on-the-ground specialist knowledge offers significant risk mitigation.

An important factor that continues to support current real estate investment is the lack of development pipeline in most key markets. This is allowing limited occupier demand to feed into headline rental growth. While headline growth may be a little offset by incentives, the key is that buildings are let, income is being generated and vacancy rates are beginning to decline.

Our latest house view pointed to little expected development pipeline for the next three years and given continuing financing difficulties, we might expect the delivery of new space to be delayed a little longer. Figure 1 uses expected stock growth across 55 European office markets, which Invesco Real Estate research tracks, to demonstrate the impact of current development pipelines. Stock growth is at the lowest levels for the last decade and well below the 2% pa average calculated since 2003.

Figure 1: Stock Growth (%pa) Highlights Subdued Office Development Pipelines, 2003-2016f



Source: Invesco Real Estate, December 2011 (*represents markets covered by Invesco Real Estate research); f=forecast

While the development pipelines for retail have been stronger, the pipeline is slowing down considerably in the last 12 months. Europe wide shopping centre openings for 2012 are close to a ten-year low. Logistics remains a build-to-suit market with little speculative development. We expect developers to continue viewing economic circumstances as negative for new development starts and for bank financing to continue to be limited for speculative schemes.

Occupier demand has improved on 2010 levels and in key markets such as London and Paris it held up towards the end of 2011 (figure 2).

Figure 2: Office Market Occupier Demand

	Office Take-up ('000 sq m)		
	Q1 11	Q2 11	Q3 11
London	212	203	256
Frankfurt	80	150	86
Madrid	76	86	78
Paris	628	541	788

Source: CB Richard Ellis, Q3 2011

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German offices also reported record take-up levels at the end of Q4 2011 with Colliers quoting the highest levels since 2007. However there is weakness beginning to show driven by the economic uncertainties businesses face. We expect occupier demand to weaken at the beginning of 2012 but for it to recover once uncertainty across the eurozone is resolved and confidence returns at the beginning of 2013. The lack of development supply is a positive for the letting markets, however for investment under-writing purposes we expect to assume longer leasing times for vacant space.

Prime yields have remained fairly flat since our last house view published in October 2011. We believe 2012 prime yield levels will remain flat in most markets although the most liquid global city markets could see some further inward movement. However, we continue to see value declines in the out-of-favour secondary markets as both investors and occupiers stay away. This is likely to continue during 2012 and generate negative headlines.

Economic Outlook

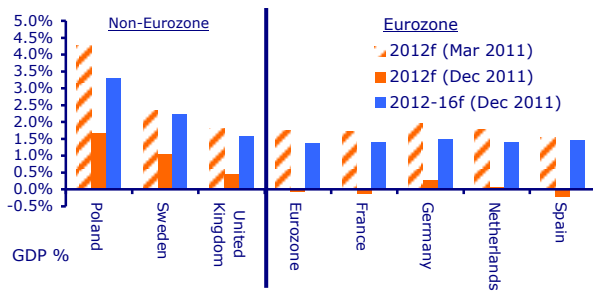
The eurozone debt crisis is expected to persist through 2012, exacerbated by the deepening recession among the heavily indebted southern eurozone members. Europe is expected to experience an elongated period of weaker than average growth as the deleveraging cycle continues. With central bank policy rates in the developed world remaining very low for an extended period, investment emphasis is expected to remain on quality assets that generate relatively safe and sustainable yields such as corporate and high-yield bonds in the fixed income area, "bond-like" equities and real estate funds that can assure strong and stable flows of rental income.¹

Our base case continues to assume a resolution to the eurozone crisis without a breakup of the euro. We have taken the steps of downgrading our economic forecasts for 2012 as it has become clear that the uncertainty surrounding the eurozone crisis resolution will continue well into 2012 and is weakening business and consumer confidence in the short-term. We expect the eurozone to experience a recession in Q1, with stabilisation in Q2 and weak recovery from Q3 2012. Stronger economic growth is expected from Q1 2013. However December 2011 business and consumer indicators in Germany have begun to tick up again indicating that the largest European economy may avoid a recession in 2012, which may provide protection to other economies that depend on German export activity.

Figure 3 shows our latest GDP forecasts for a selected number of countries across Europe. The chart shows the forecasts for 2012 (forecasts made at March 2011 and the latest at December 2011) and for the five-year period 2012-2016f.

¹ Summary of Invesco Annual Economic Outlook 19 December 2011 – the outlook is written by John Greenwood, Chief Economist of Invesco Limited.

Figure 3: European GDP Forecasts, %pa 2012-2016f



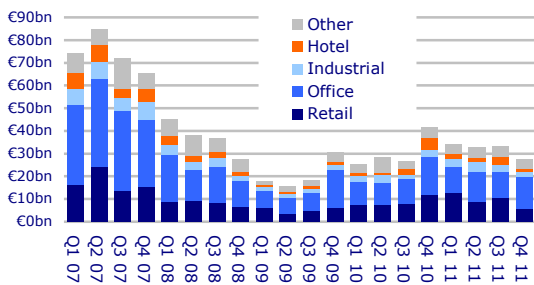
Source: Experian Business Strategies, Invesco Real Estate, Q4 2011; f=forecast

We remain confident in our longer term forecasts and expect a pick-up in economic growth rates from 2013 driven in part by the consumer and business investment. Corporate Europe remains well positioned for growth, with low levels of leverage, lean workforces and significant cash reserves. In addition, a number of international retailers are in expansion mode and BRIC based corporates are beginning to expand outside their traditional markets looking for opportunities in the developed world.

Capital Market Conditions

Despite the eurozone uncertainties developing during 2011, institutional investors have continued to target real estate. Figure 4 highlights capital flows and target sectors across the European Union.

Figure 4: European Transaction Volumes (€bn), Q107-Q411*

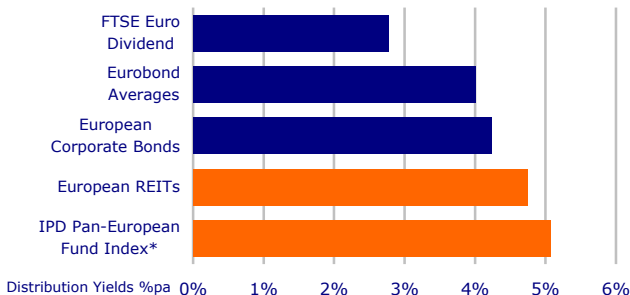


Source: Real Capital Analytics, Q4 2011 (*Q4 estimate)

We believe the realised transaction volumes underestimate the amount of capital attempting to get invested across European real estate markets. We currently estimate that there is €200bn allocated to European real estate.

Existing allocations are expected to hold over into 2012 as institutional investors remain keen to access real estate. Figure 5 highlights a key reason for investors continued interest in real estate – the delivery of strong, stable distribution yields. The chart demonstrates average net distribution (or dividend) yields for various asset classes within Europe. Both REITs and real estate funds deliver higher than average income distributions.

Figure 5: Real Estate Income Distribution %pa, Average Q409-Q311



Source: Thomson Reuters Datastream, IPD, Q3 2011
* an index of open-end direct real estate funds with a pan-European focus – the average income distribution shown is NET of all fees.

Investor interest remains focused on a narrow definition of prime in key European centres. With increased uncertainty and a focus on risk-mitigation, this definition is likely to narrow further. We do expect a greater flow of prime real estate product during 2012. We believe this flow will come from banks ending “extend and pretend” on prime assets as market conditions mean lenders will not be looking at losses if they chose not to refinance. We also expect short-term investors, who were able to acquire during 2008/2009, to realise profits made from rising market values during 2010-2011.

Financing conditions grew more difficult towards the end of 2011 as lending banks pulled back to domestic markets. Margins continued to rise due to the cost of intra-bank borrowing as banks became more cautious about counterparty risk. However, Invesco Real Estate’s experience in December 2011 is that lending is still available. German lenders with pfandbrief access indicated willingness to offer finance up to €150m on 50% LTV over five years for margins of 125-150bps. At the smaller loan size of c.€20m and without pfandbrief access lenders were offering margins of 225-250bps on up to 50% LTV². These margins, notably higher than the sub-100bps level seen in 2010, are still attractive on a historical basis given the ongoing low base rates. This situation is likely to continue throughout 2012 as base rates are forecast to remain at or below current levels until mid-2013.

More recently non-European lenders have returned to Europe and we would expect this to continue during 2012. Notably, in mid-December 2011, Malaysia’s Employee Provident Fund (EPF) closed a £300m loan for three London assets. Citigroup was reported as the lead arranger with Bank of Tokyo-Mitsubishi UFJ, OCBC Bank, Scotiabank and Sumitomo Mitsui Banking Corp joining the deal³. In addition, insurance firms are also gearing up their debt lending and should form a greater part of the lending market in 2012.

A key element of all available lending is that asset quality is vital. Finance is only available to strong managers for the best assets on long secure lease terms.

Investment Opportunities

European direct real estate investors have generally been risk-averse for the last 18 months, with the exception of a short period at the beginning of 2011. We believe investors, in general, will remain risk-averse for 2012 and continue to focus on a narrow definition of prime assets. Investors are expected to accept more risk during early 2013.

2012 Strategies

As Mark Twain is quoted as saying “I am more concerned about the return of my money than the return on my money”. Risk-averse investors are expected to continue to focus on securing income and liquidity and we anticipate a focus on the following strategies in 2012:

- **Avoiding weaker eurozone markets.** A focus on markets outside the immediate, short-term volatility of the eurozone and currency concerns. While no European market is protected entirely from the volatility we would expect the UK, Sweden and Poland to show stronger relative performance. These are markets outside the euro with their own independent central banks allowing more flexible monetary and fiscal policies. Germany also offers relative protection as the strongest eurozone economy.
- **Domestic strength is key.** Markets such as the UK, Sweden, Poland and France are economies where the

² Invesco Real Estate Structured Finance team, December 2011

³ Reuters, 16 December 2011.

domestic market is a strong driver of GDP growth. We expect domestic drivers to out-weigh international drivers in the short term. While Germany's growth is very focused on exports, it has remained stronger and better positioned than other eurozone economies and is expected to continue out-performing on a relative basis.

- **Markets which offer liquidity through attracting a broad range of capital sources.** Markets in which international capital is the only source of investment are expected to continue to be out of favour (such as Hungary and Bulgaria), while markets that offer a broad base of domestic and international pension, insurance, sovereign wealth and other investors should remain more liquid (for example, Germany, the UK and Sweden).
- **Key gateway centres.** It is important to recognise that national economic difficulties do not necessarily translate to problems in key domestic markets, particularly those with a global focus. Office markets in supply constrained key gateway markets such as London, Paris, Stockholm and Munich offer attractive lease terms let to strong tenants. Occupier demand has been holding up in these markets and the lack of new space being delivered to the market is allowing demand to translate to stable and often rising rental values.
- **All sectors can offer attractive risk-adjusted income.** If following the above strategy all sectors can offer attractive risk-adjusted income returns. Industrial and hotel assets offer the highest income returns followed by retail and office. However liquidity is better in the office and retail markets. We continue to expect retail to be the strongest performer over our five-year forecast period, but with out-performance weighted to the second half of our forecast period. Our focus will be on dominant retail assets.

A key concern for risk-averse investors is liquidity. Recent experience indicates that a growing criterion for maintaining asset liquidity is "green" or sustainable accreditation. Investors are expected to continue focusing on green ratings.

2012 Higher Risk Strategies

Financing for higher risk strategies will remain difficult during 2012 and maybe restricted to those institutional investors with equity. Given economic growth expectations business plans need to be realistic regarding lease strategies. We anticipate investors with a longer investment time horizon and higher total return expectations will pursue the following strategies.

- **Assets with curable deficiencies.** With risk-averse investor focus continuing to be on the top 1% of prime assets, we expect to continue to see opportunities to reposition assets with curable deficiencies such as leasing issues, financing difficulties and refurbishment needs. We also believe that investors are focused on very tight geographically defined prime markets and assets on the fringes of those markets are attractively priced to realise value growth when the prime definition relaxes.
- **Peripheral economies may offer opportunity.** While the liquidity is problematic in the short-term, we believe significant value can be achieved in the long-term by acquiring during 2012 at discounted prices.
- **Hotels offer long leases.** Investment in hotels is a specialist asset class but offers long, often guaranteed, leases to tenants with strong global covenants. Gateway markets with strong local businesses and transportation links offer the immediate best opportunities. Specialist sector knowledge offers very good risk mitigation.

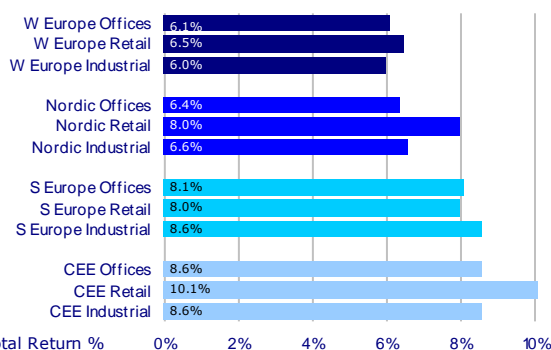
2012-2016 Return Expectations

As highlighted we believe institutional investors will continue to be focused on short-term income return with total return increasing in importance from 2013 onwards. Figure 6 indicates our total return expectations on a regional basis.

Our full five-year forecast expects Southern Europe and Central & Eastern Europe to deliver the strongest total returns driven by yield hardening in the latter half of the forecast period. However these markets are expected to suffer from greater short-term void risks.

In the first half of the forecast period the strongest returns are expected from the Nordics and key gateway Western European markets.

Figure 6: Five-Year Total Return Expectations, Q211-Q216f



Source: Invesco Real Estate, Autumn House View 2011; f=forecast

Strong market selection is expected to remain vital across Europe with a range of +10% total return between the best performing "prime" city/sector markets and the worse.

As always we believe a global investment management platform, with strong local on-the-ground transaction and asset management teams is the key to delivering strong returns in Europe.

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