Deutsche Asset
& Wealth Management

Research Report

U.S. Real Estate Strategic Outlook: Mid-Year Review

August 2013

Passion to Perform

For Institutional Investors Only

Prepared By:

Mark G. Roberts
Head of Research & Strategy
mark-g.roberts@db.com

Ross Adams
Industrial Specialist
ross.adams@db.com

Bill Hersler
Office Specialist
bill.hersler@db.com

Ana Leon
Property Market Research
ana.leon@db.com

Alexander Makarovski
Performance & Risk Analysis
alexander.makarovski@db.com

Andrew J. Nelson
Retail & Sustainability Specialist
andrewj.nelson@db.com

Alex Symes
Economic & Quantitative Analysis
alex.symes@db.com

Brooks Wells
Apartment Specialist
brooks.wells@db.com

Jay Wengang
Assistant Vice President
Performance & Risk Analysis
jay.wengang@db.com

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Executive Summary

While both economic and property market fundamentals are playing out largely as forecast in our 2013 U.S. Real Estate Strategic Outlook, in this mid-year update we nonetheless offer several modifications to our investment strategy. In particular, we have indicated in our last few updates that our forecasts reflected rising interest rates. The Fed's pronouncements in May were a reminder that, with the passage of time, the economy is becoming healthier and that capital markets will revert to their mean, implying higher interest rates. Against this backdrop, we recommend investors give greater preference for assets, markets and sectors that offer greater potential for income growth to offset capital value risks. Moreover, our property sector allocation recommendation maintains a strong overweight to industrial, with a slightly greater weight to office at the expense of retail, with apartments essentially unchanged.

To account for rising interest rates, we have reduced our five-year return expectations slightly. Currently, initial yield spreads to treasuries remain well-above average despite the recent increase in bond rates. In addition, income growth across sectors is becoming more visible. Also, we have accounted for higher interest rates by factoring in higher reversionary cap rates. Despite these effects, we continue to expect real estate to deliver inflation-adjusted real returns in the range of 5% over our forecast period and exceed expected returns from the bond market.

In summary, our revised outlook makes the following calls and recommendations:

- All property sectors continue to improve, with rising occupancies and rents forecast as the economy enters its strongest growth phase.
- Apartments were first to recover and rents now exceed prior peaks in many markets; expect slower rent gains in coming years as a surge in new supply looms.
- Our upgraded industrial forecast relies on all cylinders beginning to fire together, fueling strong income growth during our forecast period.
- The office sector continues to strengthen, but demand remains thin in most markets, in part due to changing corporate occupancy strategies that reduce space needs; but greater demand and occupancy gains are on the horizon.
- Recovery in the retail sector remains highly bifurcated, limiting overall gains as physical retailers are increasingly challenged by e-commerce. Yet more retail demand strengthens for top centers and markets.
- We expect cap rates to rise modestly (up about 30 bps to 40 bps over our last forecast), leading to lower forecasted 5-year returns (about -50 bps).
- Against the backdrop of rising cap rates, we recommend overweighting those sectors, markets and assets that can provide access to higher net operating income growth and provide better risk-adjusted relative performance.
- We also recommend an underweight to those types of investments which have more bond-like qualities in order to minimize the risk of capital loss driven by a rising rate environment. Notwithstanding interest rate risk, we recommend maintaining some exposure to these types of investments as they can provide a higher level of current income and also protect against downside risk should economic conditions run counter to our view and growth is lower than expected.

Finally, as noted in the second quarter release from NCREIF, the events we have been expecting to occur are now underway. That is, for the second quarter of 2013, the industrial sector has risen to the top while the apartment sector has seen its relative performance wane. In addition, the office market is improving, although income growth lags the other sectors as rents signed at the peak of the market are rolling down this year. Over the trailing twelve months, the retail and industrial sectors have outperformed the office and apartment sectors, reflecting our prior themes of improving household balance sheets and rising consumption demand. We expect these conditions to prevail over the coming year, absent unforeseen adverse shocks to the macro economy.

The Economy

The top economic development of the past six months concerns market reaction to the Federal Reserve's hints at the unwinding of quantitative easing. While long anticipated, the prospect that tapering will start soon caused an initial spike of interest rates and increased volatility. The good news is that this unwinding heralds stronger economic growth.

The U.S. economy has entered a period of sustained, if still modest, growth. Both businesses and consumer spending are driving growth and will continue to do so during the next few quarters. Consumer confidence continues to strengthen due to the improving job outlook, rising home and stock prices, and increased credit availability. Additionally, business profits, although decelerating, are still at record levels. However, corporations are generally holding on to cash and only reluctantly increasing spending when necessary for growth, dampening the effect of profits on economic growth.

Employment continues to grow on the strength of rising consumer spending. We expect growth will continue at a similar pace in the second half of 2013, with gains in construction and office-using employment outstripping other sectors. However, a higher proportion of these jobs are being filled by part-time workers. This ratio began rising in 2008, peaked in early 2010, and remains elevated at about 300 bps above pre-recession levels. Anecdotal evidence suggests that firms (especially in lower-wage sectors such as retail) prefer part-time labor to avoid the anticipated costs of complying with the Affordable Care Act. Were this trend to continue, the positive effects of job growth would be undermined by slower (or even negative) income gains.

Federal government spending and slower export growth are current dampers to the economy. Export growth will likely continue to be soft in the near term given the strength of the dollar and below average global growth. Additionally, federal government debt continues to be a risk, as the sequestration and additional austerity measures are dragging on economic growth. However, tax revenue growth is exceeding expectations, which may serve to reduce the US government deficit and long-term government borrowing rates.

Capital Markets

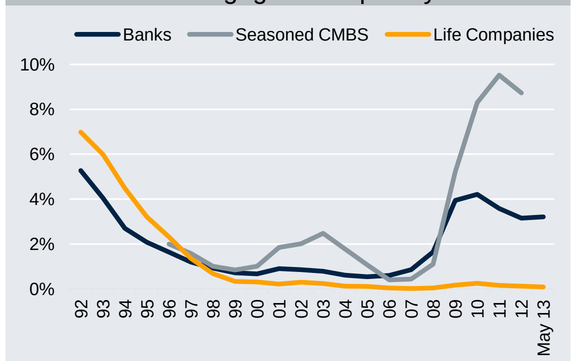
Sales volume for the first half 2013 for commercial real estate totaled $126 billion, up 21% from the first half 2012 as reported by Real Capital Analytics. The major trends are much the same as in recent periods: core real estate in gateway markets remains long-term portfolio targets, though the supply of product being marketed is scarce in most markets. Investors are beginning to take on more risk in the interest of achieving higher yields, either by assuming more leasing risk or by buying prime assets in more secondary markets. Despite rising interest rates, debt terms remain generally favorable by historical standards, supporting deal flow and low cap rates.

Apartment properties are leading in terms of transaction volume, but investors are also increasing trades for other property types. Apartment transaction volume increased to $41 billion during the first half, 51% over the same period in 2012. Cap rates are relatively stable, although yields are still higher than the prior market peak. Industrial investment totaled $17.0 billion, with the majority of volume coming from warehouse trades. Office volume increased to $38.4 billion, with much of the volume growth coming from the suburban sub-sector. CBD office cap rates remain low, but are stabilizing, while yields on suburban properties compressed during the past year from 7.5% to 7.3%. Retail was the only sector property that registered trade declines, falling 10.6% to $22.5 billion versus the same period in 2012, although yields are relatively flat.

Transaction volumes are on pace to exceed 2012 levels, driven by increasing demand for real estate from most investor types. Recent market volatility and sudden increase in interest rates may lead to challenges in pricing in the near term, but most buyers should be able to absorb a slight increase in mortgage rates. Cap rate spreads to treasuries are still high compared to historical norms, providing additional support for the asset class.

Debt Investment

Commercial Mortgage Delinquency Rates



Sources: ACLI, FDIC, PREA, and Deutsche Asset & Wealth Management.
As of August 2013.

The debt investment environment will continue to improve during the second half of the year. Real estate fundamentals are strengthening, helping to both bring down delinquency rates on legacy loans, and reduce market and asset risks on new loans. Returns on equity investments in the core markets of New York, Washington and San Francisco have compressed. However, private mezzanine debt and preferred equity investment opportunities in these markets are producing higher yields than equity in some cases, and have select opportunities to produce higher risk-adjusted IRRs as well. Additionally, mezzanine investments may yield higher risk-adjusted returns in secondary markets, where debt markets have yet to return, but demand for financing exists.

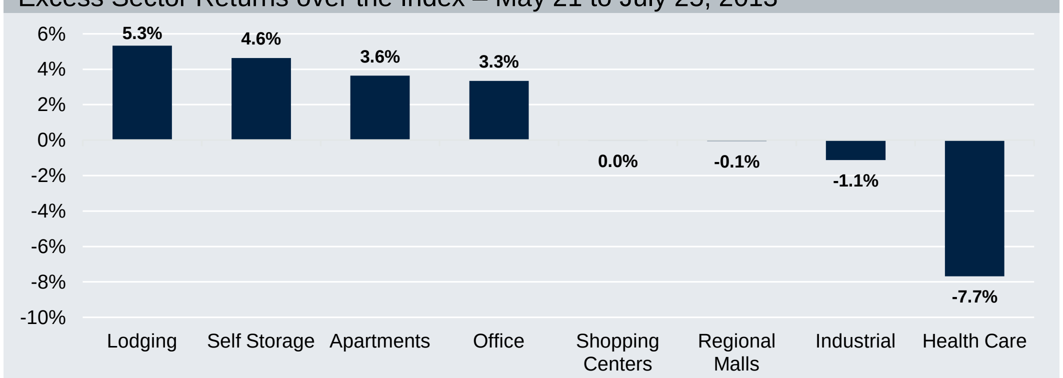
As real estate fundamentals are improving, threats to mezzanine debt investors have come less from delinquency risks, and more from competition for investments, driving down returns for a given level of risk. With all types of lenders back in the market, the better properties are attracting a large amount of attention for debt across the capital stack, especially from CMBS originators. Mortgage securitizers, which were mostly out of the market during the past few years, have returned with strength, issuing $50 billion in debt in the first half of the year. Demand for debt issuance has caused yields to compress; however, rising rates may help private debt investors in the second half of the year. Although rates may not increase measurably by the end of the year, interest rate volatility will likely continue during the next four quarters causing lending spreads to widen and rates to increase modestly. Securitized lenders are less able to operate in a volatile interest rate environment, which is advantageous to balance sheet lenders on senior notes and mezzanine lenders on junior loans. Interest rate volatility and upward movement will reduce some of the CMBS activity for the year, opening opportunities for junior-tranche debt investors.

Publicly Traded REITs

After a strong start to the year, the market turned negative in late May, with the NAREIT index[1] falling 9% during the next month. However, capital did not treat all property types the same. Sectors with longer lease terms and triple-net leases were hit harder than others. Long lease and triple-net properties include both retail and industrial, as well as the healthcare sector (medical office, seniors housing and bio-tech).

Anecdotal evidence suggests the interest rate volatility arose largely in response to the Federal Reserve's hints at winding down QE. However, the end of easing programs and rising of rates will primarily come from an improving economy, which should benefit real estate. Property types with shorter lease terms will benefit from the improving economy, and performance will counter any negative effect from rising interest rates. Property types with short lease terms include apartments, lodging, and self storage, but also certain industrial properties. However, bond-like property types, with such as health care and certain retail property types, will likely underperform in terms of income growth. The capital markets could continue to punish these property types with cap rate movements closely in line with rising rates.

Excess Sector Returns over the Index – May 21 to July 25, 2013



Note: Excess returns compared to the NAREIT All Equity REITs Index.
Sources: NAREIT and Deutsche Asset & Wealth Management.
As of July 2013.

[1] NAREIT All Equity REITs Index price return

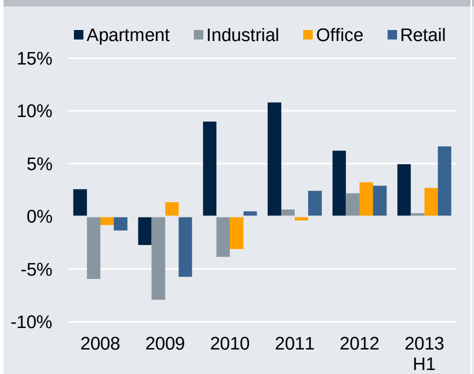
The public market tends to lead the private equity market by four quarters, so we can gain some insight from how REITs performed recently. Although supply threats are giving investors reasons to eschew apartment investment, short lease terms may give some life into the sector going forward. Retail, which had strong performance as interest rates fell during the past five years, could underperform as long lease terms increase the interest rate sensitivity. Investors should also be aware of lease roll on any new acquisitions, focusing on capturing rising rents.

Real Estate Performance

Capitalization rate compression will likely slow going forward, giving way to NOI growth as the primary source of property returns from 2014 to 2018. Compression drove performance during the past three years as investors anticipated the recovering economy. Income growth, which should drive returns going forward, will likely accelerate in 2014 for industrial, office and retail properties. While we still expect some income growth for apartments, the pace is slowing in contrast to recent years. When factoring in higher interest rates and slightly higher future exit cap rates, returns to unlevered real estate will likely moderate for investments made in 2013 producing an average annual return of 7.3% from 2014 to 2018.

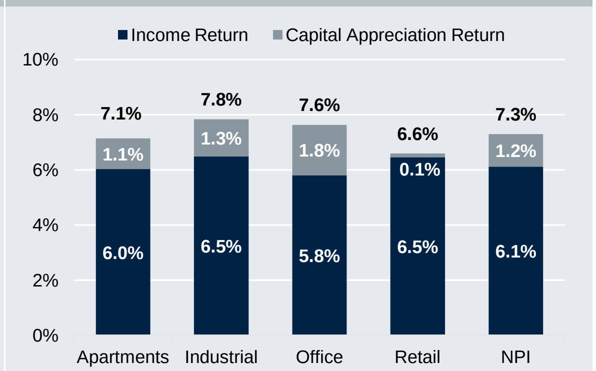
During our five-year forecast, industrial and office properties will likely outperform. Income growth for both sectors have so far underperformed in 2013, but will strengthen starting in 2014 and 2015, attracting more capital to both sectors. Apartment income growth and cap rate compression will decelerate midway through the five-year period, resulting in lower expected total returns. While the retail sector will continue to experience steady NOI growth, gains will be lower than those of the cyclical sectors of office and industrial, resulting in retail underperforming in terms of total return.

Annual NPI NOI Growth



Source: NCREIF.
As of August 2013.

5 Year NPI Total Returns Forecast



Source: Deutsche Asset & Wealth Management.
As of August 2013.

Property Markets

Real estate fundamentals should continue to improve going forward. Demand drivers are strengthening for our all property types, while supply, outside of the apartment sector, remains generally at bay. Strengthening fundamentals will result in growing rents for all four property types in the near-term. However, the sectors are at different parts of recovery and expansion, with apartment properties having led in recovery and office lagging the other sectors, especially in the suburban arena.

U.S. Vacancy Rate Trends (%)

	Actual				Forecast					
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Apartment	7.3	5.9	5.1	4.9	5.1	5.3	5.6	6.2	6.0	5.3
Industrial	14.3	14.3	13.5	12.7	12.0	11.1	10.4	10.1	10.1	10.2
Office	16.5	16.4	15.9	15.3	14.9	14.1	13.2	13.0	13.2	13.5
Retail	12.7	12.9	12.9	12.6	11.6	10.6	9.9	9.8	9.8	10.0

Sources: CBRE-EA (History) and Deutsche Asset & Wealth Management (Forecast).
As of August 2013.

While apartment vacancy is low and forecast to rise within in the next five years, we still favor the sector for the next year as robust rent growth and short lease terms are resulting in growing income.

Industrial properties have had a strong first half and vacancy is forecast to tighten further during the second half of the year. Property revenue growth has been weak during the cycle, but should strengthen going forward.

The office sector is still in the early stages of recovery. Even though office-using job growth is strong, structural trends are resulting in the square feet per worker to be lower now than during previous recovery cycles. Stronger rent and NOI growth will come as recovery becomes stronger.

Overall, retail appears to have had a modest recovery so far, even though retail sales have been robust. However, the top centers across the country are faring better, and rent growth will continue to be stronger in these locations. New supply will not be an issue for the sector.

The following sections discuss each of the four property types in-depth.

Apartments Sector Outlook

Still Positive, Though Surge in New Supply Looms: The U.S. apartment market continues to proceed through the growth phase of the real estate cycle, maintaining essentially full occupancy and producing healthy, albeit decelerating, rent gains. Currently, 21 of the 28 prime investible metros are achieving occupancy levels above 95%. The strongest performers in 2013 are markets with strong technology or energy drivers. Meanwhile, the construction pipeline shows no signs of subsiding. Annualized multi-family permitting has exceeded 300,000 units for eight of the nine previous months. The ability to absorb these units as they come online will likely be the key factor in determining market performance.

Several key drivers support continued rental demand, including improving household formation and a falling homeownership rate. The number of U.S. households grew by 980,000 in 2012, 60% higher than the average growth during the prior five years. With more jobs, a growing population, and more people graduating from college, we expect household formations to average more than a million per year through the end of the decade. Despite rising housing sales and double-digit jumps in prices, the share of Americans who own their homes was only 65% in early 2013, down from 65.4% a year earlier. The U.S. homeownership rate has now fallen to its lowest point in almost two decades, reflecting rising demand for rentals and investor purchases in the housing market.

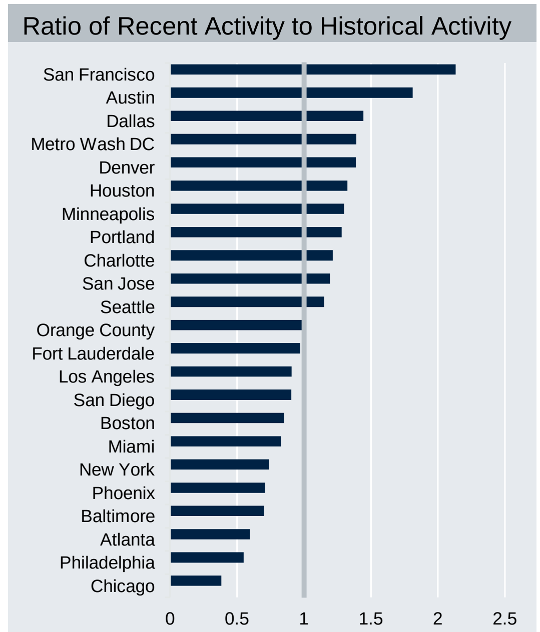
Apartment Market: Indicator Scorecard
Favorable, though affordability & permit activity

Indicator	Mid Year 2013	Historical Average	Comments
U.S. Vacancy Rate	4.6%	5.5%	Staying below historical average
Rent Affordability Ratio	25.6%	21.3%	Rising rents / Income growth remains flat
Rent to Homeownership Ratio	88%	(see note 1)	Reversed (was 121% YE 2012) - now favors renting
Homeownership Rate	65.0%	67.7%	Remains flat
Multi-Family Permits (May)	350,000	290,000	Been above 300k for 8 of the 9 last months
Cap Rate Spread (see note 2)	2.8%	1.8%	Cap rates remained steady / Interest rates surged

Note 1: Rent to Homeownership Ratio was 121% at YE 2012 & 120% at YE 2011.
Note 2: Spread between cap rates (5.3%) and 10-Yr Treasuries (2.5%) / Survey of institutional quality assets in major markets.
Sources: CBRE-EA, Axiometrics, Moody's Analytics, U.S. Census, Sentier Research, NAR, Real Capital Analytics, and Deutsche Asset & Wealth Management.
As of June 2013.

The Indicator Scorecard (see above) confirms several key market trends – apartments continue to enjoy strong demand and new supply will likely be delivered into a tight market. The recovering for-sale housing market does not appear to pose a threat to renter demand. However, slow income growth could weaken the ability for renters to continue to afford rising rents that are already at historically high levels and single-family homeownership still remains attractive relative to renting. While cap rates for Class A apartment communities in major markets have remained fairly steady, the spread over the risk-free rate did narrow as the U.S. 10-Year Treasury rate surged from May to July – though the spread remains well above its historical average. In the near term, these indicators point to continued favorable market conditions and investor sentiment. Longer term, rising construction activity and weak income growth remain the primary challenges to the market outlook. In addition, the pace of growth in the prime-renter cohort (persons between the ages of 20 to 29) reached a peak in 2010 and is decelerating. Whereas this portion of the population had grown by 5% since 2007, the pace of growth is expected to decelerate to a total of 2.2% through 2022. This will represent a marked slowdown in demand over the medium term.

Responding to strong market fundamentals and investor demand, developers have begun to build new apartment housing at a pace comparable to the last downturn. Urban infill locations will account for the bulk of the new supply being delivered this year, although construction activity is now starting to accelerate in some suburban markets as well. Some of the hottest markets in terms of performance have attracted the most developer enthusiasm. Multifamily permitting has been strong in such low-barrier markets as Houston, Dallas, Austin, Denver, Minneapolis, and Charlotte, but also in the high-barrier markets located in the San Francisco Bay Area. Though still coveted by investors, metro Washington D.C. remains the most at risk market for oversupply.

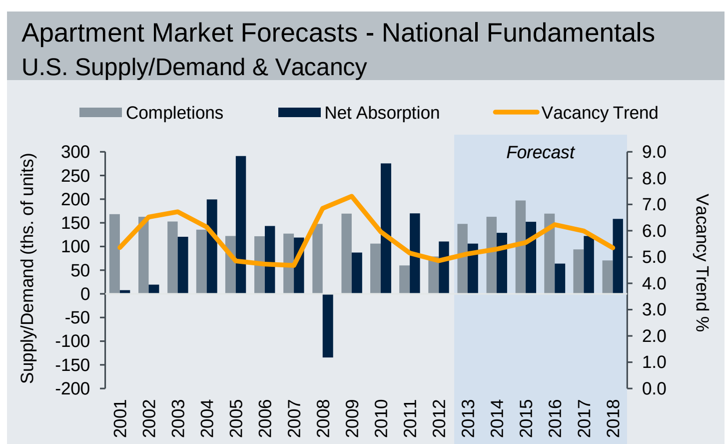


Sources: Moody's Analytics, CBRE-EA & Deutsche Asset & Wealth Management.

As of June 2013.

The exhibit above ranks the metros with highest ratios of recent multifamily permitting to historical averages. Markets with more elevated vacancies and muted rent growth are seeing relatively tepid activity from developers; these include Los Angeles, San Diego, Baltimore, Phoenix, Philadelphia, Riverside, and Atlanta.

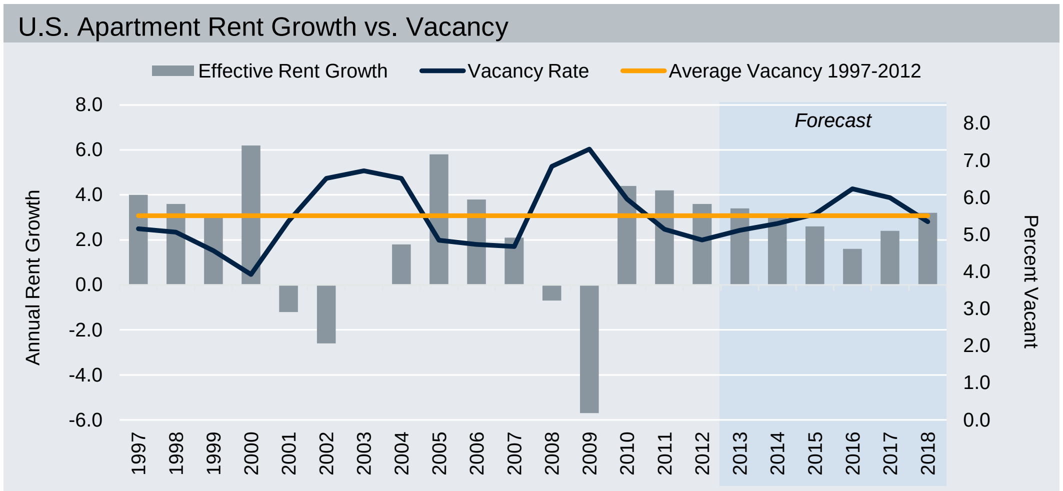
Market Outlook: Vacancy rates are expected to establish cyclical lows in 2013 even as the first wave of new deliveries reaches the market. But occupancy is likely to slip as the looming construction pipeline is projected to deliver a total of 500,000 units over the next three years with completions peaking in 2015. Although renter demand is projected to climb over the next several years as the job market strengthens, it will not be enough to offset the projected ramp up in new supply.



Sources: CBRE-EA and Deutsche Asset & Wealth Management.

As of August 2013.

Low vacancy rates, coupled with sustained renter demand, will drive apartment rents higher for another 12 to 18 months, averaging 3.2% per year. Rent growth is projected to slow thereafter as the vacancy rate climbs above its historical average.



Sources: CBRE-EA, Axiometrics and Deutsche Asset & Wealth Management.
As of August 2013.

The number of metros that will be able to sustain healthy rent growth will diminish as an active construction pipeline shifts the favorability of market conditions away from landlords and towards tenants. Income growth will be greatest in metros where vacancy rates are below 4%, with strong economic growth prospects and rent-to-homeownership ratios that favor apartment living. The markets that are forecast to outperform include: Boston, New York, San Francisco Bay Area, Seattle, South Florida, and Southern California.

Sector Strategies: Investment strategies need to be positioned for long-term growth in revenues. Investors should target high-quality communities located in prime urban core districts of gateway and/or knowledge-based markets, but avoid pockets of potential oversupply. With developers focused on urban opportunities, consider well-located and highly-amenitized suburban locations, especially “next generation” communities that appeal to today’s youth-oriented renter. Look for pre-sale, joint venture and build-to-core opportunities that will provide investors access to “next generation” product in prime locations.

Industrial Sector Outlook

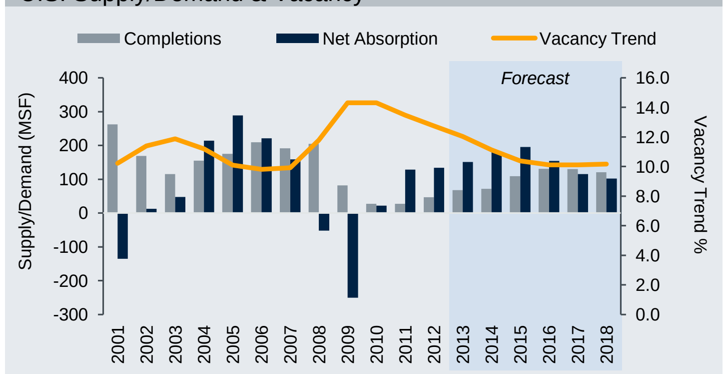
Gaining Strength and Momentum: Occupier and investor demand momentum surged beginning in late 2012, with two of the strongest quarterly demand figures since mid-2006 posted during the fourth quarter and first quarter, while the supply pipeline remains modest. Sensing solid growth prospects in the sector, investors aggressively searched the market for opportunities, driving cap rates and total return expectations lower.

The national vacancy rate fell by 30 basis points in each of the last three quarters and by 100 basis points year-over-year through second quarter 2013, the most of the four property sectors. Trends in leading coastal markets are well ahead of national averages, while low-barrier Midwest and South/Southwest markets generally lag, although a few are beginning to post strong vacancy rate declines.

Recovery is now broad by market and product type, with warehouses (particularly large-bay) continuing to lead. Investors are paying premiums for scarce opportunities in primary gateway and inland hub markets, while non-warehouse (flex) assets remain out of favor, with going-in cap rates about 150 basis points higher than for warehouse.

Market Outlook: Forecast broader and stronger economic growth bodes well for industrial property markets. Forecasted employment growth, as well as expanding international trade and retail spending, should support warehouse demand. Additionally, renewed housing production should lift the smaller warehouse and multi-tenant industrial segments. Recession in Europe and moderating growth in Asia may temper high-tech consumption and hurt the manufacturing sector over the next year, but overall the longer-term macro drivers for industrial space demand are as good as they have been since the 1990s.

Industrial Market Forecasts - National Fundamentals
U.S. Supply/Demand & Vacancy



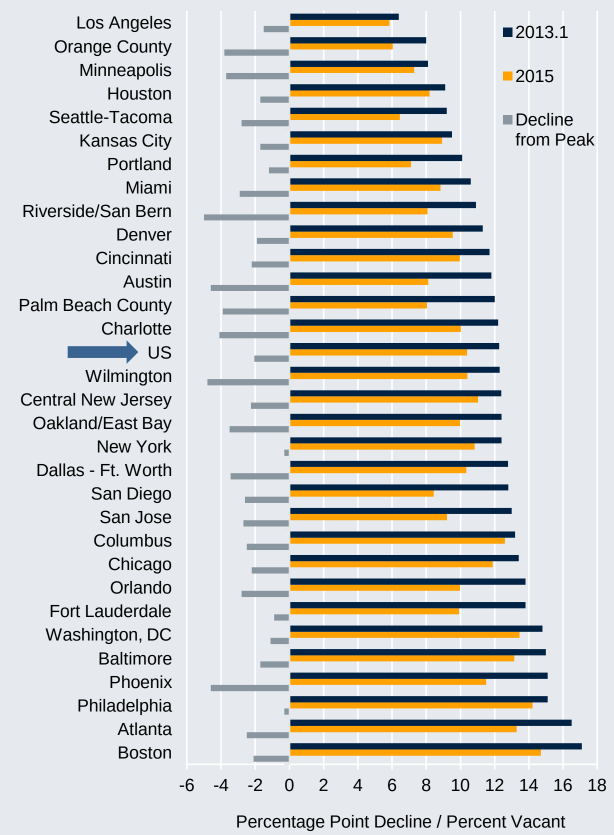
Sources: CBRE-EA and Deutsche Asset & Wealth Management.
As of August 2013.

We expect a gradual ramp up of industrial construction through 2015. Growing obsolescence of older stock will fuel some near-term replacement supply, as will a shortage of large state-of-the-art bulk warehouses in coastal markets. Large bulk warehouses are planned or underway in Southern California and Northern New Jersey, but the majority of markets remain oversupplied and will see only limited development. Demand should outpace supply through 2015, allowing for solid occupancy and market rent gains. We expect national vacancy to decline to the 10% range and market rent growth of about 5% per year over the next two years.

Sector Strategies: Further vacancy declines and market rent gains in our target markets over the mid-term horizon should translate into one of the strongest income growth profiles among the four property sectors.

Several regions are positioned to perform especially well: California, the Pacific Northwest, New York/New Jersey, and South Florida. In the Southwest/Mountain area, Phoenix and Denver should recovery strongly, while Austin and Dallas should outperform in Texas. Industrial properties in these markets should see occupancy and rent gains, driven by solid regional economic growth and stark supply-side gaps.

Metro Vacancy Forecast and Change from Peak



Sources: CBRE-EA and Deutsche Asset & Wealth Management.
As of August 2013.

We can broadly recommend all the metros in the top half of our vacancy rate ranking exhibit, with the exception of Cincinnati and Kansas City. The metros in the bottom half are either low barrier markets with relatively high current and expected vacancy rates, or more volatile, late recovery markets that are set to improve (i.e., Oakland, San Jose, San Diego, Fort Lauderdale and Phoenix). Over the longer term, we advocate overweighting high-barrier markets and limiting core investing in lower-barrier markets to newer Class A warehouse in top submarket locations. As a group over the long term, high-barrier markets have broadly outperformed both in terms of market vacancy rate fundamentals and historical NPI returns.

The best prospects where fundamentals are healthiest are Los Angeles, Riverside, Orange County, San Jose, Oakland, Austin, Seattle and Miami, where recent rent gains will benefit near-term leasing efforts.

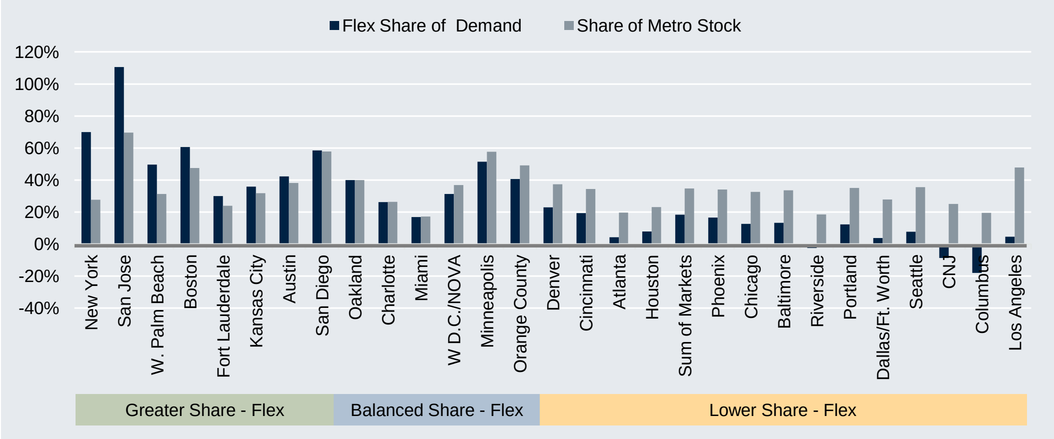
Opportunities in yet-to-recover markets with good future prospects will be in San Diego, Phoenix, Portland and Fort Lauderdale. These markets have higher than average vacancy but they should experience sharp declines soon, as well as rent growth.

Core markets with solid demand fundamentals but less upside include Chicago, Minneapolis, Houston, Dallas, and Atlanta. They can provide market-perform characteristics but have also underperformed over the longer term due to supply-side threats. Baltimore and Washington D.C./Northern Virginia also fit in to this group due to demand-side risks stemming from potential defense spending cuts.

Large-bay bulk warehouses in gateways and inland hubs appear to be aggressively priced with the lowest going-in cap rates. Total returns prospects are better in Southern California, Seattle and New York/Northern New Jersey compared to Chicago, Dallas and Atlanta. Multi-tenant warehouses in high-barrier markets will be the next outperforming segment as they should achieve strong occupancy and rent gains over the next three years.

The non-warehouse (flex) segment is starting to recover, but investors should remain selective. The stronger markets tend to be on the left half of the chart below and include primary Northern and Southern California metros, South Florida, Seattle, Denver and Austin. In this group, only in Fort Lauderdale is the metro flex vacancy rate higher than the U.S. average industrial vacancy rate.

Demand Recovery for Non-Warehouse Space by Metro Market
Non-Warehouse Share of Demand, 2Q2011 – 2Q2013



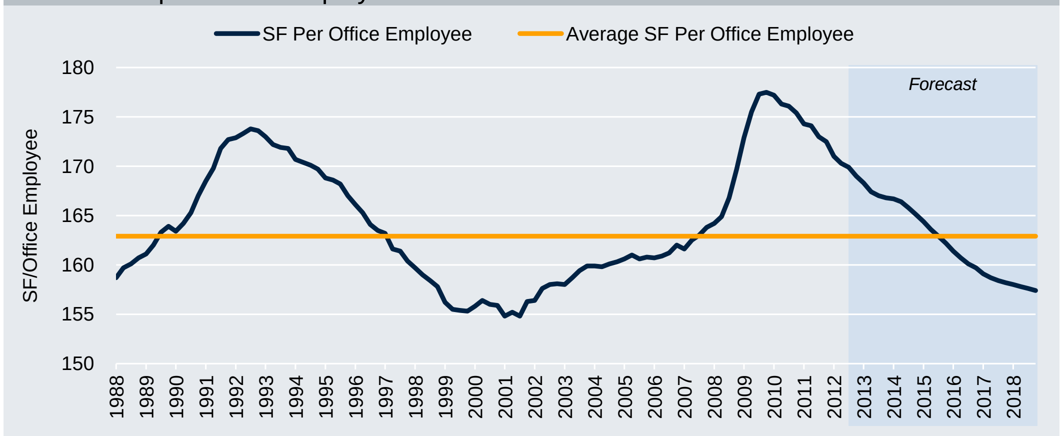
Sources: CBRE-EA and Deutsche Asset & Wealth Management.
As of August 2013.

Office Sector Outlook

Demand Broadening, But Still Thin: Job growth continues to generate positive office demand, which is helping improve rent recovery in the sector. But currently absorption remains thin, with 2012 not much better than the weak gains in 2011. Recovery is still limited to a few key metros, with markets having strong tech and energy components remaining the strongest performers, while a fifth of major metros saw a loss of occupied space in the first half of 2013. More positively, demand is spreading to more submarkets, albeit at tepid levels.

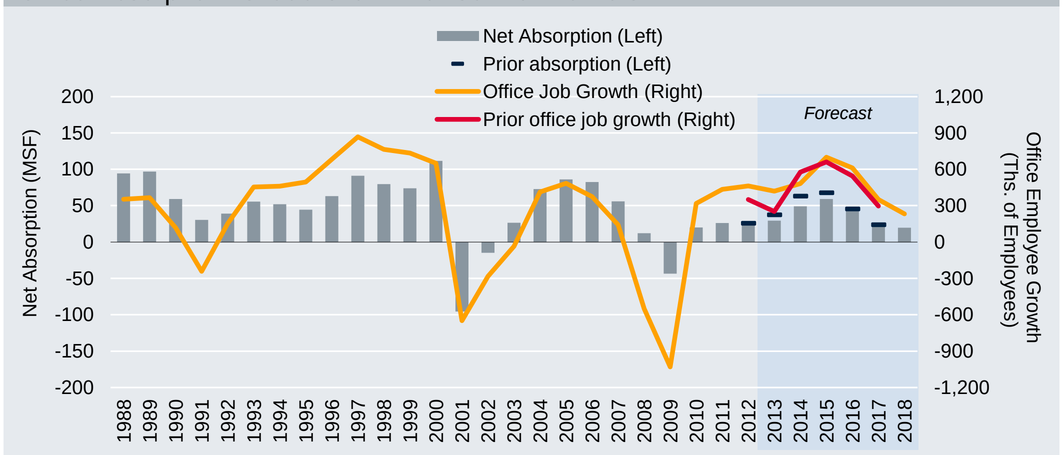
The key issue is that office job growth recovery is not translating into strong demand growth for office space. Since demand recovery began in 2010, net office absorption has been held down by shadow vacancy left behind as companies decreased payroll counts faster than their real estate footprints. Also percolating was a trend toward office occupiers redesigning their spaces in ways that increased their utilization and density. Redesigns save on real estate costs by improving space efficiencies, but also reflect a re-thinking of traditional office layouts to make space more productive and collaborative. These reductions in office footprints are taking wind out of the sails of the office recovery relative to prior expansions.

Office Area per Office Employee



Sources: CBRE-EA, BLS, Moody's Analytics, Deutsche Asset & Wealth Management.
As of August 2013.

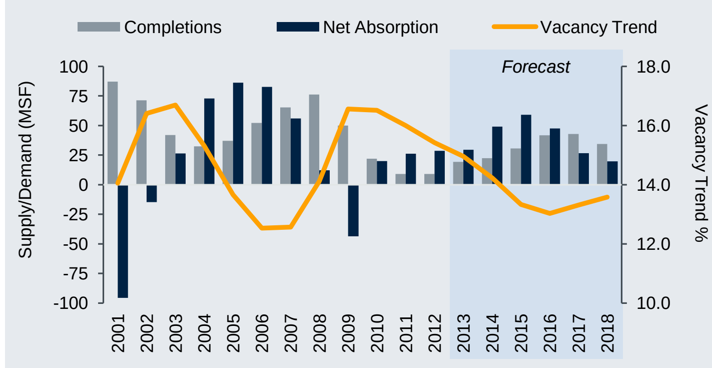
Office Absorption vs. Job Growth for Sum of Markets



Sources: CBRE-EA and Deutsche Asset & Wealth Management.
As of August 2013.

Market Outlook: Despite office job gains, absorption during the first half of 2013 actually has been slower than in 2012, reflecting the twin drags of shadow space and tenant efficiency gains. New completions added only 0.15% to existing stock, but with persistently weak demand, market vacancy has decreased only 20 bps to 15.2% in the first half of 2013, continuing the sector's achingly slow occupancy gains. We expect greater improvement in the second half of 2013 as the economy strengthens, but have lowered our near-term demand forecast, considering the persistent weak translation of jobs into absorption. Our current outlook is for demand in 2013 to only hit about the same level as in 2012 and 2011.

Office Market Forecasts - National Fundamentals
U.S. Supply/Demand & Vacancy



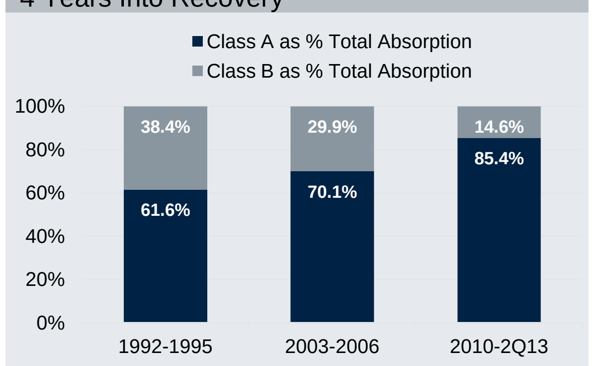
Sources: CBRE-EA and Deutsche Asset & Wealth Management.
As of August 2013.

The good news for office demand is that recovery is expected to broaden this year: the number of markets posting rent gains is expanding, with 60% of submarkets expected to post rent gains of more than 1% in 2013, more than doubling the share in 2012.

Another positive factor is that construction remains low in most metros – with a few conspicuous exceptions. While the pipeline is up in New York and San Francisco, these metros face low near-term risk since they have strong positive demand outlooks and long completion schedules. On the other hand, we are more concerned about Houston and Austin – two metros with demand growth but even larger supply pipelines. Finally, the risks are mounting in Washington D.C., where a large pipeline is delivering into demand that has been falling in recent quarters.

Suburban vacancy decreased during the first half of this year by 30 bps while CBD vacancy declined 10 bps. But the suburbs have more ground to make up, with a vacancy load of 17% compared with 12% in CBDs. More telling is a comparison of the absorption of Class A versus Class B space. During 2010 through mid-year 2013, occupancy increased by 3.6% in Class A stock but only 0.9% in Class B, as Class A accounted for 85% of all net absorption. The pattern of Class A outpacing Class B during recoveries is typical as tenants chase quality space at relatively cheap rates. However, the current ratio of Class A to Class B

Class A vs. B Cumulative Absorption
4 Years Into Recovery



Sources: CBRE-EA and Deutsche Asset & Wealth Management.
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gains is higher than in past recoveries. Anecdotal evidence suggests that tenants covet not just the physical quality of Class A space but its superior functionality as well.

Also evident in the market is that new tenant standards for space are spurring build-to-suit and build-to-own projects as a strategy for designing space for optimum productivity. These trends are likely to accelerate the obsolescence of non-functional locations and product.

Sector Strategies: Our target market selection remains unchanged. Locations with vibrant live/work/play environments will remain important to tenants and will grow in significance, as will walkability and access to transit. These preferences put premiums on locations in metros with vibrant CBDs. Suburban nodes containing many of these elements also should be considered, though the desirable attributes vary by metro. Building quality is as important as ever. Properties that can accommodate high density usage, as well as characteristics supportive of enhanced employee productivity: large functional floorplates, high ceilings, access to natural light and air, and access on-site amenities such as fitness centers. Assets lacking these attributes will struggle more than those with them, and risk becoming obsolete and/or candidates for re-use.

Retail Sector Outlook

Improving Fundamentals But e-Commerce Threats Loom: The financial health of both consumers and retailers continues to strengthen, but these gains have yet to translate into a robust, broad-based retail property recovery. The key issue is e-commerce, which increasingly drains retail sales out of shopping centers, shifting and reducing retailer demand for space. Fundamentals at most properties continue to improve, if slowly, but many centers lag and will never catch up, blunting the overall recovery figures.

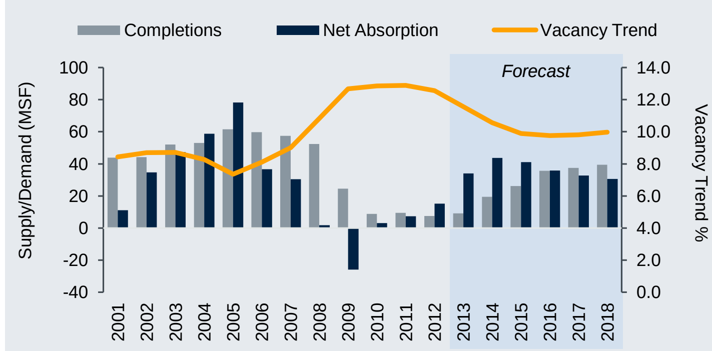
The main story for the retail sector is that the major demand drivers are recovering faster than property fundamentals. Consumers, in particular, are in their strongest position in many years. Household debt as a share of income is down to levels not seen in almost four decades, the result of mortgage write-offs, lower interest rates, and more conservative lending and borrowing, as well as a higher savings rate. Meanwhile both employment and home prices are growing, providing households more income and equity, and hence purchasing power. Consumer confidence is higher now than at any point since before the recession. With more means and a more optimistic outlook, consumers are out spending again. Since bottoming four years earlier, nominal retail sales (excluding auto related) were up almost 8%, or 10% adjusted for inflation through the first quarter of 2013. At the same time, retailers are much stronger, with improved balance sheets and more realistic growth strategies. The widespread bankruptcies and mass store closings that occurred during the recession are now long past, with most chains posting stronger sales and at least modest store growth.

Yet these gains are not translating into significant leasing gains. Though retail absorption has been positive for 15 consecutive quarters since mid 2009, the improvement in occupancy has been minimal despite the almost complete absence of new supply. CoStar estimates that shopping center vacancies dipped below 9% in the first quarter, down only 70 basis points since peaking in early 2010. Why the disparity? First, e-commerce has siphoned off a fast-growing share of sales that otherwise would have transacted in shopping centers. Though e-commerce still accounts for less than 5% of all retail sales, this share rises to 6.5% excluding auto-related segments and to over 15% in the core retail categories excluding the items that rarely transact online (like groceries and building materials). Second, retailers themselves are encouraging more sales to go online through omni-channel strategies that emphasize efficiency over growth. With the retail world increasingly going online, the leading chains are occupying fewer and smaller stores, reducing demand for retail space.

Market Outlook: Overall, the nation's retail property markets continue to improve, though slowly. Our forecast still calls for gradual market recovery in the near term consistent with recent trends, with accelerating gains in the following years. We anticipate the 12.3% vacancy in community and neighborhood shopping centers will drop below 10% by 2015, as moderate demand absorbs existing vacancies and little new space is added to the market. With a pickup in deliveries starting in 2016, we expect vacancies to essentially flatten thereafter through the end of our forecast period in 2018. Rent growth will generally commensurate with occupancy rates, and peak rents will not likely reached nationally until 2017 or later.

Retail Market Forecasts - National Fundamentals

U.S. Supply/Demand & Vacancy*



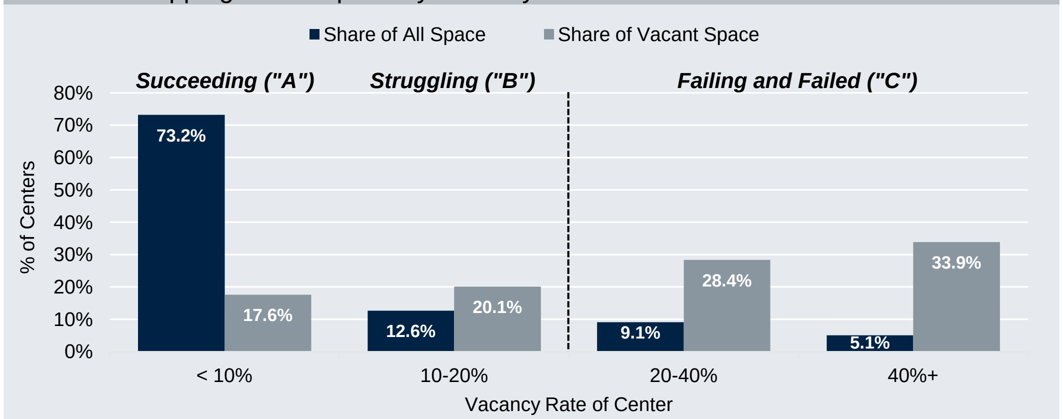
*Neighborhood and community centers only.

Sources: CBRE-EA and Deutsche Asset & Wealth Management.

As of August 2013.

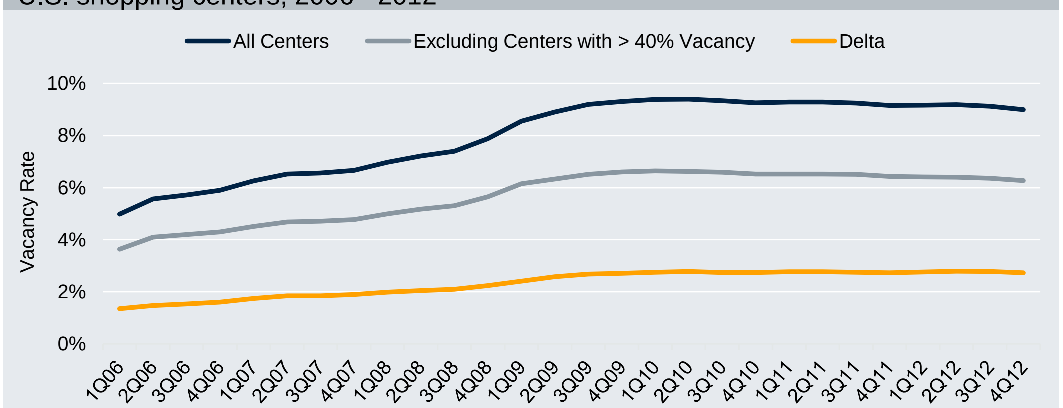
However, a more positive view of industry health is revealed by separating obsolete, non-competitive centers from the industry data, much as the office sector separates Class B from Class A building data. Upwards of 10% of the nation's retail stock is redundant, as evidenced by enduring vacancies of 40% or more. With barely 5% of all shopping center GLA, these obsolete centers account for fully one third of all vacant space. Excluding this space from vacancy calculations reduces the indicated vacancy rate by almost 300 basis points, and is a more meaningful measure for institutional quality centers. This split between the best- and worst-performing shopping centers has grown wider since before the recession and seems to be enduring. The centers with high vacancy continue to have trouble attracting tenants.

Share of shopping center space by vacancy rate of center



Sources: CoStar, PPR, Deutsche Asset & Wealth Management.
As of December 2012.

Total and adjusted vacancy rates
U.S. shopping centers, 2006 - 2012



Sources: CoStar, PPR, Deutsche Asset & Wealth Management.
As of December 2012.

Sector Strategies: High-street retail has been the star performer in recent years, followed by dominant regional malls, as retailers seek to showcase their wares in high-profile space. Power centers and lifestyle centers have lagged, but there is considerable variation in each category. The biggest risk now may be to the traditional grocery-anchored neighborhood centers, as discounters and specialty stores eat away market share and online retailers, like Amazon, take another run at grocery delivery, threatening weaker regional super-market chains. Additionally, the mom & pop shops that populate the in-line space struggle with limited access to capital and greater threats from e-commerce.

No matter what type of center, we prefer the dominant (#1 or #2) center in supply-constrained markets, particularly those in more affluent gateway metros. Most of these metros are found on the coasts: Miami, New York, San Francisco, and Seattle, among others. With increasing market bifurcation, we are especially wary of the highest vacancy metros with few supply con-straints, typically located in the nation's faster growing southern metros.

House View Portfolio

The Real Estate House Portfolio is a recommended allocation by property sector for core portfolios in the United States formulated using both quantitative modeling and qualitative factors. Our goal is to provide long-term risk-adjusted outperformance to our portfolios versus the market as a whole and against relevant benchmarks. The table below summarizes our recommended weightings in comparison with the NCREIF Property Index (NPI). We recommend an active overweight for the industrial sector, a modest underweight to the apartment and retail sectors, and an underweight to the office sector. Relative to our prior view, we recommend a greater allocation to industrial and office, at the expense of retail, and essentially no change to apartments. We remain confident in the absolute level of performance in the retail sector given our outlook for the economy. It also provides stable income and downside protection as well. At this point in the real estate cycle, we believe the industrial and office sectors are likely to provide better relative performance and our weighting recommendations reflect this view.

House Portfolio Construction – Sector Allocation

Sector	NPI Weights	Research Forecasts	Quantitative Input[1] Weights	Qualitative Inputs[2]	House Portfolio[3]	Active Bet	Recommended House Portfolio Range
Apartment	25%	• Fully valued without additional cap rate compression • Strong demographic support from a prime renter age cohort • Well into the growth cycle, allowing limited future gains in NOI	Model suggests underweight	Well into growth cycle	22%	(3%)	18% - 28%
Industrial	14%	• Expect relatively high going-in return and solid income growth as rents and occupancy rise • Benefits from expanding U.S. population and job gains as well as housing production, technology consumption and trade • Rents rising, and gain momentum in next two years.	Model suggests overweight	Attractive relative valuation, poised to outperform	25%	+11%	21% - 31%
Office	35%	• Demand forecasts are downgraded due to lower absorption per employee • Rent growth expectations have been pushed later in the forecast • Returns strong as rent growth and occupancy gains are realized	Model suggests underweight	Late recovery but near growth phase	31%	(4%)	25% - 35%
Retail	23%	• Higher yield will make long duration leases less attractive • Rent growth still slow to spread beyond top markets and retail centers • Bifurcation results in stronger winners while e-commerce will squeeze weaker retail centers further out of favor.	Model suggests underweight	Limited upside in growth cycle; muted recovery forecast	22%	(1%)	16% - 26%
Hotel	3%	N/A	Underweight	N/A	0%	(3%)	0%

[1] Quantitative inputs based on Deutsche Asset & Wealth Management Real Estate Quantitative Allocation Model.
[2] Qualitative Inputs include inputs from Transactions, Asset Management and Portfolio Management teams.
[3] House Portfolio is the target allocation that incorporates both qualitative and quantitative views in addition to tactical and strategic considerations.
Source: NCREIF and Deutsche Asset & Wealth Management.
As of August 2013.

Sustainability

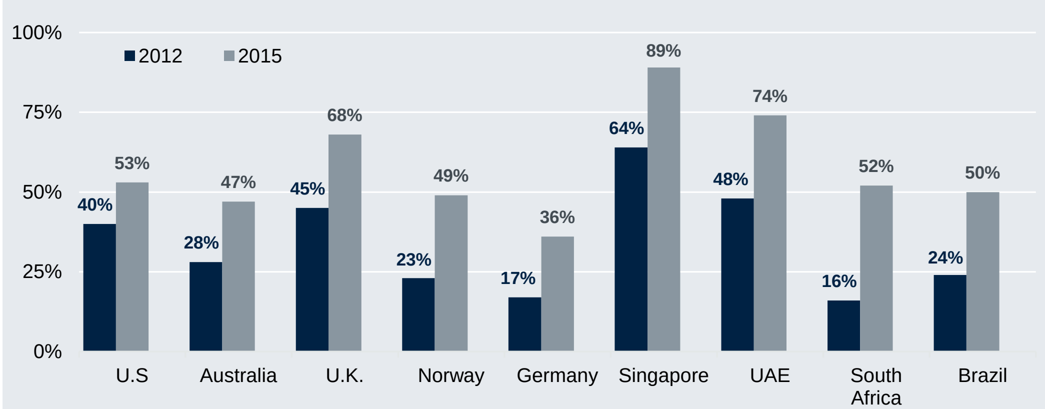
Two notable sustainability topics continue to strengthen at a significant pace: regulations impacting buildings in the United States, and the share of construction activity that is "green," globally and by region.[2]

Growth in Green Building

Green buildings continue to account for a growing share of new construction. In 2009, only 13% of architects, engineers, and contractors globally indicated that 60% or more of their work was green, according to a survey by McGraw Hill. By 2012, this figure had grown to 28% of firms globally, and respondents expect the green share will reach a majority of their work by 2015. Share of firms reporting a majority of their work was green is even higher in the United States. Over 40% of firms in the U.S. reported over 60% of work was green. Overall, in 2012 green construction is estimated to account for 38% of all projects globally.

Growth is evident across the globe, although clearly it has taken hold and will likely grow at different rates, as shown in the figure below. This growth is reflected in evolving views toward sustainability. When McGraw Hill first surveyed the global construction market in 2008, the top driver for green building was "doing the right thing," but by its sixth annual survey this year, they found that "business drivers such as client and market demand" are what matter most.

Percentage of Firms with More Than 60% of Work Green
(2012 and Expected for 2015)



Source: McGraw-Hill Construction, 2013.
As of August 2013.

Growth in Energy Benchmarking and Disclosure Requirements

In the United States, local and state laws requiring annual benchmarking of energy use in large buildings (usually greater than 50,000 square feet) continue to proliferate. Following the leads of New York City, Washington D.C., and California, nine large cities and two states now require benchmarking. Some of these, including New York City and Washington D.C., mandate that this information be publicly available. Others require the data upon asset sale, lease or financing, taking a page from the European Union regarding instances in which energy benchmarking is required. In some jurisdictions, water benchmarking is also required.

[2] "SmartMarket Report – World Green Building Trends", McGraw Hill Construction, 2013.

Also to watch are imitations of New York's regulations associated with PlaNYC covering buildings, such as requirements to conduct energy audits; employ retrocommissioning; comply with much more advanced lighting and energy codes upon building renovation; and provide tenants with submetered electricity data in all spaces larger than 10,000 square feet. Successful policies here could again be followed by other cities and states in the coming years.

Appendix – Target Metros

Investible Metros: We screened top U.S. metros, which represent 86% of the NCREIF Property Index (NPI), and identified the investment markets for each property sector that we believe have the best prospects for superior performance during the market cycle or a portion of it. This metro selection is based on property market size, liquidity, growth characteristics, income, historical returns and other factors indicative of future performance. The list of these metros remains generally static, although some metros may be added or subtracted over time due to structural market changes.

Target Investible Metros: These are a subset of the universe of investible metros and include markets expected to outperform or market perform during the next three to five years.

Investible and Target Markets

✓ Target Investible Metros ✔ Investible Metros

Market	Apartments	Industrial	Office	Retail*
Atlanta	✔	✔	✔	✔
Austin	✔	✓	✓	✓
Baltimore	✔	✔		
Boston	✓		✓	✔
Charlotte	✔			✔
Chicago	✔	✔	✓	✔
Dallas	✔	✔	✓	✔
Denver	✔	✓	✓	✓
Fort Lauderdale	✓	✓	✓	✓
Houston	✔	✔	✔	
Long Island				✔
Los Angeles	✓	✓	✓	✔
Miami	✓	✓	✓	✓
Minneapolis	✔	✔		
New York	✓	✓	✓	✓
Northern New Jersey	✓	✓		✔
Oakland / East Bay	✓	✓	✓	✔
Orange County	✓	✓	✓	✓
Philadelphia	✔			✔
Phoenix	✔	✓	✔	
Portland	✔	✓	✔	✔
Riverside	✓	✓		
San Diego	✓	✓	✓	✔
San Francisco	✓	✓	✓	✓
San Jose	✓	✓	✓	✓
Seattle	✓	✓	✓	✓
Ventura County	✓			
Washington DC	✔	✔	✔	✓
West Palm Beach	✔	✓	✔	✔
Total	**28**	**24**	**21**	**23**

*For retail properties, the top two centers in most major markets would also be recommended in addition to the list of target metros.

Source: Deutsche Asset & Wealth Management.

As of August 2013.

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Office Locations:

Chicago
222 South Riverside Plaza
24th Floor
Chicago
IL 60606-1901
United States
Tel: +1 312 537 7000

Frankfurt
Mainzer Landstraße 178-190
60327 Frankfurt am Main
Germany
Tel: +49 69 71909 0

London
Winchester House
1 Winchester Street
London EC2A 2DB
United Kingdom
Tel: +44 20 754 58000

New York
345 Park Avenue
24th Floor
New York
NY 10154-0102
United States
Tel: +1 212 454 6260

San Francisco
101 California Street
26th Floor
San Francisco
CA 94111
United States
Tel: +1 415 781 3300

Singapore
One Raffles Quay
South Tower
Singapore 048583
Tel: +65 6538 7011

Tokyo
Floor 17
Sanno Park Tower
2-11-1 Nagata-cho
Chiyoda-Ku
Tokyo
Japan
Tel: +81 3 5156 6000

Research & Strategy Team – Alternatives and Real Assets

Global

Mark Roberts
Head of Research & Strategy
mark-g.roberts@db.com

Americas

Ross Adams
Industrial Specialist
ross.adams@db.com

Bill Hersler
Office Specialist
bill.hersler@db.com

Ana Leon
Property Market Research
ana.leon@db.com

Andrew J. Nelson
Retail & Sustainability Specialist
andrewj.nelson@db.com

Jaimala Patel
Quantitative Strategy
jaimala.patel@db.com

Alexander Makarovski
Performance & Risk Analysis
alexander.makarovski@db.com

Alex Symes
Economic & Quantitative Analysis
alex.symes@db.com

Brooks Wells
Apartment Specialist
brooks.wells@db.com

Jay Wengang
Performance & Risk Analysis
jay.wengang@db.com

Europe

Simon Durkin
Head of Research & Strategy, Europe
simon.durkin@db.com

Tom Francis
Property Market Research
tom.francis@db.com

Lisa Strohbuecker
Property Market Research
lisa.strohbuecher@db.com

Maren Vaeth
Property Market Research
maren.vaeth@bd.com

Simon Wallace
Property Market Research
simon.wallace@db.com

Asia Pacific

Leslie Chua
Head of Research & Strategy, Asia Pacific ex-Japan & Korea
leslie.chua@db.com

Koichiro Obu
Head of Research & Strategy, Japan & Korea
koichiro.obu@db.com

Minxuan Hu
Property Market Research
minxuan.hu@db.com

Natasha Lee
Property Market Research
natasha-j.lee@db.com