Aberdeen Standard Pan European Residential Property Fund

Quarter 3, 2018

For professional investors only, in Switzerland for qualified investors only – not for use by retail investors or advisers

A core fund designed to invest in a sustainable residential property portfolio across Western Europe.

Investment objective and strategy

The Aberdeen Standard Pan European Residential Property Fund (the "**Fund**") is an open-ended, core fund designed for institutional investors with the investment objective to seek income and capital growth by investing in large, high quality and sustainably constructed, purpose built residential blocks in "AAA" locations that deliver Accessibility, Amenity and Affordability for the occupier. The Fund's strategy is to deliver strong, defensive returns from the residential sector with a multi country strategy that reduces risk through diversification. Residential property exhibits very strong demand/supply fundamentals, particularly in Europe's leading cities and growth potential achievable via improved operational efficiency and market rental growth. The Fund will not engage in speculative property development and will pursue active management during the holding period in order to enhance performance in a controlled fashion. The Fund pursues a long-term absolute return target, comprising a cash dividend return target of 3-4% per year, and a total return target of 5-7% per year.[1]

Quarterly commentary

Market commentary

"Our overall European real estate outlook remains positive in relation to other global markets, but is generally slowing as we have moved further through the capital market cycle."

- European direct real estate is set for another positive year of performance, owing to strong demand and supply side fundamentals and supportive financing conditions. While risks remain tilted towards the external environment and domestic growth drivers are in good shape, we believe risk adjusted returns will continue to be attractive to many pools of capital.
- The overall economic environment is more benign than in 2017, but closer inspection shows that the bulk of the weakness is coming from external factors outside Europe. Stronger domestic fundamentals, more relevant to real estate, are holding up well and we still expect Europe to grow by 2% in 2018 and by 1.7% in 2019.
- Investment demand remains strong, with over €290 billion invested over the year to Q3 2018. Competitive bidding on the best assets is continuing to support pricing. However, sector differentiation is the widest ever recorded according to the latest investor sentiment surveys, with logistics in high demand and retail out of favour. Prime yields have fallen further from all-time lows seen in late 2017, as investors compete for income and increasingly the income growth prospects in some segments.
- Our overall return outlook remains positive in relation to other global markets, but is weaker as we have moved further through the cycle. Our most-favoured investment themes in the Eurozone include the private rented residential sector, which benefits from strong population growth in winning cities, restricted supply and limited sites for new development. We also favour logistics (urban and big box), which is being supported by the growth of online retail; dominant retail locations; and alternative sectors, such as student halls and senior living.

"Stronger domestic economic performance is supported by stronger credit growth too, with liquidity in loans to the private sector, non-financial corporations and households all growing steadily at between 4% and 5% per annum."

[1] Target returns are offered as strategy goals and are not referenced to past performance. There can be no guarantee the target returns will be achieved.

Important information overleaf

Key information

Legal structure	SICAV-RAIF
Domicile	Luxembourg
Risk style	Core
Term	Open ended, infinite lifetime
Investment universe	Western Europe
Target size (GAV)	EUR >1.5 billion
Current size (GAV)	EUR 337.2 million
Minimum commitment	EUR 3 million
Target return (net of fees and taxes)[1]	Income return: 3-4% per annum Total return: 5-7% per annum
Currency	EUR
Leverage	Maximum LTV of 40% of GAV; Current LTV of 31.5% of GAV; Long-term LTV of 25% of GAV
Liquidity	Quarterly (three-year lock in with a maximum two years for repayment)
NAV reporting frequency	Quarterly
External asset valuation	Quarterly by real estate appraisers. Valuation advisors rotated every three years
Launch	29 March 2018
Annual management fee	Fund management fee of 90bps of NAV for commitments up to EUR 25 million; 80bps for commitments of EUR 25-50 million; 70bps for commitments > EUR 50 million

The value of investments and the income from them can go down as well as up and an investor may get back less that the amount invested.

For further information please contact the relevant representative from your region:

Robert Matthews, Global
Phone +44 131 528 4328
Email: robert.matthews@aberdeenstandard.com

Lina Alvemur, Nordics
Phone +46 8412 8026
Email: lina.alvemur@aberdeenstandard.com

Sin-Niew Loh, Asia Pacific
Phone +65 6395 2441
Email: sin-niew.loh@aberdeenstandard.com

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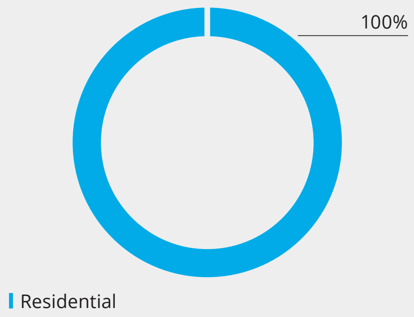
Economic outlook

- The European economy has slowly ground into a more sustained period of lower growth. The negative external environment has been the main cause, with political factors, such as Brexit, the Italian budget deficit hike and the trade war between the US and China taking their toll on sentiment. The Eurozone composite PMI fell to 54.1 in September, its lowest level for four months. While our full year 2018 GDP growth forecast remains at 2%, it is likely to end up slightly lower.
- However, in the context of real estate demand drivers, taking a closer look at what is driving economic performance gives a more positive picture. Seasonally adjusted unemployment in the EU stabilised at 6.8% in August 2018, its lowest level for over 10 years. The Eurozone equivalent fell to 8.1%, down from 9.1% a year ago. The further tightening of the labour markets in Europe is helping to support occupier demand in business space and also supports cash running through tills in the retail sector. Stronger domestic economic performance is supported by stronger credit growth too, with liquidity in loans to the private sector, non-financial corporations and households all growing steadily at between 4% and 5% per annum.
- European leases with indexation have supported net operating income growth in recent months. Eurozone consumer price inflation (CPI) broke through the European Central Bank (ECB) target of 2% in June recording 2.1%, the first time it has exceeded the target since December 2012. While the rate has remained elevated through to September, the key driver of higher inflation has been strongly rising energy prices. The oil price in Euro-terms increased by over 40% over the year to September 2018. As energy price inflation begins to drop out of the numbers, we believe modestly rising core inflation, supported by a more consistent level of wage growth, should underpin a level closer to 1.5%.
- Given the modest outlook for inflation, the ECB is expected to continue to maintain a very gradual tightening in monetary policy. Forward guidance suggests Quantitative Easing will be fully tapered by the end of 2018, with the base rate first increased by 10 to 15 basis points in the Summer of 2019. Forecasts suggest the base rate will remain below 1% until 2023.
- The surprise decision by the Italian coalition government to increase the budget deficit from 0.9% to 2.4% left markets sceptical about the sustainability of Italian debt levels and their ability to service the interest payments in the long term. The 10 year Italian bond yield increased to 3.7% on the news, highlighting investor caution over the decision. There has been very little contagion to other European markets, highlighting that the political situation in Italy is not being priced as a systemic issue for the European Union.

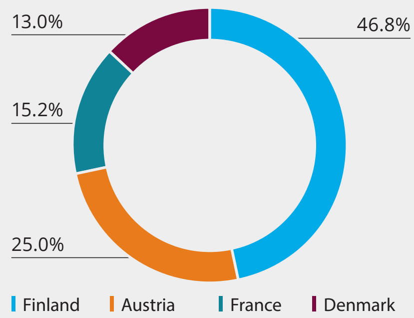
Investment market trends

- Investment demand remains strong, with competitive bidding on the most wanted assets continuing to support pricing. Total investment volumes are lower but holding up well, with €290 billion transacted in the year to Q3 2018. This represents a 5% fall over the previous 12 month period. Indeed, the most recent quarterly numbers show deal flow is slowing, as investor demand is increasingly focused on smaller segments where opportunities are less prevalent, particularly in logistics and residential sectors.
- While volumes in the office and retail segment remain the highest by sector, only logistics and residential experienced an increase in investment over the year to Q3 2018. This highlights the increasing demand for assets in segments with the strongest long term structural demand fundamentals. Q3 2018 investor intentions surveys highlight that the spread between logistics and resid ential at the top and retail at the bottom, has never been wider.

Current sector allocation (%)

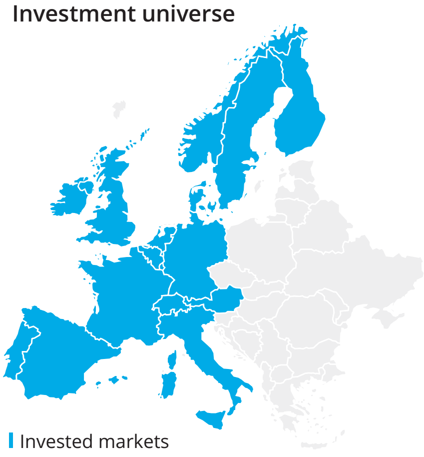


Current geographic allocation (%)



Figures may not always sum to 100% due to rounding.

Investment universe



All figures (unless otherwise indicated) are as at 30 September 2018.

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- Prime residential yields have begun to stabilise after an unprecedented period of compression, fuelled initially by huge monetary policy stimulus and more recently by income growth prospects. PRS yields of good institutional quality across Europe have fallen from 3.9% in Q3 2017 to 3.7% in Q3 2018.

Performance outlook and risk tolerance

- We expect the trend for above-average but slowing returns to continue in continental Europe and Ireland over the next 12-to-18 months. In general, prime asset yield compression has now run most of its course, although the best secondary assets are now benefiting from the trend and by sector.
- The range of forecast returns between segments is narrowing, with logistics expected to be the best performing segment and residential short thereafter. Low-yielding and low-growth segments, including some high street retail are expected to see the weakest performance. While for both logistics and residential income returns are expected to remain an important component in addition some further capital growth is forecasted especially in the next three years period.
- Our overall return outlook remains positive in relation to other global markets, but is slowing as we have moved further through the cycle. This is corroborated by our measure of long term worth. Ware moving through the strongest phase of the cycle, we do not see any specific triggers for a correction in values at this stage, although there are risks that could bring forward a more cautious investment market scenario.

Chart: Short-term indicators: positive in all continental European markets; flat for UK

Note: Capital value direction is determined by a net result of six indicators, with a double weighting applied to property investor sentiment.

Across the six short-term indicators, net scores are calculated by subtracting negative results from positive results. Capital value direction is judged as follows: net score of +3 or greater is up, net score between -3 and +3 is stable, and a negative score of -3 or weaker is down.

Q3 2018	REITs	Availability of Funding	Economic Outlook	Rental Value Outlook	Bond vs. Prop Yields	Property Investor Sentiment	Direction of Capital Values
Eurozone	+		+	+	+	+	+
Nordics	+	+		+		+	+
Central Europe	Not Covered	+	+	+		+	+
France		-	+	+		+	+
Germany	-		+	+		+	+
Italy	Not Covered	+	-		-	+	
Spain	+		+	+	+	+	+
UK	-	-	-	-	+		

Source: Reuters Ecowin, IPD, RICS, IFO, Aberdeen Standard Investments, September 2018

“We do not see any specific triggers for a correction in values at this stage, although there are risks that could bring forward a more cautious investment market scenario.”

Investment themes, house view and recommendations

Our key stock selection themes remain unchanged and are as follows:

- Residential – private rental sector. Strong population growth in winning cities, restricted supply with tight planning controls and limited sites for new development. Maturity and market size can be an issue when venturing outside Germany, Austria, Switzerland, Netherlands and the Nordics.
- Student halls and senior living. These can provide durable, high-quality income because of limited vacancy risks and typically strong covenants, while the demand drivers offer funds genuine diversification of cash flows. Covenant strength is a key risk that needs to be tested rigorously.
- Prime logistics units and multi-let estates in supply constrained urban areas. There is strong demand for 'last mile' delivery hubs for retail goods bought online; vacancy rates are low and competition from higher-value land uses is limiting supply too. However, falling yields have reduced the initial income return and future income growth is often harder to generate.
- Dominant, well-located retail assets with a convenience anchor, good food and beverage offer or strong and diversified customer base. Changing consumption patterns and technology are making some retail assets overpriced relative to future income potential. However, we believe certain retail formats still offer strong cash flows, diversification and leasing tension. Close attention needs to be paid to competing centres and rent levels, especially when considering the impact of re-letting potential voids.

Transaction

In June 2018, the Fund proceed with its first investment by acquiring a high quality core asset in Vienna's 3th district. In July, three further high quality transactions could be signed in the South Harbour of Copenhagen, 10th district of Vienna and Suresnes in Paris followed by a portfolio transaction in the Helsinki Metropolitan Area. In total, 1,433 apartments have been secured with a lettable area of 92,201 sqm. The net value of these investment properties is EUR 443.7m.

Properties in Birmingham, Copenhagen (x2 assets) and Paris (x2 assets) are currently under exclusivity and in due diligence. Assets under negotiation are currently in Frankfurt (x2 assets).

This brings the total pipeline volume to 7 properties for a total net value of about EUR 420 million.

Key activities

In March 2018, the Fund was established with First Close commitments of EUR 355.5m by nine different investors from four European countries. As at 30/09/2018, the Fund has committed equity of EUR 398.2m. Main target is to secure assets and sign the transactions under exclusivity to allocate the committed capital by end of the year. A strong investment pipeline shall built up interest and commitments for the next close end of the year. The Fund pursues an ESG strategy with a strong focus on sustainability.

Asset management

Local management expertise and resources are among our key strengths in Europe. Having native speakers on the ground, with local expertise and networks, is essential for maximising portfolio returns and optimising risk control. The current focus is on overseeing the development status of the different construction phases and letting activities in the standing investment in the South Harbour of Copenhagen and Helsinki Portfolio to achieve an occupancy rate of 100%.

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Important information

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