

Europe Real Estate Strategic Outlook

December 2024

IN A NUTSHELL

- Promising new chapter for European real estate as we expect limited new supply, strong rent growth and yield compression over the next five years. However, focus on real estate fundamentals more important than ever.
 - Our investment strategies and market calls prioritise supply-constrained markets, with a focus on logistics and residential, where the limited availability of space and a constrained supply outlook could help sustain rental growth.
 - Compelling value-add opportunities in the living sector, capitalising on a rare convergence of improving fundamentals, pricing dislocation, new living solutions, and technology-driven operational efficiencies.
 - Niche real estate sectors – such as data centres, senior living and healthcare – appear poised for growth, driven by demographic shifts, technological advancements, and evolving market demands.
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1 / Market Outlook

Over the past two years, the European real estate market has faced a challenging downturn, marked by declining values and volatile financial markets. Yet, as of the second half of 2024, a sense of optimism has begun to permeate the market. Prime yields have found their footing, stabilising after a prolonged period of price correction. Property price indices and total returns have turned positive, signalling we've turned a corner. Market fundamentals held strong in 2024, with robust prime rent growth driven by low vacancy of modern stock. And adding to this positive momentum, the easing interest rate environment has provided a much-needed boost to financing conditions and liquidity. This confluence of factors has set the stage for what we expect to be promising new chapter in real estate investment, brimming with opportunities for growth and stability.

Interest rate cuts are now well underway across Europe, providing tailwinds for the industry. In the Eurozone, DWS expects another 125 basis points of rate cuts by the end of next year, bringing the deposit rate down to 2% by December 2025.¹ In the Nordics, Sweden's Riksbank has been the most aggressive to date, reducing rates by 125 basis points between May and November. Meanwhile the Bank of England base rate sits at 4.75%, with more cuts to come, possibly bringing the bank rate down to 3% at the end of next year.²

¹ DWS CIO View 2025, November 2024

² DWS CIO View 2025, November 2024

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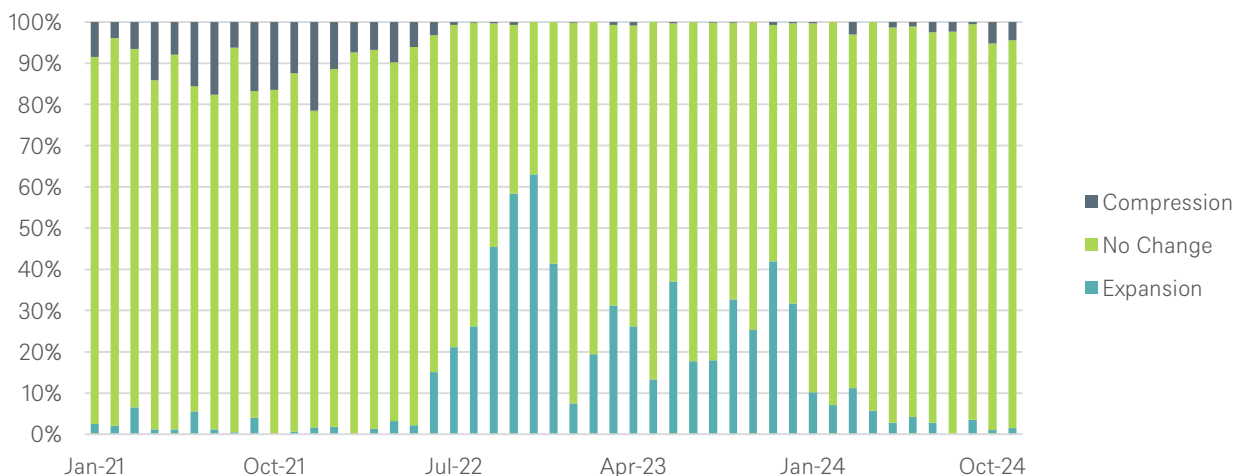
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The recovery is unlikely to be all smooth sailing, with geopolitical tensions and bond market volatility casting shadows. Potential business failures, driven by relentless cost pressures, add to the uncertainty, while pivotal European elections are also on the horizon. Investors may need to tread cautiously as the real estate market navigates a complex landscape, and as such, focusing on underlying real estate fundamentals is more important than ever.

Real estate pricing and transaction volumes

Following a period of price corrections in 2022 and 2023, which we estimate at around -20% across core sectors, prime values stabilised during the summer of 2024. We’ve seen some encouraging data points, implying signs of recovery. Yield expansion is broadly over, with even some yield compression in a handful of markets (see chart below). Green Street’s real-time market value index is up 2.5% since the start of the year, suggesting stable yields and rent growth driving up values,³ while INREV’s ODCE fund-level index showing positive total returns in both Q2 and Q3 for Europe’s core funds.⁴

European Monthly Net Initial Yield Movement (Share of 600 city & sector markets)



Source: CBRE, November 2024

On the capital markets side, conditions have shown signs of improvement in recent months, sentiment indicators are trending higher and liquidity is gradually returning. Year-on-year investment volumes turned positive in Q2 2024 for the first time in two years,⁵ driven largely by logistics and residential. The office sector has shown limited signs of recovery, with the exception of London and Paris. At the country level, the United Kingdom is leading the revival in transaction volumes, while Germany is lagging. Moreover, investor sentiment has been on the rise according to the RICS global survey. For the first time since early 2022, optimistic views outnumber negative market assessments, suggesting a further uptick in activity in the coming quarters.⁶

³ Green Street Commercial Property Price Index (CPPI), November 2024

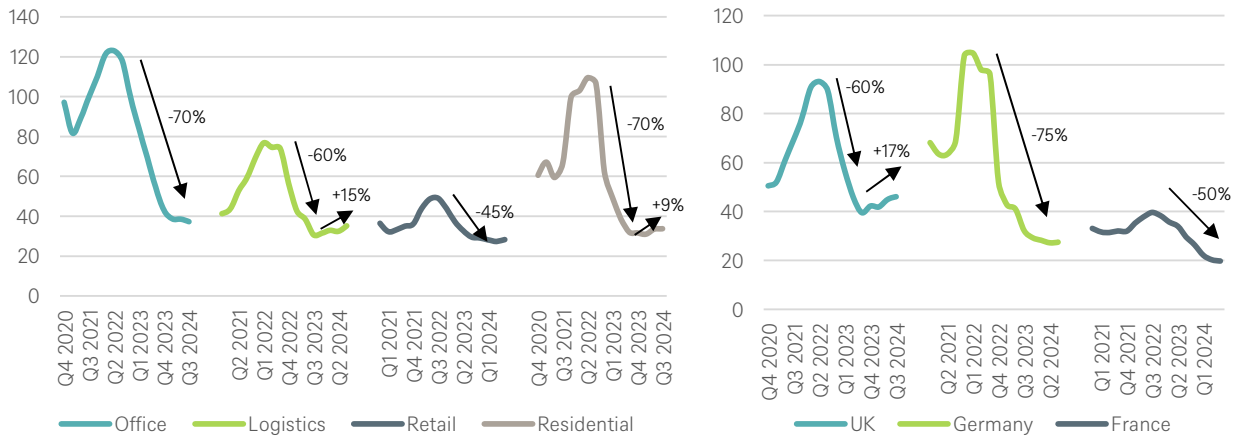
⁴ Reference ODCE and PEPFI

⁵ RCA, October 2024

⁶ RICS, Q3 2024

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Transaction Volumes Europe (€ billion, rolling annual value)



Source: RCA, November 2024

Sector outlook

As we move beyond the shadows of European recession, the real estate industry stands on the cusp of a promising recovery. Robust occupier fundamentals underpin this optimistic outlook, yet we observe a growing polarisation between locations and asset qualities. This intensifying divide is creating a landscape where the discrepancies across sectors and markets are more pronounced than ever. Such uneven trends are likely to result in a greater dispersion between the "winners" and "losers." Against this backdrop, prime assets continue to shine, driven by an ongoing flight to quality pushing up rents.

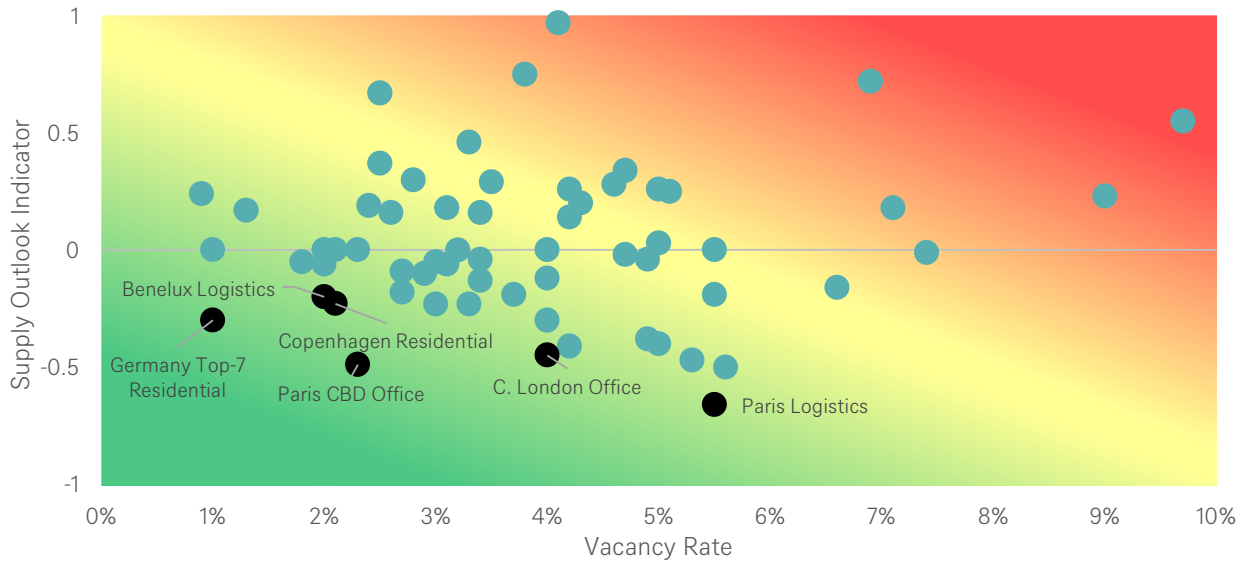
However, this recovery is not without its risks. Geopolitical tensions pose a potential threat to demand, and the widely anticipated increases in US tariffs could have economic repercussions in Europe. With economic growth remaining modest, tenant demand and take-up for commercial real estate may experience a sideways trend, reflecting the cautious sentiment in the market.

As we navigate these complexities, focusing on real estate fundamentals is more important than ever. As economic growth remains modest, long-term structural drivers as well as the outlook for supply and occupancy are expected to be the primary drivers of rent growth. Often the vacancy rate – and the change in vacancy – is the biggest driver of near-term rent growth. Barriers to future supply, development margins and the impact of regulations on future development are a good gauge of medium-to-long-term rent growth. The viability of future developments will likely require a considerable uplift in values, as rising development costs (including financing) and repricing have substantially reduced development profit margins.

The chart below provides a tool for investors and developers to help assess market conditions and make informed decisions about property development, acquisition, and leasing strategies. A low vacancy rate coupled with a constrained supply outlook suggests a landlord’s market, where demand outstrips supply, potentially leading to higher rents and lower tenant incentives. However, we may see differences in rent growth between micro locations and quality of stock besides, rent growth is not the only factor that determines an investment decision.

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European Market Vacancy Rate vs. Supply Outlook



Note: Supply outlook indicator is based on vacancy trend, barriers to future supply, growth in construction costs, development margins and regulation. Office vacancy refers to grade A vacancy.
 Source: DWS, broker sources, Oxford Economics, Green Street, December 2024

Our sector-level outlook remains largely unchanged compared to earlier in the year. We continue to favour logistics and residential, as both sectors remain on an upward trajectory that began over summer. The retail sector reappears on the investment agenda, while offices mostly remain out of favour.

European **logistics** finds itself at a crossroads. Demand, fuelled by the ongoing e-commerce boom, remains strong, yet the market is experiencing a subtle shift. Vacancy rates, which had been at historic lows, have risen as pre-correction developments are delivered at a time of moderating post-Covid demand. Although at a little over 4%, current European vacancy is still well below the 12% seen in the years immediately post-GFC,⁷ and demand for modern, high-quality logistics space has typically absorbed most new supply. Market and asset selection will be more important for the logistics sector this time around. Rent growth is anticipated to continue at a robust, albeit more moderate pace, with prime rents forecasted to increase by around 3-4% per annum over the next five years. Biddings are getting increasingly competitive, and prime yields might start falling in the very near term.

Residential is the most supply constrained sector, with chronic and increasing undersupply. Despite persisting concerns about affordability and regulation in some European markets, demand-supply imbalances remain a critical issue without an imminent solution. Demand remains robust, particularly in growing cities, where urbanisation and lifestyle changes drive the need for housing. High mortgage rates are also nudging more people towards renting, intensifying competition for rentals. Vacancy rates are low, reflecting the tight supply, as new construction struggles to keep pace with demand. This imbalance is pushing rent growth upwards, with rates expected to rise steadily throughout the next five years. Looking ahead, the sector is poised for continued resilience, with continued strong demand and limited supply. We forecast prime rents to grow by 3-4% p.a. over the next five years. In addition, yields are already starting to compress in key markets – a trend we expect to accelerate next year.

⁷ CBRE, November 2024

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The European **office** market is seeing some signs of cautious optimism. Demand is gradually picking up, driven by a slow but steady return to office environments and evolving workplace strategies. Occupiers are increasingly focused on rightsizing and enhancing the quality of their spaces, leading to a noticeable polarisation between prime assets and lower-quality properties. Vacancy rates are nearing their peak, with high-quality new spaces becoming scarcer. New supply also remains tight, with development activity falling. Despite challenges within the sector, rent growth is expected to be positive, with prime rents forecasted to rise by around 2-3% over the next five years. Again, we expect a wide divergence between (sub)markets. Yields are already getting tighter in key markets such as Central London, Paris CBD and selected German cities for high-quality assets.

Demand for prime **retail** locations has picked up as retailers hope for renewed consumer enthusiasm driven by rising real wages and easing inflation. However, cost pressures remain a constant challenge, with many retailers navigating the delicate balance between maintaining profitability and attracting foot traffic. Vacancy rates, though slightly elevated, have begun to stabilise, particularly in prime assets. The limited supply of high-quality retail spaces has further fuelled competition, pushing rents upward after a period of declines. As the year progressed, rents rebased and started to grow, reflecting the market's cautious optimism. Looking ahead, we forecast a steady growth of 1-2% p.a. over next five years. Yields may stay somewhat elevated, making this a cash-on-cash play.

Total return outlook

As 2024 ends, the outlook for European real estate in 2025 and beyond shines brighter. Yields have stabilised, and the cycle of interest rate cuts suggests potential yield compression, adding a layer of excitement to the investment landscape. With development profit margins under pressure, new supply is expected to remain limited, driving strong rent growth. We believe the year 2025 is set to be a standout vintage year marked by exceptional returns. Over the next five years, property-level returns are projected to significantly exceed the long-term average, potentially making it an ideal time to deploy capital.



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2 / Investment Strategies

Logistics

What: Logistics occupiers are increasingly seeking best-in-class product with the highest specifications, and aspects such as dock-to-door ratios, floor loading capacity and clear internal height are often imperative. With that in mind, we would typically target modern assets in last-hour locations, especially in supply-constrained areas.

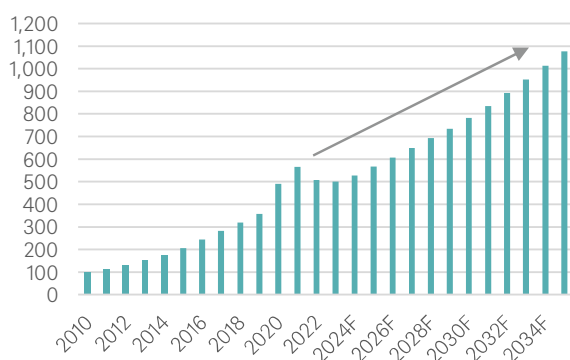
Why: Logistics still has low availability of high-quality stock, despite an uptick in new supply. Demand for modern, high-quality, logistics space has typically absorbed most new supply. The demand for prime logistics assets still well exceeds supply, creating a fiercely competitive landscape in selected markets. Investment appetite is strong, and logistics is ranking high on investors' wish lists. There is a pressing risk of missing the window to capitalise on expected yield compression, making timely and strategic investment decisions more crucial than ever.

Where: *Benelux, Paris, Southern France, CEE and Italy*

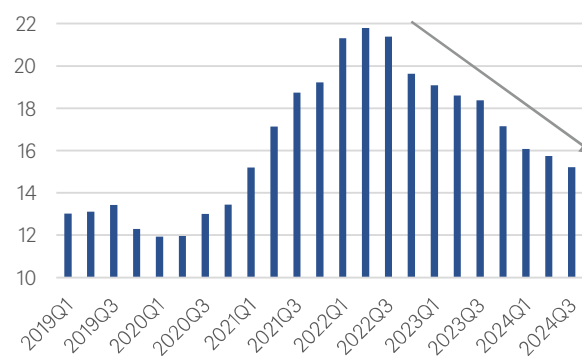
- Benelux stands out due to generally tight supply and strong international demand, which should lead to strong rental growth over the next five years.
- Vacancy rates are exceptionally low, driving strong potential rental growth in Paris and Southern France.
- Central and Eastern Europe also shows promising prospects for robust returns driven by higher entry yields and nearshoring demand. Coupled with a strongly growing economy, Poland in particular is seen as a beneficiary. However, given healthy supply and elevated vacancy rates, this could be a strategy that plays out well in the medium term.
- Ongoing supply shortages and the development of Northern Italy (including Milan) as a key hub in the Southern European logistics corridor.

The **data centre** sector – which could be seen as a subsector of logistics – is underpinned by strong fundamentals and significant growth potential. Demand is significantly outstripping supply, with no signs of slowing down. Data centres are becoming more concentrated, primarily due to the 'network effect.' Leading data centre markets have expanded by attracting physical infrastructure, such as networks and fibre. Real estate investors can access the data centre market through the investment of powered shells, which involve securing long leases with single tenants, with market entry typically facilitated through build-to-suit developments or sale and leaseback agreements. However, gaining access to such product might be difficult with relatively few transactions in the market. An alternate way of accessing the sector would be via private real estate debt.

Online Retail Sales* (€bn, 2015 prices and exchange rates)



Logistics Space Under Construction** (Million SQM)



*EU and UK

**Total of Belgium, Czech Republic, France, Germany, Hungary, Italy, Poland, Spain & Sweden

Source: DWS, Property Market Analysis, Oxford Economics, JLL, December 2024

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Residential

What: We prefer new-build residential assets, especially in commuter locations within major cities, given the better affordability ratios. These assets provide the ability to increase rents in line with the market and meet ESG-related goals including energy efficiency ratings, air quality and carbon emissions. Co-living concepts could also work well in fast-growing cities with high-productivity employment.

Why: Residential is the most supply constrained sector, with chronic and increasing undersupply. Despite persisting concerns about affordability and regulation in some European markets, demand-supply imbalances remain a critical issue without an imminent solution.

Where: *Germany top-7, Spain, Copenhagen*

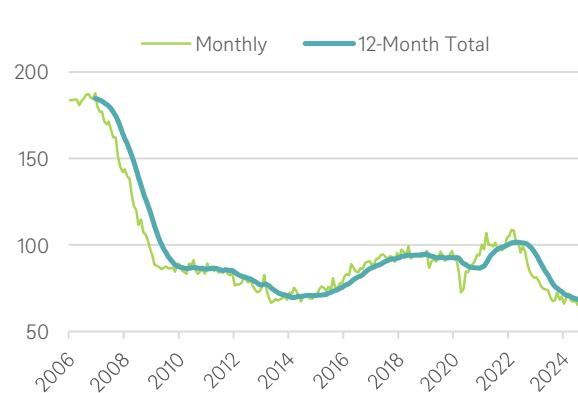
- Countrywide vacancy levels were trending down further to 2.5% in Germany, while in both major hubs and dominant regional cities, vacant space is virtually non-existent.
- The demand for more affordable housing underlines the acute strain on households posed by rising rents in Madrid and other key cities in Spain. We still see an opportunity for investment in the residential sector where there is some degree of public-private partnership.
- Copenhagen is supported by a persistent demand-supply imbalance. In commuter locations, such as Herlev and Glostrup, affordable build-to-rent offers stronger rent growth potential and higher entry yields than city centre multi-family, which should facilitate more attractive risk-adjusted returns.

On the operational residential side, we believe the **senior living** sector is poised to benefit from demographic and societal trends. A model whereby the investor directly lets age-restricted residential units to individual tenants and hospitality or medical space to an operator is possible in some markets, including the Netherlands and Germany.

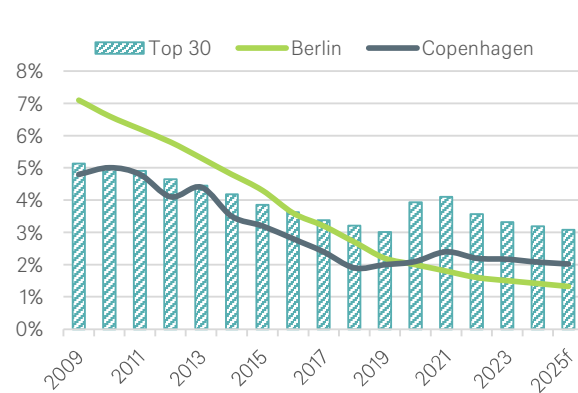
Student housing is once again proving its resilience through an economic downturn, with strong rental growth and below-average value declines compared to other sectors. Demand is coming from both domestic and international students, given the lack of good-quality purpose-built student accommodation (PBSA) and tight for-rent residential markets. Direct-let strategies that include management contracts with operators are closest to the build-to-rent model. Continental European markets – including Germany, Spain and Italy – score well based on low provision rates, growing student numbers and tight residential markets.

The scalability of both senior living and student housing are robust, supported by favourable market fundamentals. The expertise and knowledge acquired through traditional multi-family investments can often be leveraged effectively, as both sectors are akin to the build-to-rent sector.

EU Residential Building Permits (volume Index, 2021 = 100)



Residential Vacancy Rate (%)



Sources: Eurostat, Greenstreet, December 2024

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Office

What: Trophy assets continue to attract strong bids with lower-levered buyers taking the lead in bidding processes. Meanwhile, lower-quality assets are struggling operationally and are facing limited interest. Interestingly, while trophy offices are drawing the most attention, there lies a strategic opportunity to acquire well-located, high-quality offices that require only modest capital expenditures. These properties, just a notch below trophy assets, present a compelling investment case.

Why: At present, much of the European office sector remains out of favour among investors, although rent growth appears to have exceeded expectations in 2024, showing strong momentum in prime rents – a trend we anticipate will continue in the coming years. Additionally, a small handful of markets are beginning to show early signs of price recovery. Recent transactional evidence in the City of London and Paris CBD, for example, indicate yield compression for prime product.

Where: *London City, Paris CBD fringe, select German markets*

- London City's prime office market is expected to be a notable rental outperformer, supported by robust fundamentals, and its position as a more affordable submarket versus the West End.
- Paris CBD is already experiencing an increase in liquidity and has already seen some yield compression, and the more affordable CBD fringe areas in particular are seeing a rise in tenant demand for inner-city office locations.
- The supply pipeline in Germany's top-7 office markets continues to trend downwards. Vacancy rates are stabilising, with the potential for renewed decline, particularly for grade A stock. Berlin, Hamburg and Frankfurt should see the strongest rent growth.

Medical offices may present a compelling alternative to office investments. Favourable demographic trends, increased healthcare spending and a shortage of modern, purpose-built medical facilities underpin the sector's potential. Moreover, healthcare real estate often features long-term leases with sticky, office-like tenants, ensuring stable income streams. Investors can gain exposure to healthcare through the acquisition of existing portfolios, which may require capex, or through development.

Retail

What: Retail parks, with their affordable rents and low capital expenditures, attract a steady stream of tenants and shoppers. Supermarkets, known for their e-commerce resilience and ability to pass through inflation costs, remain essential fixtures in communities. Outlet centres, with their consistent performance across economic cycles, draw in value-conscious consumers.

Why: Retail has weathered three significant challenges: the rise of e-commerce, the COVID-19 pandemic, and the latest repricing cycle driven by higher interest rates. There is now a growing consensus that the market has fully adjusted.

Where: *United Kingdom, Spain and Italy*

- UK retail parks look attractively priced and well placed to outperform.
- Dominant Spanish shopping centres are attractively priced and have affordable rents for tenants.
- Expansion of discounter supermarkets in Italy could also be an opportunity to gain exposure to a resilient sector.

Value-add strategies

The European real estate market presents a compelling value-add opportunity for investors, particularly in the living sector. Strong fundamentals, such as low vacancy rates, falling supply, and robust rent growth, coupled with a pricing correction, create a unique window for investors. A comprehensive asset management approach is essential to align properties with tightening regulations and to provide future-fit living solutions. This strategy not only helps ensure compliance but also can help position assets to capitalise on the high growth living sector. Key components of this strategy include living-to-living refurbishments, which focus on rent increases and unit size optimization, and (re)development of under-valued or sub-optimal sites and structures. These efforts are aimed at unlocking the full potential of permitted plots and enhancing their value.

Repurposing existing structures, such as converting offices or parking spaces into living spaces like co-living, serviced apartments, or student housing, is another critical element of this strategy. Conversion to the highest-and-best use maximises the utility and profitability of the assets. Operational excellence and diverse living solutions further drive value creation for investors, ensuring that properties are not only future-fit but also aligned with market demands. Focusing on these strategies, may help drive significant value and create sustainable, high-performing living properties.

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3 / Country Performance

Risk-adjusted returns become more diverse: sector and location story replaces country views

The **German** market exemplifies the current prolonged and bumpy recovery story. So rather than focusing on the next year, we should focus on a five-year horizon when it comes to a rebound in the real estate industry. With sentiment downbeat, one could easily overlook the potential of the country. However, Germany remains our top pick on a risk-adjusted basis as fundamentals remain exceptionally healthy. The residential market is undersupplied, developments in the office sector continue to fall and logistics is benefitting from very low vacancy. Focus on top-7 markets across sectors.

Having been one of our top picks over the past twelve months, the outlook for the **United Kingdom** has somewhat lessened over recent months, reflecting in part rising borrowing and hedging costs, but also rising valuations and lowering prime yields relative to the rest of Europe. Despite the downgrade, we continue to favour London office, regional logistics and retail.

We anticipate notable variance in the recovery across different countries. However, our key focus remains on cities rather than countries. Urban centres with stronger fundamentals and more resilient economies are expected to see an earlier return of liquidity and a faster rebound.

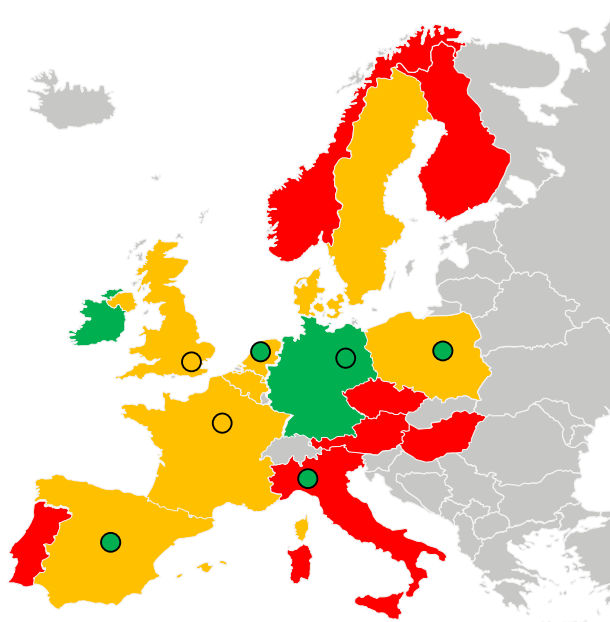
Cities like **Berlin, Paris, London and Amsterdam**, with their robust infrastructure and dynamic economic activities, are set to lead the recovery. Conversely, cities with weaker fundamentals (i.e. slower population, job and wage growth) may experience a slower pace of revival, underscoring the importance of a strategic, city-focused investment approach to capitalise on diverse opportunities within the European real estate landscape.

Poland presents an appealing story. The country offers an attractive outlook on a risk-adjusted basis, making a compelling case in the medium term. The economy is improving further and the political tone more accommodating. Beyond the office sector, the outlook on logistics is particularly positive. While last mile locations around Warsaw are set to benefit from a strengthening of consumers, manufacturing hubs (e.g. Silesia) could profit from re-shoring. Also, the current strong supply pipeline is fading, likely lowering vacancy rates, thus increasing rental pressure.

Outside of the gateway cities, a slower return of liquidity could provide investors with a window to benefit from more attractive pricing. We like **Madrid** for its vibrant real estate market, driven by strong demand and dynamic economic activities. The city boasts robust infrastructure, a thriving cultural scene, and significant international appeal. Additionally, **Spain** is projected to be one of the fastest-growing economies in the Eurozone. **Milan** stands out with its business environment, and strong demand for high-quality properties. The city consistently attracts international investors and businesses, driving liquidity and stability in its real estate market. **Dublin's** real estate investment fundamentals are strong, driven by robust economic growth, a thriving tech sector, and a young, educated workforce.

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Market Calls (all sector average)



Source: DWS, December 2024

Note: Based on DWS in house real estate return five-year forecasts for office, logistics, residential and shopping centres. Green = Positive, Orange = Neutral, Red = Negative

4 / Country Summaries

| | | |
|-----------------|---|---|
| Germany | <ul style="list-style-type: none"> – Political uncertainty and new elections present both risks and opportunities. Increased government spending is possible and could push economic growth after two years of stagnation. – We expect gradual recovery but pronounced sector differences. Office sentiment is still challenging despite prospects for strong returns and rents, with Frankfurt and Hamburg at the top. | <ul style="list-style-type: none"> – Residential remains our top pick given the huge supply imbalances and strong rent growth across all top-8 cities. Commuter locations and refurb strategies are also in focus. – Logistics remains positive but more selective given increasing supply. We favour Munich, Frankfurt and Düsseldorf but are more cautious in the north and east, such as Berlin and Bremen. |
| France | <ul style="list-style-type: none"> – Cuts to national expenditure are likely to weigh on short-term economic growth rates. – Yields are now stable in most sectors and are even starting to compress for logistics, Paris CBD offices, and PBSA, narrowing the window of opportunity to maximise total returns. | <ul style="list-style-type: none"> – PBSA is developing quickly as an investable sector, with Paris leading the way in terms of investment volumes, development opportunities and student demand. – Oversupply in logistics persists in Hauts-de-France but in regional markets further south, vacancy rates are exceptionally low, driving strong potential rental growth. |
| UK & Ireland | <ul style="list-style-type: none"> – Economic growth remains weak, but enhanced government spending, alongside further anticipated rate cuts in 2025, should support economic recovery over the medium term. – Select markets, such as London City offices and UK logistics, have shown early signs of price recovery. The window of opportunity for excess returns is already starting to narrow. | <ul style="list-style-type: none"> – London City's prime offices are expected to be a notable rental outperformer, supported by robust fundamentals, and its position as a more affordable submarket versus the West End. – After a prolonged period of correction, retail liquidity appears to be recovering. Retail parks that emphasise experience, leisure and necessity are expected to perform well. |
| Southern Europe | <ul style="list-style-type: none"> – Even with a slight slowdown in H2 2024, Spain is likely to be one of the fastest-growing economies in the Eurozone. Italian growth is slower but Milan is a clear national outperformer. – The main opportunity is in supply-constrained logistics hubs, chiefly Milan, Rome, Barcelona and Valencia, where rental growth rates are likely to outperform. | <ul style="list-style-type: none"> – Residential regulatory constraints are driving investment into operational sectors including co-living and student housing, which are both highly undersupplied relative to demand. – Retail in both Iberia and Italy is seeing a turnaround in performance as vacancy rates decline and investor sentiment improves. |
| Benelux | <ul style="list-style-type: none"> – With stringent planning controls, such as the limitation of greenfield development, and a scarcity of high-quality space, there is potential for development-led strategies. – A swiftly ageing population and a deficiency of suitable, high-quality senior living options create an opportunity for investment in this sector. | <ul style="list-style-type: none"> – The pronounced scarcity of student accommodation, coupled with the increasing presence of international students, make investments in the PBSA sector promising. – A privatisation strategy for residential assets could be profitable as owner-occupied (and vacant possession) house prices keep rising |
| Nordics | <ul style="list-style-type: none"> – The Nordic capital cities are expected to be European economic outperformers over the forecast period, supported by continued urbanisation and robust employment growth. – Copenhagen residential remains a top pick. Target operational residential, such as PBSA and co-living, in central Copenhagen and affordable build-to-rent in commuter locations. | <ul style="list-style-type: none"> – Logistics supply remains tight in both Copenhagen and Helsinki, supporting healthy rent growth prospects. In Stockholm our logistics outlook has been downgraded given elevated vacancy. – Stockholm's office market is supported by strong employment growth prospects and a constrained supply pipeline. However, pricing remains expensive, limiting returns over the forecast. |
| Central Europe | <ul style="list-style-type: none"> – Poland remains an economic outperformer, likely seeing accelerated growth in 2025. The key drivers are real household income growth and investments, fuelled by EU-funding. – Fundamentals in the logistics sector have weakened, as supply has outpaced demand, leading to higher vacancy. However, we see re-shoring as a strong driver going forward. | <ul style="list-style-type: none"> – Despite elevated vacancy rates in the office sector, rental pressure on prime assets persists thanks to continued polarisation. Prime yields are stable and trending sideways. – Slowing supply in the residential sector is driving prices higher. We see the residential sector continuing to mature, with a focus on operational residential. |

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