

Marketing Material*

July 2020 / Research Report

EUROPE REAL ESTATE STRATEGIC OUTLOOK

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Table of Contents

1 / Executive Summary	3
2 / Private Real Estate	4
2.1 Occupier Fundamentals.....	4
2.2 Capital Markets.....	7
2.3 Returns and Market Calls	11
3 / Private Real Estate Debt	16
4 / Listed Real Estate	17
5 / Appendix	18
Research & Strategy—Alternatives	19
Important Information	20

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1 / Executive Summary

European real estate has shown its resilience over the past four months. Having entered this downturn in a strong position, and with the support of exceptional action from government and central banks, values have so far fallen less than expected. However, this is no time for complacency. While we continue to see attractive long-term opportunities, the coming months will be challenging.

We remain concerned about parts of the occupier market. The real estate market started this year on the front foot, but with unemployment rising and millions of employees still supported by furlough schemes, we do not see an immediate increase in occupier demand. However, the picture is far from uniform. Prime office rents are forecast to fall by 6% this year, but residential and logistics look far more resilient, particularly urban logistics where surging demand for home delivery is pushing rents higher. In contrast, an already weak retail market remains under considerable pressure.

Overall we expect all property prime values to fall by around 10% in 2020. This is an improvement on our March forecasts, and reflects our view that yields will not rise by as much as we had originally feared. While transaction volumes are down compared to a year ago, there remains a large amount of dry powder ready to invest. And with recent improvements in equity and bond markets, real estate pricing is once again looking relatively attractive. Assets with a strong income and a long-term growth story continue to attract considerable attention and may even see yield compression.

Looking further ahead, the market is forecast to enter its recovery phase from next year onwards. Initially led by yield compression, we expect returns to turn positive in 2021 before accelerating into 2022 with the return of rental growth.

We see the most attractive risk-adjusted returns in Core European markets such as Germany, Paris, the Netherlands and the Nordics. London also stands out as a top pick, although there are clear short-term risks around Brexit. Logistics and residential remain the top performing sectors, with attractive opportunities across almost all major cities. We're more cautious on office, and while prime CBD demand should improve with the jobs market, structural changes are increasing the risk of obsolescence – something that will continue to weigh heavily on the outlook for shopping centres.

The European market has weathered this storm better than many of us were expecting. However, the storm is not over yet. While it's right to prepare for the recovery, risks remain elevated. With this in mind it is important we retain a focus on sustaining current income while also looking to benefit from long-term structural drivers.

EUROPE REAL ESTATE SUMMARY:

Occupier Market	Elevated income risk over the coming quarters as rent collection rates remain below average and vacancy rates rise.
	Job losses leading to rental decline. Residential and logistics the most resilient sectors.
	Rental recovery forecast from 2022 onwards, supported by economic growth and a reduced pipeline of new supply.
Investment Market	Reduced investment activity but sales volumes expected to pick up in the second half of 2020.
	Prime yields rising less than expected in 2020, and expected to be lower for longer over the coming years.
	Prime returns falling by less than had been expected in 2020. Positive total returns forecast from next year.
Investment Strategy	Overweight calls on logistics and residential. Neutral call on office. Underweight shopping centres.
	Strategic focus on commuter residential, last hour logistics and next generation offices.
	Outperforming markets expected to include Germany, Paris, Netherlands and Nordics. U.K. well priced but Brexit risk remains.

Source: DWS, July 2020. No assurance can be given that any forecast will materialise.

2 / Private Real Estate

2.1 Occupier Fundamentals

We still have limited data with which to assess the state of the European occupier market since the Covid-19 crisis has taken hold. First quarter data offered relatively little insight into the potential effects, and the early signs suggest that second quarter data will offer little more. Ongoing government support to businesses and employees has so far prevented a raft of business failures, meaning that many occupiers, even if not fully occupying their space, have continued to pay rent. This is not the case for retail, however, where rent collection rates have been among the hardest hit.

During the second half of the year, we would expect that government support will gradually begin to be withdrawn. We may begin to see more lease forfeitures and rising vacancy among certain sectors, leading to a rebasing of market rent levels. This is most notably the case for retail, where we expect a sharp fall in prime shopping centre rents over the next two years. But the hotel sector is also likely to be strongly impacted, and we are forecasting rental declines to varying degrees for offices and logistics. We believe the residential sector will weather the storm best, with rent collection rates remaining high so far, but even here we would expect some negative impact to occupancy and rental growth in the near term.

For some sectors, the medium term outlook could receive a boost from lower development activity and a strong economic bounce back. However, at the same time, even less-affected businesses will start to reassess their longer-term space needs, with implications for future demand. Decisions over lease renewals and business moves are also likely to take longer. As always, sector averages mask a range of outcomes by city and country, but at the pan-European level we do expect that short-term changes to working practices, shopping habits, supply chain mechanics, travel and study will, to varying degrees, persist into the future, impacting future occupier trends.

Our view is that over the long term, logistics and residential are likely to be the winners here, with offices, hotels and retail all seeing some measure of lasting negative impact. Nevertheless, with shifting demand patterns, there will still be bright spots even within the weaker performing segments of the market.

Office: At the beginning of this year, the pan-European vacancy rate had fallen to 6.4%, its lowest level in 18 years; prime rents were growing at an annual rate of more than 5%; and the near-term supply pipeline wasn't hugely out of line with expected demand.

At the time of writing, we don't yet have a complete set of second quarter data, but we do expect to see some significant changes to occupier conditions by the end of this year. To date, the economic impact of Covid-19 has been cushioned in a number of ways by governments across the continent. And at the same time, the ability of office-based employees to work remotely has allowed many companies to continue with relatively little disruption. In this way, the large scale office-using job losses that were seen in the immediate aftermath of the GFC have so far been avoided.

However, as government employment support starts to be withdrawn, we are likely to see a rise in unemployment in parts of the service sector. And at the same time, with a much greater proportion of the office-based workforce now set up to work from home, companies will need to make decisions about how much office space they are likely to need in the future. Certain high profile tech companies, for example, have already announced that they will allow all staff to continue to work remotely on a permanent basis. How sustainable this model proves to be will become apparent in time, but it seems likely that we will see at least some reduction in aggregate demand for European office space in the future.

On average, we are forecasting European prime rents to fall by 6.2% this year, with the greatest falls occurring in Dublin, Paris La Défense and the London markets. Paris CBD and some of the German markets, where vacancy rates are among the lowest in Europe, are likely to be more insulated in the short term, although are still set to see rental declines.

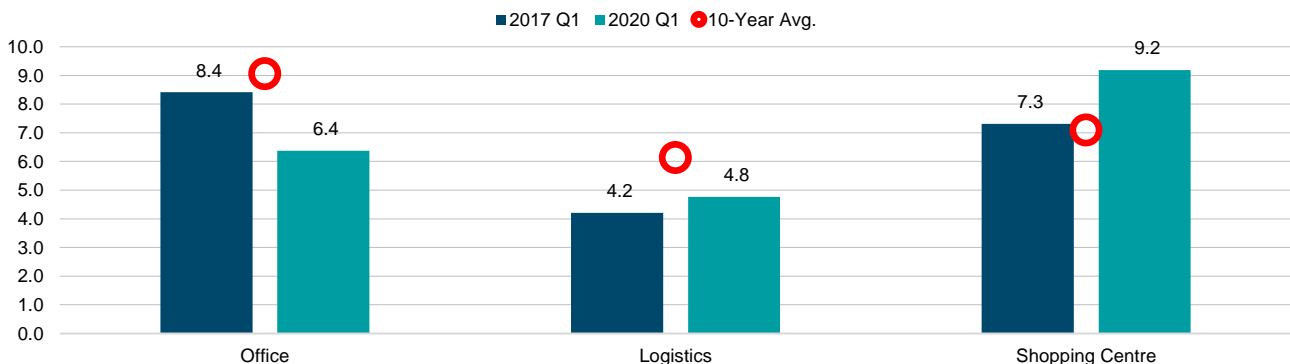
Next year, we expect the rental recovery to be muted, given higher levels of unemployment and higher vacancy, although we should start to see stronger growth materialising thereafter, aided by a slightly reduced outlook for net completions. Still, at the pan-European level, we don't expect prime rents to return to their 2019 level until three years from now. Looking beyond the recovery period, we have generally downgraded our long-term office rent growth projections, although there are still certain markets where we would expect to see stronger growth. These include Paris La Défense, as major infrastructure improvements near completion, and the Central European markets, thanks to their stronger economic growth outlook.

Logistics: While there are certainly longer-term structural trends supporting the logistics market, we believe it would be wrong to assume that the sector will be completely unaffected this year. Lower consumer spending, a risk of retailer failures, disruption to global supply chains and trade flows, and a reduction in manufacturing output could all have a negative impact on the logistics market. At the same time, despite aggregate prime rent growth reaching 4.5% last year – impressive for a sector that has historically seen relatively little growth – pan-European vacancy had already begun to trend upwards slightly, while take-up was down on the previous year's record.

However, there are also positive short-term influences at play – most notably the sharp rise in online spending seen during lockdown, but also a reduction in the total amount of logistics stock under construction.

For European big box corridor logistics markets, we would expect the short-term economic impact to outweigh changes to spending patterns. For this segment of the market, we are forecasting a prime rental decline of 6.3% this year, but with a relatively fast recovery and a sustained period of above-average rent growth thereafter. Yet for urban logistics assets – those located within or close to major agglomerations and primarily serving a last mile delivery function – the significant growth in online spend could well be enough to keep rents growing throughout the downturn. As such, we expect prime urban logistics rents to grow by 2.6% this year, and by an average of more than 4% per annum until 2024, significantly higher than the rate for big box logistics.

VACANCY RATE BY SECTOR (%)



Source: PMA, JLL, Cushman & Wakefield, DWS, July 2020

Retail: The retail sector is something of an outlier. The only sector already facing major structural headwinds before this year, it has also been one of the worst affected by the Covid-19 crisis. A large proportion of non-essential shops across Europe were forced to close for a period of weeks or months during the second quarter, leaving significant numbers of retail tenants unable to pay rent. We are already beginning to hear of a number of European retailers that will not fully reopen as lockdowns are lifted, and there are likely to be more failures as in-store and leisure spending is restricted further by ongoing social distancing measures. The gradual withdrawal of government support programmes later this year and into next year

will only add to retailer woes, whether directly through a withdrawal of access to additional financial support, or indirectly through a rise in unemployment and a squeeze on disposable incomes.

It has taken around 20 years for the online sales ratio to reach 10% in Europe. This year, the ratio looks likely to increase rapidly within a very short space of time. While some of this additional online spending will migrate back to instore sales once shops are fully open and social distancing rules relaxed, we believe that a large proportion will remain online. Online retailers – particularly grocers – have struggled to increase delivery capacity fast enough to deal with excess demand, but additional infrastructure is being put in place. And more of the consumers that have had no choice but to shop online in the current environment may continue to do so to some degree, even as shops reopen fully.

We expect to see vacancy rates continue to move out this year and beyond, with retailers becoming even more concentrated around the best locations and centres. Average prime shopping centre rents are predicted to fall by a total of 14% this year and next. And with countries like the United Kingdom, France and Germany having already seen rental declines of 5-10% before this year, the peak-to-trough fall could be as much as 25% in these locations. The situation for secondary centres will undoubtedly be even worse than this. Southern and Central Europe could fare slightly better in the near term, being much further behind in online sales rates, although even here it seems inevitable that rents will suffer eventually.

Nevertheless, for the best-located and most well-run centres, rent growth is expected to turn positive by the end of the forecast period as the non-performers are weeded out and the increase in online sales migration begins to slow. Still, there is further pain ahead before the tide turns.

Residential: Of the four main sectors we forecast, residential is seen as a clear outperformer on the occupier side. Economic volatility this year and next is very likely to lead to a rise in unemployment and a fall in disposable incomes. But at the same time, stricter mortgage lending criteria and a reluctance for owners to sell and realise a loss in a falling market – hence limiting the stock of properties for sale – could help to drive demand for rental property. In addition, planning permissions in Core Europe have fallen by around 15% over the past two years, meaning it's likely that housebuilding will slow in the years ahead, leading to additional pressure on the housing supply balance.

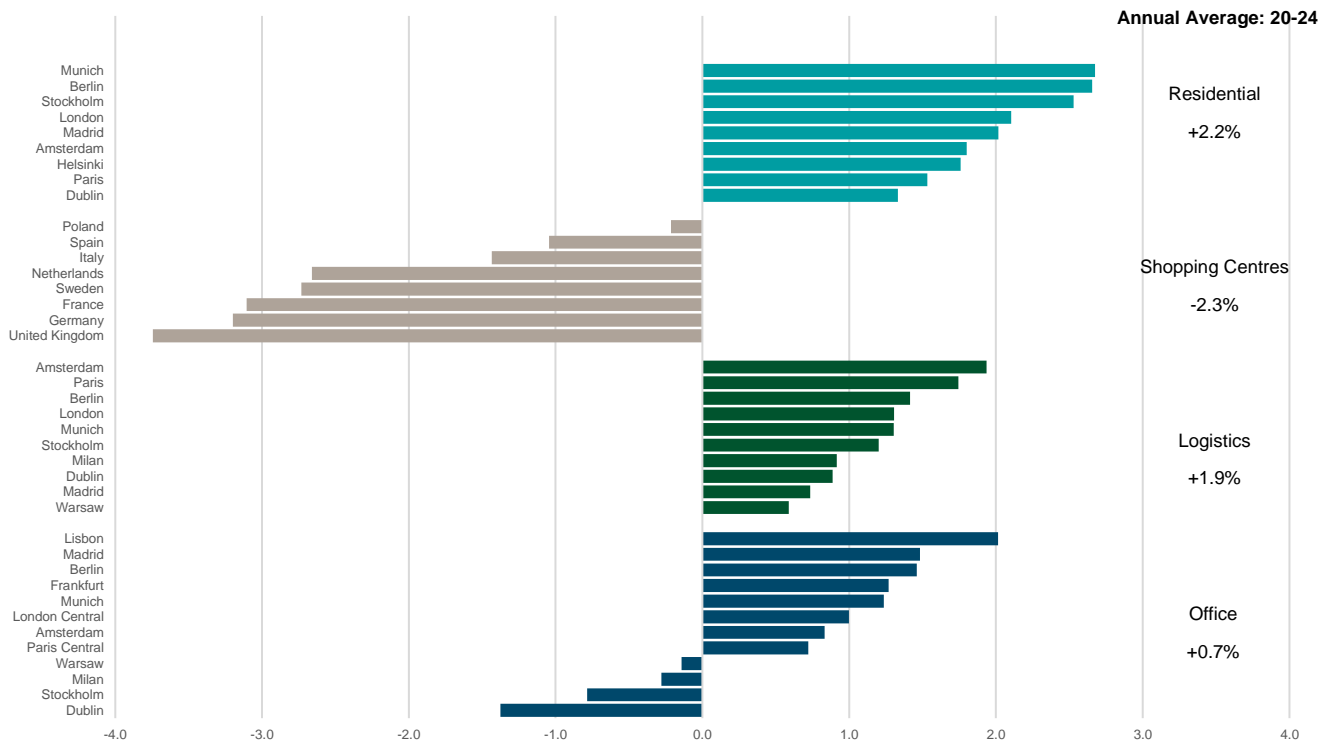
European homeownership rates have remained stable in recent years, but the proportion of the population in private rented accommodation has grown steadily, reaching 22% on average across the EU in 2018.¹ Equally, while European population growth has moderated to levels last seen in the late 1990s, and is forecast to drop even lower, population in the continent's major cities continues to grow healthily.²

Last year marked the tenth consecutive year of rental growth in the European residential sector, with annual growth averaging almost 4% over this period. This year, we expect this impressive run to come to an end, and yet we would expect rental decline within the sector to be more muted than in the other sectors. Over the next five years, we are forecasting average rental growth to be 2.2% per annum, the strongest of any of the main sectors, with rents broadly keeping pace with personal disposable incomes as the economy recovers into the middle part of the decade. We would expect the German markets to be among the most resilient this year, and to return to stronger growth first, driven by disposable income growth and exceptionally low vacancy. Here, together with London and Stockholm, we are forecasting some of the strongest growth over a five year period.

¹ Eurostat, July 2020

² Oxford Economics, June 2020

PRIME RENTAL GROWTH 2020-24F (% ANNUAL AVERAGE)



Source: DWS, June 2020.

Note: F= forecast. Forecasts are not a reliable indicator of future returns. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

2.2 Capital Markets

Investment & Pricing: Going into this year, the European investment market remained in excellent shape. Transaction volumes last year were just shy of the record set in 2015, sentiment among investors was positive, and pricing continued to tighten for a majority of sectors and locations. Last year, German open ended real estate funds also had their strongest year of net inflows since 2003, and the first quarter of this year marked a continuation of this strength, with net inflows of almost EUR 4 billion.³

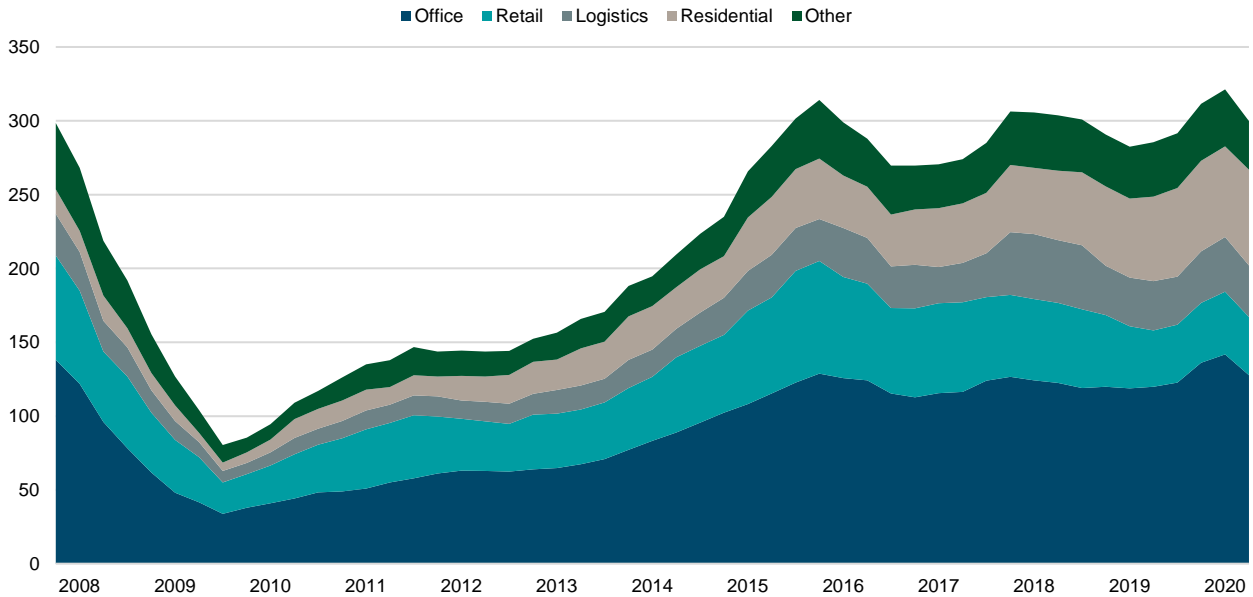
During the early part of the Covid-19 crisis, uncertainty increased significantly among investors. So far, the market has held up slightly better than we were expecting though. During April and May – the two full months where we have data during the lockdown period – European all property volumes were down by just 17% compared to the average from the same period over the four previous years. And in fact, over the whole of the first five months of the year, volumes were still in line with the previous year’s trajectory.

However, a deeper dive into the different sectors reveals a wide differential. Residential – predicted to be more resilient to the downturn – has lived up to expectations, with volumes for April and May well above the same period in previous years.

³ BVI, June 2020

Retail and hotel, on the other hand have seen volumes drop by 40% and 65%, respectively, with offices also seeing a 35% drop over this period.⁴

EUROPEAN REAL ESTATE TRANSACTION VOLUMES BY SECTOR (€ BILLION, 12-MONTH ROLLING TOTAL)



Source: Real Capital Analytics, July 2020.

Among this latter group of sectors, some of the decline in activity may be down to short-term fears over a sharp weakening in occupier conditions. In addition, obtaining financing for certain property types is going to be difficult, as many lenders are likely to be concerned about weak rent collection rates and an increased chance of tenant default. But many investors will also be looking at the potential long-term effects. A forced acceleration of online spending rates is likely to add to retailer difficulties, for example, while hotels could be affected by a decline in business travel and offices might see a reduction in long-term demand as home working becomes more widespread.

A look at investor confidence also tells a similar story. Sentiment towards residential property actually rose in the second quarter, while logistics suffered only a minor drop, remaining close to a ten-year high. At the other end of the scale, retail investment sentiment plunged to a new all-time low, in some countries reaching rock bottom.⁵ By region, the largest falls in sentiment have been in Southern and Central Europe compared to last year – likely a reflection on the higher risk that those markets are thought to carry, and somewhat of a flight to safety in markets such as Germany and the United Kingdom.

These trends have also been mirrored to a large extent in the REIT market. Between mid-February and mid-March, the FTSE EPRA/NAREIT Developed Europe Index lost 42%, and has since regained only a third of these losses. Amid the initial panic, all sectors lost a fair amount of ground. Retail was the worst hit sector, with losses of 56%, but even residential and industrial lost 33% and 38%, respectively. Yet while the initial trends perhaps reflect a sense of widespread shock across sectors, residential and logistics have since recovered a large proportion of their initial losses; meanwhile, offices and retail remain not far above their troughs.⁶

⁴ RCA, July 2020

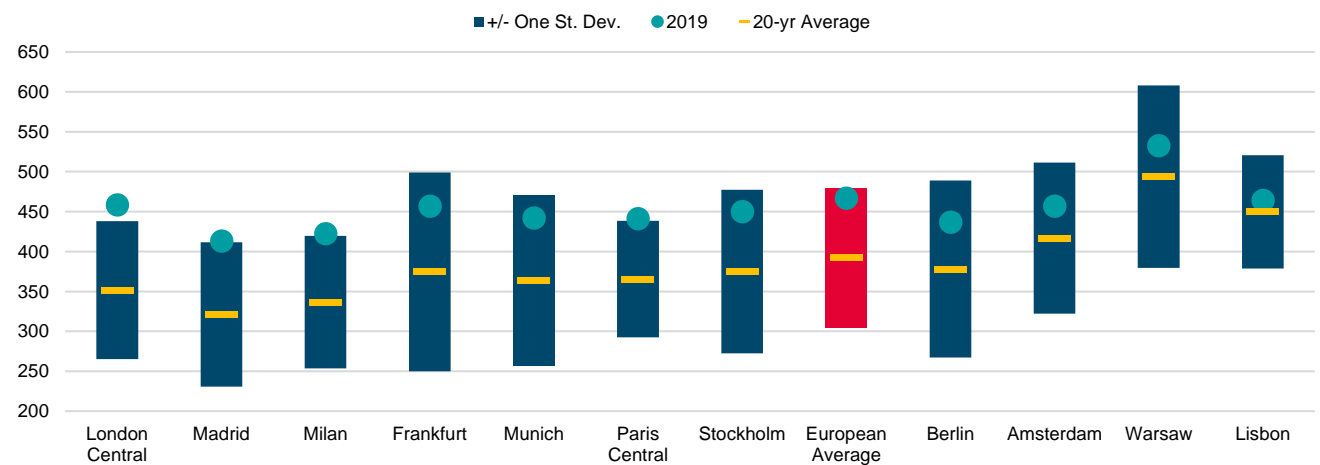
⁵ PMA, June 2020

⁶ Macrobond, July 2020

A look at recent fundraising activity also paints a relatively positive picture. Europe-focused private real estate fundraising in the first half of this year was not too far below the volume achieved over the same period last year, and dry powder remains at elevated levels.⁷

With demand for European real estate holding up a little better than expected and interest rates remaining low across the continent, there is still limited evidence to suggest that yields have moved out significantly so far. Generally, while the retail and hotel sectors did see yields move out, valuers generally held office and logistics values steady in the first quarter.⁸ In the absence of second quarter data, the MSCI UK Monthly Index suggests that average retail yields and office yields have moved out by 30-40 basis points since the beginning of the year, with industrial and residential yields increasing by around 10 basis points.⁹ Ongoing political uncertainty in the United Kingdom makes comparisons more difficult, but this still gives some idea of how pricing might move in the rest of Europe.

PRIME OFFICE MARKET YIELD SPREAD OVER REAL 10-YR GOVERNMENT BONDS



Source: DWS, PMA, Oxford Economics, June 2020. Past performance is not a reliable indicator of future returns.

Outlook: Since our interim update in April, the economic growth outlook for this year has worsened substantially, although we still expect a strong bounce back over the next two years. Yet at the same time, there is a growing sense that both inflation and interest rates are likely to stay low for a considerable period. Our expectation now is that the German 10-year government bond yield will still be below 1% even five years from now.¹⁰

At the all property level, our outlook for yields reflects these trends. This year, with rent levels widely expected to come under pressure, we still expect yields to move out across many markets and sectors. Although with sentiment and investment activity holding up slightly better than anticipated, we now expect a more moderate rise compared to our interim forecast in April.

Unsurprisingly, the greatest outward shift is foreseen within the retail sector. With many shopping centre markets already seeing rising yields going into the crisis, the rapid further decline in sentiment towards retail – even for those markets previously considered more insulated from the march towards online sales – means we now expect prime European shopping centre yields to move out by a total of more than 100 basis points by the end of next year. For secondary retail, the rise will almost certainly be even greater.

⁷ Preqin, July 2020

⁸ CBRE, April 2020

⁹ MSCI, June 2020

¹⁰ DWS, Oxford Economics, June 2020

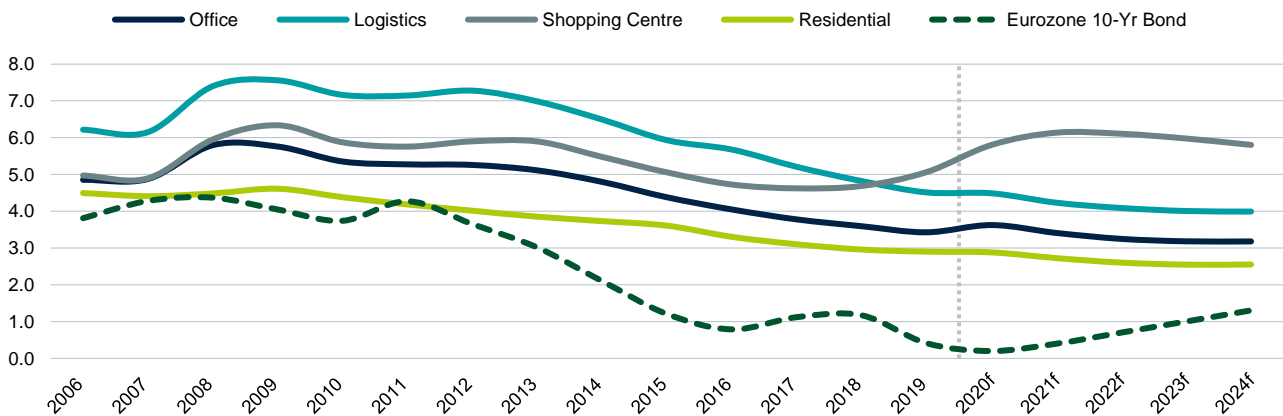
Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect. Past performance is not a reliable indicator of future returns.

Office yields are expected to move out by around 20 basis points by the end of this year, while logistics and residential yields are predicted to remain broadly flat, with certain markets – most notably urban logistics within major agglomerations – even seeing yields continue to fall.

Beyond this year, there are likely to be different forces at play. If economic growth accelerates next year, as expected, this should create an environment where occupier demand picks up and rents begin to recover quite quickly. At the same time, property yields could begin to look particularly attractive on a relative basis. Based on our current expectations, office yield spreads over 10-year government bond yields should reach their highest ever level this year. And with bond yields set to remain very low, and a period of potentially strong rental growth, we would expect to see yield compression across most markets from 2021 onwards.

Over the long term we expect all sectors to benefit from more attractive pricing relative to government bonds, although compared to our forecasts six months ago it is the logistics and residential sectors that have seen the largest changes to long-term yield projections. We believe that structural changes will continue to support growing occupier demand for these two sectors over the long run, in turn attracting keener pricing in the investment market. Conversely, retail, office and hotel are likely to face headwinds, albeit to differing extents. As such, we would expect to see the price differential between sectors evolve over time, with logistics closing the gap further over offices.

PRIME YIELD OUTLOOK BY SECTOR (%)



Source: DWS, PMA, Cushman & Wakefield. June 2020. Past performance is not a reliable indicator of future returns. No assurance can be given that any forecast will materialise. Forecasts are not a reliable indicator of future returns. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

Six months ago, we predicted Central Europe to be the top performer in terms of yield impact. Given recent changes to the outlook, things have now shifted around a little. We believe a flight towards safer markets in the short-to-medium term should push yields lower in Core Europe. In the United Kingdom, yields have been kept artificially higher by the uncertainty surrounding Brexit. Under our base case scenario, where a comprehensive trade deal with the European Union is reached by this year's deadline, we would expect attractive relative pricing and the U.K. market's relatively strong long-term fundamentals to attract a wave of new capital, leading it to be an outperformer in terms of yield compression. Conversely, markets such as Southern Europe, which have seen strong momentum recently, could lose out on a relative basis due to a perception of higher risk.

2.3 Returns and Market Calls

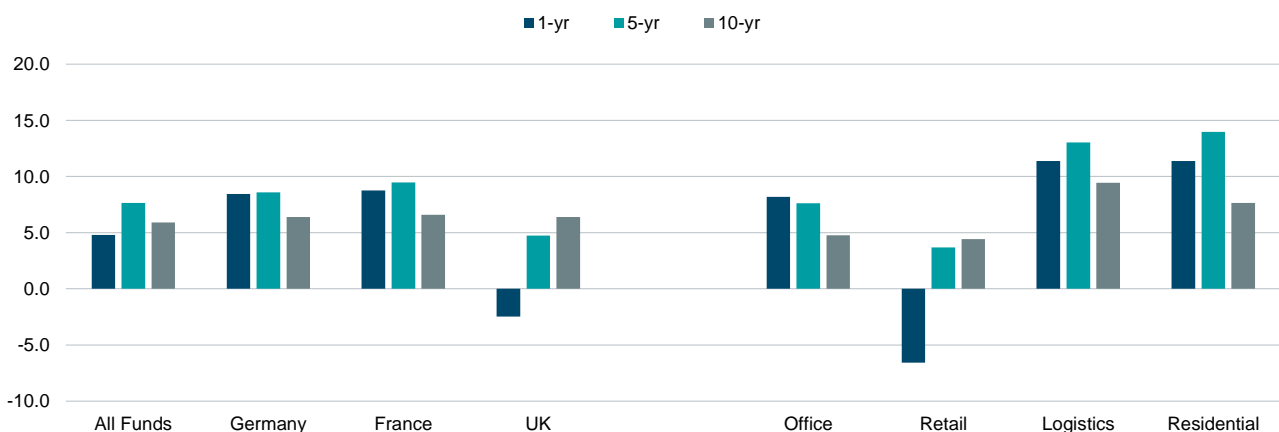
A rapid change in market conditions has led to a significant revision in our near term performance outlook, with flat or negative returns now foreseen across all sectors this year. However, with interest rates expected to remain lower for a longer period, this should allow a renewed impetus to take hold from next year onwards. As such, despite the near-term correction, our all property total return forecast has been revised upwards by 50 basis points per annum over the next five years compared to our December 2019 forecasts.

Recent performance: Annual returns for the INREV All Funds index reached 6.3% in 2019 – a moderation in performance since a year earlier, but still above the 10-year average.¹¹ This year, with a sharp correction in the occupier market and rapid change in investment conditions, a seven-year run of positive annual returns is at risk of coming to an end. While first quarter performance is unlikely to paint the full picture – given that European lockdowns only began to be implemented in March – there are still some signs of what may be to come.

Quarterly fund-level returns for the INREV index fell abruptly to just 0.2%, the lowest figure for seven years. A similar story was told by the MSCI Pan-European Quarterly Property Fund Index, where quarterly returns dropped to -0.2%.¹² It is difficult to say at this stage how much of this trend can be attributed to Covid-19 disruption, but it is likely this was the key driver.

In December, we highlighted the strong performance of the residential sector. First quarter data would seem to support the view that the sector will be one of the most insulated against current market conditions, with annual returns almost unchanged on 11.4% within the INREV index. All other sectors saw a notable fall in annual returns, with retail moving to a new post-GFC low of -6.6%. By location, the United Kingdom and parts of the Nordic region saw quarterly returns move into the red within both the INREV index and MSCI PEPFI, while the Netherlands remained comfortably the best performer on an annual basis.

ANNUAL FUND-LEVEL RETURNS TO Q1 2020 (%)



Source: INREV, June 2020

Note: Past performance is not indicative of future results.

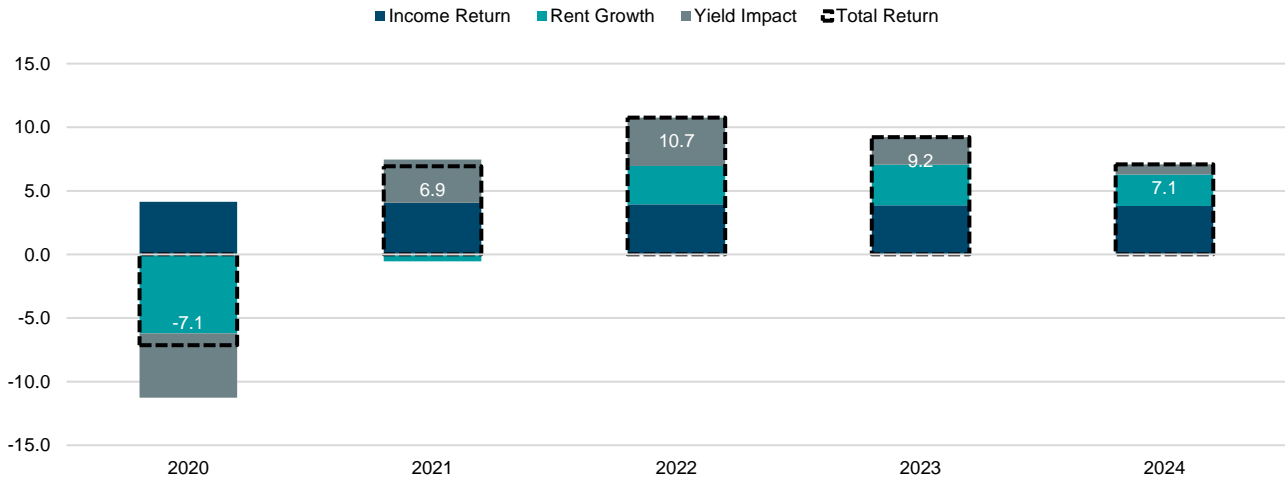
Outlook: While it is still too early to assess the full scale of any market correction, we do have some early evidence that values are already being written down. Still, we believe that there is more to come this year, and our forecasts for prime capital value growth highlight this view. We now expect all property prime capital values to decline by around 10% in 2020, before a modest recovery next year and a stronger bounce back from 2022 onwards. That said, a further reduction in our yield forecasts mean that for most sectors, average annual returns over a five year period have actually improved since our

¹¹ INREV, June 2020

¹² MSCI, June 2020

pre-Covid-19 forecast six months ago. All property prime total returns are now forecast to be just over 5% per annum between 2020 and 2024.

EUROPEAN AVERAGE ALL PROPERTY PRIME TOTAL RETURN (2020-24F, %)



Source: DWS, June 2020

Notes: f = forecast. No assurance can be given that any forecast will materialise. Forecasts are not a reliable indicator of future returns. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

However, this aggregated trend hides significant differences between the sectors. In fact, the sector hierarchy remains unchanged since our year-end forecasts, with logistics predicted to be the best performer over the coming five years, followed by residential and offices, and retail a distant last. However, the spread in expected performance has grown.

Expectations for logistics prime total returns have grown by more than one percentage point to 8.4% per annum, with corridor logistics at 7.4% and urban logistics comfortably into the double digits. While few sectors of the economy have suffered as much as physical retail during the Covid-19 crisis, online sales sit at the other end of the spectrum, seeing growth rates pick up during the crisis. So in addition to the positive longer-term structural impact, it is perhaps one of the few sectors that could see occupier demand remain unchanged or even increase in the short term. As such, urban logistics assets are among the only properties where we expect no value correction this year.

The residential sector has seen an even bigger upgrade, and despite a much lower income return, is now close behind logistics in terms of expected total return. The sector has already been gaining in prominence over recent years, accounting for a growing proportion of the wider institutional real estate market. Early indications for the second quarter show that residential investment continued to grow while other sectors saw notable falls in activity. As such, residential is likely to have accounted for a record share of total real estate investment in the three months to June.¹³

Our office forecast has seen a small upgrade over five years, although beyond this we expect a more pronounced flattening of returns. Offices will continue to play a vital role in the functioning of the economy, but lockdown measures during the current crisis have forced a large number of people to work from home for an extended period, and in our view it is likely that some degree of increased home working will persist into the long run, reducing aggregate office demand. With this in mind, prime offices should continue to perform relatively well, but secondary and out-of-town locations may see the greatest impact from this shift in working patterns. Over the next five years, we expect the United Kingdom – and particularly London – to be the best performing office market, driven by a tightening of the currently elevated yield spread over Core Europe, as well as positive long-term economic fundamentals.

¹³ RCA, July 2020

Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect. Past performance is not a reliable indicator of future returns.

And finally, retail has been further downgraded. Prime total returns for shopping centres are now foreseen at -15% this year, and just 1% per annum on average between 2020 and 2024. Although as we have discussed previously, retail's declining weight in a pan-European portfolio is likely to offset some of these losses for well balanced funds. Looking further ahead, however, we do see light at the end of the tunnel for those centres strong enough to survive short-term market pressures. When online spending rates eventually begin to plateau, landlords and centres that have managed to adapt and evolve could begin to see stronger rent growth once more. And with some centres bound to disappear altogether, a reduced stock of investment property could mean centres that have proven themselves resilient find themselves in demand once more. We expect this trend to play out first in the United Kingdom, where online sales are already far ahead of elsewhere. However, we would expect returns to pick up across the continent eventually.

PRIME TOTAL RETURNS BY SECTOR AND REGION (2020-24F, %)



Source: DWS, June 2020

Notes: f = forecast. Core Europe = Germany, France, Benelux, Nordics, Austria & Switzerland; Periphery = Iberia, Italy, Greece & Ireland; CE = Czech Republic, Hungary & Poland. There is no guarantee the forecast shown will materialise. As such, the performance and forecast shown represent hypothetical and simulated performance, which has many inherent limitations. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. No assurance is made that forecast returns will be achieved.

By region, the main beneficiaries of the revised economic outlook are the United Kingdom and Core Europe. Over the next five years, we now expect U.K. all property prime total returns to be similar to those in Central Europe, meaning that on a risk-adjusted basis the United Kingdom would be a clear outperformer. Of course, it's worth reiterating that our U.K. forecasts are based on the assumption of a trade deal being agreed and no cliff edge come the end of the transition period, although clearly this is still far from certain.

Core Europe is expected to see the lowest absolute returns, but the gap to the other regions has closed, and on a risk-adjusted basis the Benelux countries and Germany look relatively attractive. Southern Europe has been a top performer of late; however, we expect a moderation in performance looking ahead, with a steeper near-term correction and a slower recovery in Italy. Parts of the Southern European logistics market still look attractive, along with Spanish residential, but we expect lower risk-adjusted returns in the office market.

There are also several areas where we are recommending a strategic focus. First, as discussed already, urban logistics – where growth in e-commerce, competition for land and low levels of vacancy should support a strong and sustained outlook for rental growth. We believe this applies to last mile assets located within or very close to the city boundaries, but also to last hour delivery assets within the wider metropolitan area. Second, mass market, affordable residential assets in accessible, well connected commuter locations. We expect tenants to demand more space in larger units and in family-friendly environments looking ahead, and would focus on areas benefitting from infrastructure improvements, leading to reduced commuting time. And third, we expect changing occupier needs following Covid-19 to support a next generation of new office concepts. We believe that a focus on assets that can provide flexible layouts in well-connected and improving areas in key cities could yield outperformance. There is likely to be a limited supply of such assets, and we expect to see increasing demand from major corporate tenants.

Additionally, we see a number of tactical opportunities – those where short-term drivers may look less attractive, but where we still buy in to the long-term fundamentals. One of these would be budget hotels, where domestic travel is already starting to increase again, and we do expect a return to the longer-term growth trend in international leisure travel, with the mobile younger generation the first to recover. Another would be student housing, where current university closures have caused major disruption. But looking beyond the crisis we expect that the globalisation of education will continue to drive demand for institutional quality facilities at the best universities. In particular, the experience offered by those universities located in attractive cities should limit the longer-term impact from e-learning.

Market calls: In the following table we summarise our key market-level calls for the three main commercial sectors and the private rented residential sector over the next five years. This provides our views on market selection based on our forecasts for prime property performance and also accounts for market risk. These views are not all encompassing within the real estate investment universe and should be considered in conjunction with the strategic themes discussed in this document.

Market Summary

Market Calls

	Market Summary	Market Calls
Germany	<p>Resilient economy, interest rates lower for longer and exceptionally low vacancy rates in most sectors resulting in Germany offering some of the highest risk-adjusted returns.</p> <p>Active investment market suggesting the continued attraction of the low-risk German markets during periods of economic uncertainty.</p>	<ul style="list-style-type: none"> Major city residential markets are attractive. Focus on commuter locations benefitting from population growth, cost push and changing occupier requirements. Risk-adjusted office returns tending to outperform other European office markets, with low vacancy helping to sustain rents this year.
France	<p>Slightly deeper than average recession but recent economic reforms continue to offer long-term upsides. More evidence of occupier markets feeling the effects of the crisis.</p> <p>Paris benefitting from the Olympics and Grand Paris project over the long term. We see relatively few attractive opportunities in the prime segment within major regional cities.</p>	<ul style="list-style-type: none"> Some signs of weakness within the Paris office market. However the CBD should continue to perform well given very little vacancy. La Défense vulnerable over the coming years. Paris logistics remains overweight, especially urban and last mile assets; additional demand for home delivery to support further rental outperformance.
U.K. & Ireland	<p>After a period of weak performance, the U.K. market is well positioned for a period of outperformance. This was evident in early 2020 ahead of the CV-19 lockdown, with overseas capital attracted by higher yields and greater clarity on Brexit.</p> <p>However, Brexit risks still remain and the risk of disruption at the end of this year cannot be ruled out.</p>	<ul style="list-style-type: none"> Increased yield premium combined with falling hedging costs and reduced supply leading to an overweight call, although with elevated downside risks in the short term. Dublin residential and logistics remain attractive compared to the all property average. Rising net completions and affordability a risk for Dublin prime offices.
Southern Europe	<p>Recession in Italy and Iberia expected to be deeper than the rest of Europe. However, the lasting impact of this crisis on the real estate market is expected to be much less than the GFC.</p> <p>Similarly to the rest of Europe, transaction volumes fell sharply in the second quarter, and with capital cautious, liquidity in the region may remain low for the rest of the year.</p>	<ul style="list-style-type: none"> Residential becoming an increasingly important part of the Iberian market. Logistics gaining over the long term as crisis has pushed online spending up from recent low levels. Italy a relative underperformer, with prime office keenly priced. Best opportunities in logistics. Residential and student housing emerging as an attractive asset class.
Benelux	<p>Having eroded its yield premium over recent years, the Benelux is no longer a strong outperformer, with absolute returns projected to be slightly below the European average.</p> <p>But with the region seen as a low risk part of the market, we expect capital to continue to be attracted to assets offering a strong, long-term growth story.</p>	<ul style="list-style-type: none"> Densely populated, low risk and with an economy expected to outperform the European average, Dutch urban logistics and mass market residential look well placed. Brussels office offering a higher than average return over five years given tight CBD supply, low net completions and a 50 basis point yield premium over other Core European cities.
Nordics	<p>Over the coming decade, cities like Stockholm and Copenhagen are expected to see some of the fastest population growth in Europe.</p> <p>The region is forecast to see some of the highest residential and logistics risk-adjusted returns. A more mixed picture for prime offices, with high Stockholm CBD rents vulnerable.</p>	<ul style="list-style-type: none"> We expect Stockholm and Copenhagen to offer the best opportunities in residential, offering a yield premium above other European cities and strong long-term rental growth. Prime logistics yields in the region are currently around 50 basis points above European average. Strong e-commerce growth and low vacancy should support outperformance.
Central Europe	<p>Recession expected to be less severe. Nonetheless, the relative outlook for the real estate market has been downgraded, pushing most markets underweight.</p> <p>Anecdotal evidence of price correction in markets like Warsaw. Market liquidity more of concern in Central Europe as overseas capital retrenches to lower-risk Core European markets.</p>	<ul style="list-style-type: none"> Over the long term, the Polish market is set to outperform but a sharp increase in Warsaw office vacancy leading to below average risk-adjusted returns over the coming three years. Corridor logistics vulnerable to land banks and reduced trade flows, but urban logistics expected to benefit from the rapid and sustained growth of online spending.

3 / Private Real Estate Debt

Current Conditions: Current market conditions have increased the risk attached to real estate lending, also leading to a widening risk differential between sectors. Direct property returns are forecast to be markedly lower for the best performing parts of the market this year, and negative for the remainder. Yet the return on offer from real estate debt has increased. With careful selection, we believe that debt could offer an attractive risk-adjusted return profile looking ahead.

Recent years have seen a period of relative stability for European lending terms. Margins were creeping downwards across much of Continental Europe, particularly at the prime end of the market. Equally, average LTVs were relatively stable, edging out marginally but remaining well below pre-GFC levels.¹⁴ Since March, we have seen a change in conditions.

Due to the lower level of market activity, assessing current loan pricing is difficult. European banks are already dealing with higher capital costs from Basel IV, but a rise in liquidity costs in the second quarter and a revised risk assessment for some sectors has almost certainly led to higher margins. With concerns over increased loss provisioning and material uncertainty over valuations making it more difficult to assess LTV ratios, banks are likely to become more cautious.

A look at the corporate bond market also supports upward pressure on loan pricing – yields for both A and BBB bonds are trading around 50 basis points higher than at the start of the year.¹⁵ Our own experience suggests that this would be broadly reflective of the type of rise we've seen in real estate loan margins, although for retail and hotels the increase could be considerably more than this, particularly for anything outside the prime segment. However, for logistics and residential – seen as more resilient to current market stress – the rise has been lower.

Outlook and Investment Strategies: Looking ahead, we expect the returns from real estate debt to increase. However, for some sectors in particular, this will come at the cost of increased risk. Nevertheless, the current market still offers the opportunity to secure higher returns on even the most secure properties, compared to the beginning of the year.

For retail, where prime shopping centre values were already down by almost 10% going into this year, we expect a further 25% fall in values over the next two years. With banks and many alternative lenders pulling back from riskier lending, we would expect a sizeable rise in retail margins over the remainder of the year. Still, while the best retail assets are far from immune to market pressures (both cyclical and structural) they could get caught up in the current wave of negative sentiment towards the sector. At lower LTVs, this could still leave opportunities to achieve good risk-adjusted returns.

The same may be true for hotels and student housing in the short term, but with less impact to the longer-term trends driving these sectors, we still see good opportunities for senior lending at the prime end of the spectrum for these assets. We would also expect higher lending returns for the office sector – and with concerns over the level of future demand for offices, focussing on properties that are centrally located but have curable deficiencies could offer strong risk-adjusted returns. For subordinated lending opportunities, we would tend to favour logistics and residential, where the risk of near-term value decline is lower, and long-term trends remain positive for the underlying assets.

	Theme	Comment
Debt Strategies	Senior	Logistics, residential and prime offices in Core Europe and the United Kingdom attractive. Also consider emerging segments like student housing and hotels, where there are still positive long-term drivers.
	Mezzanine	Sectors with less near-term risk, and asset selection important. Given market uncertainty, exercise caution in the United Kingdom, despite it being the largest market.

¹⁴ Cass, IREBS, July 2020

¹⁵ Macrobond, July 2020

4 / Listed Real Estate

Current Conditions: Covid-19 has resulted in high volatility within public markets and created structural headwinds for listed real estate companies. The lockdown of European economies has driven more people to shop online, allowing logistics to benefit further from the increasing share of online sales. Physical retail is bound to face decreasing footfall and a less attractive shopping experience due to social distancing measures. Working from home has raised fears over the future of office demand, although re-densification and economic growth are probably more suitable indicators of such changes.

European listed real estate returned -21.7% YTD, underperforming the Stoxx 600 by 940 basis points.¹⁶ The pandemic has raised questions around financial leverage, sustainability of cash flows and dividend payments. Companies with the highest rent collection rates proved to be the most resilient: the living and logistics sectors returned +5% and +3% YTD, respectively, outperforming the benchmark.

The U.K. listed real estate market has delivered a total return of -24.0% YTD,¹⁷ underperforming the wider U.K. market by 540 basis points, but recovering from a low of -37.3% in March. Like in the rest of Europe, logistics has been one of the strongest sectors of the listed U.K. market, with companies issuing £1bn of new equity at premiums to book value. Retail has been hardest hit, with the percentage of online sales rising from 19% at the start of 2020, to stand currently at 33%.¹⁸ The pandemic has already resulted in the demise of Intu, owner of some of the largest U.K. shopping malls, including Lakeside and the Trafford Centre. The company was already struggling pre-crisis under the weight of high debt levels and falling asset values, succumbing to administration in late June.

Outlook and Investment Strategies: We continue to believe U.K. companies operating in alternative, less cyclical areas such as healthcare or PRS should deliver the strongest NAV growth, with relatively appealing earnings and dividend growth; logistics too, as the companies benefit from structural change. Student accommodation, while suffering a difficult 2020 due to the pandemic, should recover in the 2020-21 academic year, assuming universities can reopen. London office names still look well placed, with reasonable tenant demand in a supply constrained environment. Companies with retail assets will continue to struggle following significant pre-crisis asset valuation write-downs and tenant failures. Valuation evidence from sales of Intu assets at well below book by the company's administrators are likely to add more pressure to balance sheets.

Asset allocation remains challenging during 2020 given high stock volatility and deep valuation spreads. Living and logistics are expected to be the best performers this year. Despite some risks around the Berlin rent freeze, the return profile of companies exposed to this market is relatively attractive versus the wider sector. Both living and logistics are the only sectors trading at premiums to spot NAVs. Offices remain cyclically sensitive, relying on employment growth; however, companies exposed to CBD areas with an underlying demand/supply imbalance – for example, Paris or Madrid – should be the most resilient. Retail stocks have been forced to waive, defer or reduce rents, which makes future collections and lease renegotiations more demanding. Most listed companies withdrew their 2020 guidance; however, it's only retail stocks that effectively cut their dividends for 2020.

	Theme	Comment
Listed Market Strategies	United Kingdom	Logistics names likely to continue to offer the best returns. Slowing returns for U.K large caps suggest discounts to NAV are unlikely to reverse over the short term as retail asset write-downs bite.
	Continental Europe	Companies with high cash sustainability, low leverage and undisturbed demand, coupled with attractive NAV discount, should offer the highest returns in 2020.
	Non-cyclical Alternatives	We expect healthcare and residential companies to be relatively untouched by Covid-19, with resilient income. Student accommodation should recover strongly after a difficult 2020.

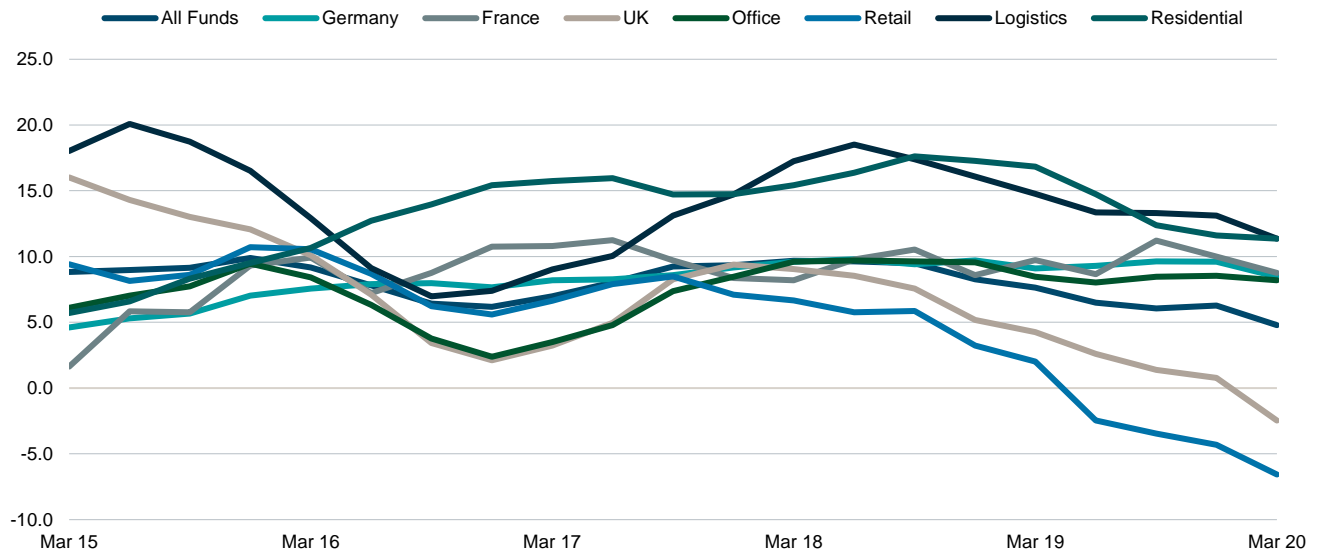
¹⁶ EPRA, Bloomberg, June 2020

¹⁷ EPRA, Bloomberg, June 2020

¹⁸ Datastream, June 2020

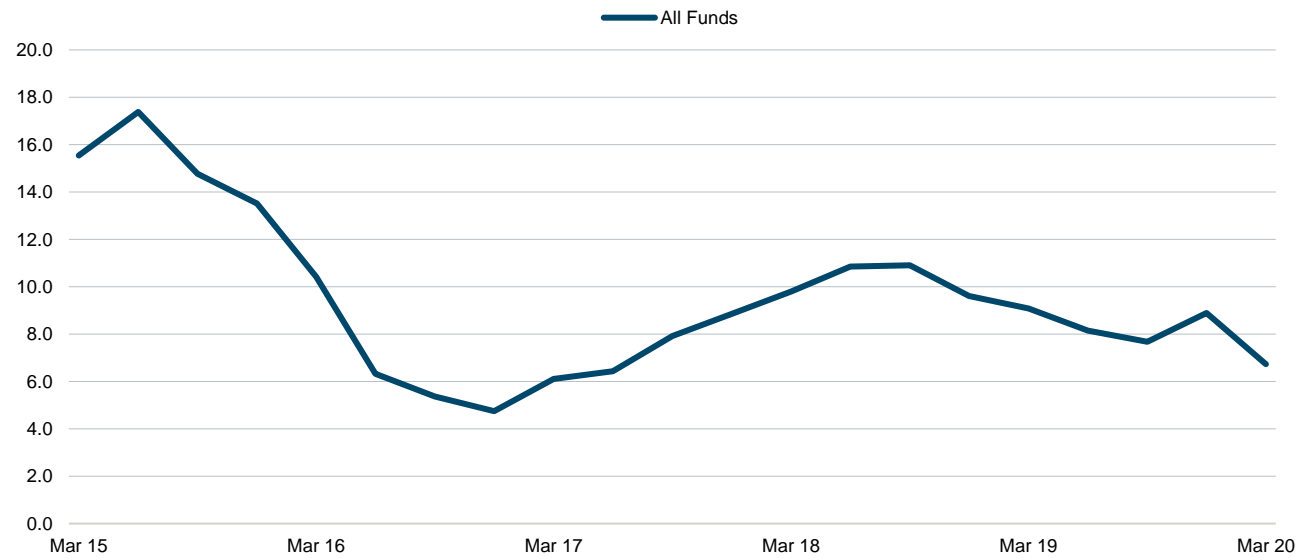
5 / Appendix

EXHIBIT 8: INREV HISTORICAL ANNUAL FUND-LEVEL RETURNS TO 2020 Q1 (%)



Source: INREV, June 2020
 Note: Past performance is not indicative of future results.

EXHIBIT 9: MSCI HISTORICAL ANNUAL FUND-LEVEL RETURNS TO 2020 Q1 (%)



Source: MSCI, June 2020
 Note: Past performance is not indicative of future results.

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