DWS

U.S. Real Estate Strategic Outlook

Mid-Year 2024

IN A NUTSHELL

- Real estate prices have bottomed, in our view. Appraisal-based values are lagging, but we believe they will return to growth in the second half of 2024.[1]
- We believe that interest rates have peaked, removing a significant headwind from real estate valuations. Over time, modest interest rate relief could act as a tailwind.
- In our view, a new cycle is coming into view, characterized by elevated cap rates and strong fundamentals, aided by low levels of new supply.
- We believe that underlying fundamentals will drive greater performance dispersion, favoring the industrial, residential, and retail sectors, and markets in the Sun Belt and Mountain West.

[1] GSA (prices); NCREIF (values). As of March 2024.

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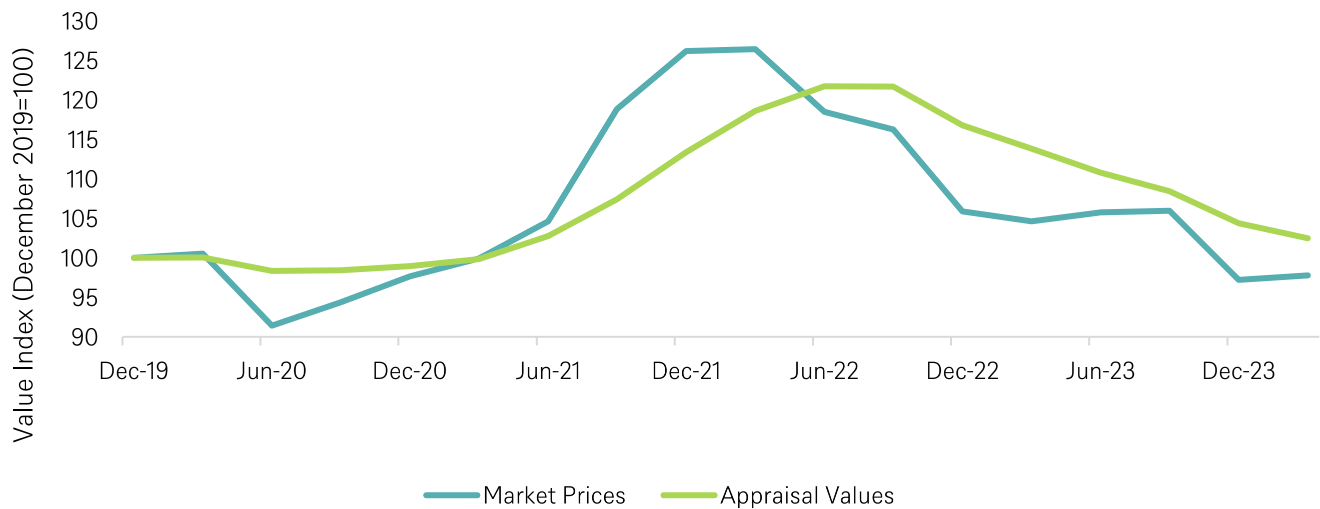
1 / Real Estate Outlook

Real estate registered its sixth consecutive quarter of negative returns in the first quarter of 2024. However, prices picked up slightly in transactions markets. The disconnect is not unusual: Historically, appraisal-based valuations have lagged and smoothed market fluctuations (see Exhibit 1). We believe the recent firming in market prices augurs well for a return to positive returns in the second half of the year.

EXHIBIT 1: U.S. REAL ESTATE PRICES AND APPRAISAL VALUATIONS



Note: Weighted Industrial (35%), Apartment (30%), Office (20%), Retail (15%).
Sources: GSA (prices) & NCREIF (values). As of March 2024. As of March 2024.

Appraisal metrics imply that values have nearly digested the impact of the roughly 400 basis-point-increase in long-term interest rates since late-2020, in our view.[2] Historically, long-term BAA corporate bond yields of about 6% are consistent with cap rates in the high-5% range (see Exhibit 2).[3] Appraisal-based cap rates were well below that in the first quarter, at 4.7%.[4] However, after four years of strong growth, there is an extraordinary gap (18%) between in-place and market rents, primarily in the industrial sector, but also to a degree in the residential and retail sectors.[5] On a mark-to-market basis, appraisal cap rates of 5.5% are arguably below levels consistent with interest rates, but only slightly.[6]

[2] Federal Reserve (interest rates). As of June 2024.
[3] Moody's (BBB yields); NCREIF (cap rates); DWS (calculations). As of March 2024.
[4] NCREIF. As of March 2024.
[5] Altus. As of March 2024.
[6] NCREIF (appraisal cap rates); Altus (mark-to-market); DWS (calculations). As of March 2024.

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EXHIBIT 2: BAA Yields and Real Estate Cap Rates

Sources: Moody's (BAA), NCREIF (cap rate), & Altus (mark-to-market); DWS (calculations). As of March 2024.

To be sure, another jump in the cost of capital would upend the market once again, but we believe that the balance of risks tilts toward lower, not higher, interest rates. The Federal Reserve's (Fed's) preferred inflation measure, the core Personal Consumption Expenditure (PCE) index, increased 2.8% (year-over-year) in April 2024, down from 5.5% in September 2022.[7] While still above the Fed's 2% target, the index is skewed by a housing component (up 5.4% year-over-year) that we believe substantially overstates and trails reality.[8] Excluding housing, core PCE increased 2.2% year-over-year.[9] While the Fed is in no hurry to cut interest rates with unemployment at 4%, we believe that it will do so as falling housing measures drag core inflation lower.[10]

The Fed's quarterly Summary of Economic Projections suggests that once it begins to cut policy rates, it will continue until they fall to about 2.6% over time.[11] Long-term rates will not drop as much, in our view, not least because the yield curve is inverted today.[12] However, history shows a strong (0.9) correlation between long- and short-term rates, implying that directionally, the former will come down as well.[13] Lower long-term yields could compress cap rates, supporting real estate values.

Nevertheless, we believe that real estate is well positioned to deliver competitive returns even without a decline in rates. The combination of falling values (down 16% since the second quarter of 2022) and resilient net operating incomes (NOI, up 7%) has lifted income returns to their highest levels in nearly a decade, with further gains in store as landlords roll existing leases to higher market rates.[14] Moreover, we believe that the outlook for rent growth is increasingly bright.

[7] Bureau of Economic Analysis. As of April 2024.
[8] Bureau of Economic Analysis. As of April 2024.
[9] Bureau of Economic Analysis. As of April 2024.
[10] Bureau of Labor Statistics (unemployment). As of May 2024.
[11] Federal Reserve. As of March 2024.
[12] Federal Reserve. As of June 2024.
[13] Federal Reserve (rates); DWS (calculations). As of June 2024.
[14] NCREIF. As of March 2024.

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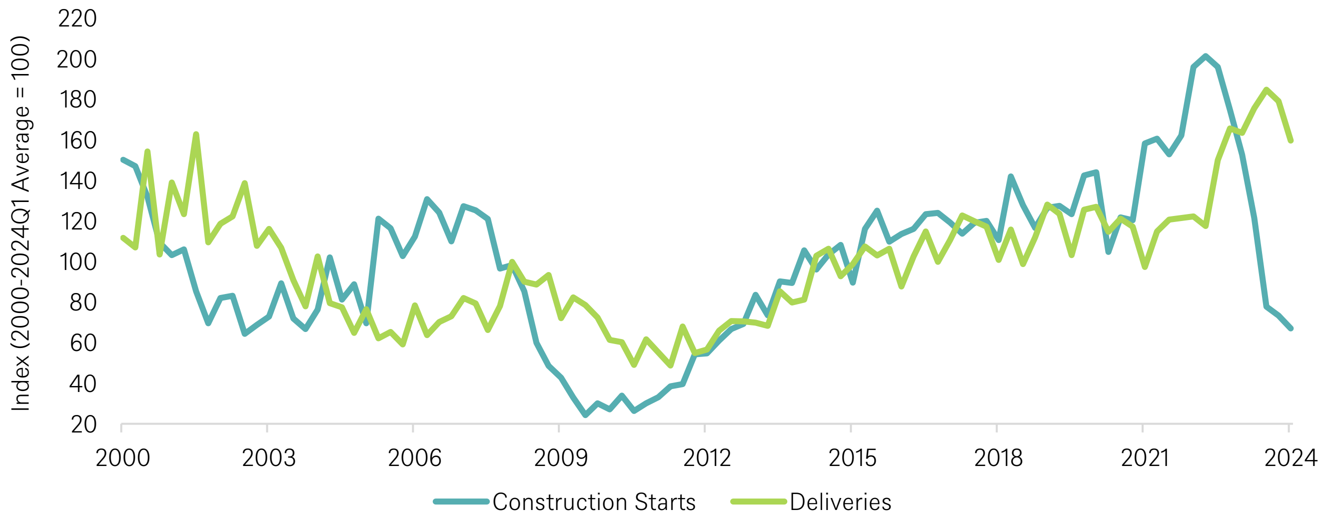
To be sure, fundamentals have softened of late: vacancies increased 80 basis points from the second quarter of 2022 to 6.1% in the first quarter of 2024 (although they remained well below their 33-year average of 8.5%), while NOI growth decelerated from 11.5% (year-over-year) to 5.4%.[15] In part, the slowdown reflects a reset from the pandemic, when e-commerce and social distancing fueled booming demand in the industrial and residential sectors (which account for 60% of the NCREIF index).[16] Apartment absorption has since rebounded from its post-COVID lull, a pattern that in our view will be repeated in the industrial sector.[17] Thereafter, we believe that structural forces, including population growth (residential) and e-commerce (industrial), together with a growing economy, will propel demand.

A larger factor has been a wave of development triggered by the COVID demand surge. Industrial and apartment supply reached record levels (in both absolute terms and as a share of inventory) in 2023 and the first quarter of 2024.[18] However, construction starts have dropped 67% from their 2022 peak (on a sector-weighted basis), pointing to a sharp reduction in deliveries in 2025 (see Exhibit 3).[19] As demand revives from its post-COVID hiatus into an emerging supply void, we believe that fundamentals will strengthen materially, supporting rental growth averaging 3%-4% annually over several years (more in industrial, less in Office).

EXHIBIT 3: CONSTRUCTION STARTS AND DELIVERIES



Weights: Industrial (35%), Multifamily (30%), Office (20%), Retail (15%).
Source: CoStar (starts, deliveries) & DWS (calculations). As of March 2024.

In our view, elevated yields and robust rent growth prospects are launching a new cycle, one driven by cash flows rather than cap rate compression, which is unsustainable in perpetuity. Cap rates could fall too, if and when interest rates decline, and we believe investors should position for that eventuality. Regardless, we believe that the ingredients are in place for a rewarding real estate recovery.

[15] NCREIF. As of March 2024.
[16] CBRE-EA (demand); NCREIF (index share). As of March 2024.
[17] CBRE-EA. As of March 2024.
[18] CBRE-EA. As of March 2024.
[19] Costar (starts); NCREIF (weights); DWS (calculations). As of March 2024.

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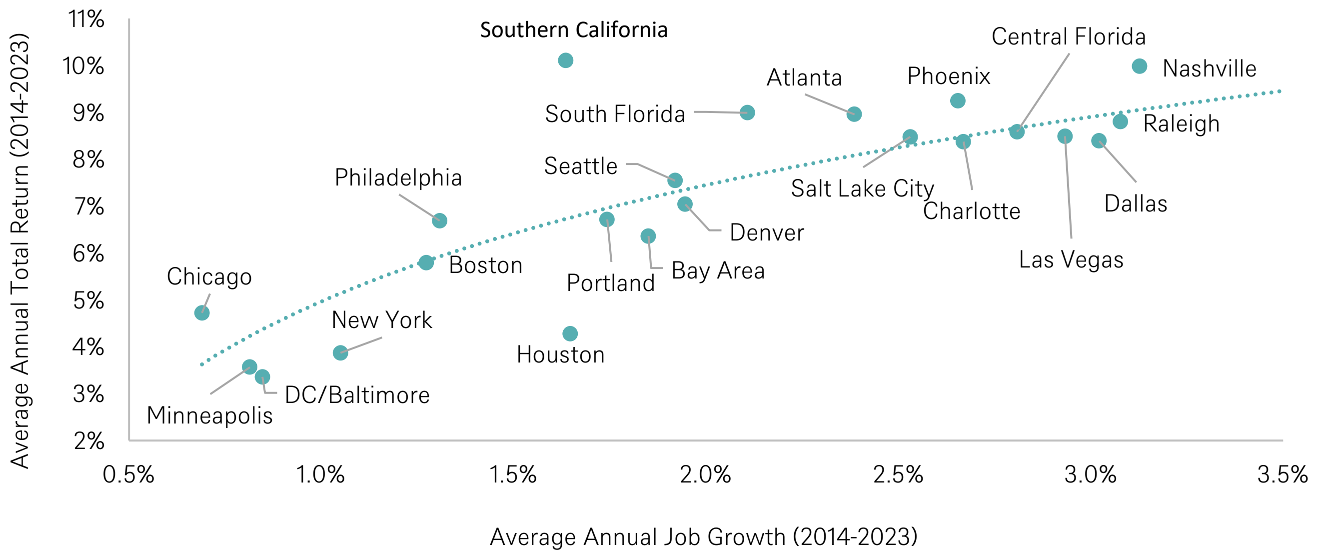
2 / Investment Strategy

Investment performance across sectors and markets has converged over the past two years as the macro effects of rising interest rates have dwarfed differences in underlying fundamentals (the challenged office sector notwithstanding).[20] However, we believe that as interest rates stabilize, fundamentals will drive greater dispersion.

Key to understanding the fundamentals, in our view, is the outlook for critical demand drivers, including the economy (people, jobs and spending) and structural forces (e.g., e-commerce). Supply can momentarily over-saturate demand, as we have recently witnessed in parts of the apartment and industrial sectors. Over the long-term, however, demand has generally trumped supply as a performance driver. Across 22 major U.S. markets, the correlation between relative job creation and real estate returns is 0.83 over the past 10 years (see Exhibit 4).[21]

EXHIBIT 4: JOB GROWTH AND REAL ESTATE RETURNS (2014-2023)



Source: Bureau of Labor Statistics (jobs) & NCREIF (returns). As of December 2023.

In turn, we believe that demand drivers are largely influenced two key macro factors: demographics and digitization. Homebuilding has failed to keep pace with population growth since the Global Financial Crisis.[22] Millennials are pursuing lower costs and more space to raise families.[23] The population of seniors is swelling as Baby Boomers age.[24] Virtual applications allow more people to work from home and satellite offices.[25] E-commerce has temporarily cooled from its COVID spike, but its long-run trajectory is positive.[26]

[20] NCREIF. As of March 2024.
[21] Bureau of Labor Statistics (jobs); NCREIF (returns); DWS (calculations). As of March 2024.
[22] Census Bureau. As of April 2024.
[23] Census Bureau. As of April 2024.
[24] Census Bureau. As of April 2024.
[25] DWS, based on office demand (CBRE-EA) and migration (Census Bureau). As of April 2024.
[26] Census Bureau. As of March 2024.

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Locationally, we believe that these macro factors will continue to promote migration to the Sun Belt and Mountain West. Across sectors, e-commerce and housing shortages will support Industrial and Residential, respectively, while (technology-enabled) remote work will weigh on Office. Retail will also prosper, having reconciled to e-commerce (hosting more services) over a decade of growing consumer spending and minimal construction. Meanwhile, within sectors, low-density housing (such as garden-style apartments and single-family rentals) and grocery-anchored retail centers will cater to an expanding suburban population.

Industrial (Overweight): Fundamentals have softened over the past 18 months, sparking concerns that that Industrial's 10-year bull run (relative to other sectors) has come to an end.[27] We believe that these concerns are misplaced. Absorption has slowed sharply, but this represents a predictable unwinding of excess COVID-driven demand. After a lull, e-commerce growth rebounded to 9% year-over-year in the first quarter of 2024, pushing online sales to 20.3% of retail sales (excluding autos and gas), close its COVID peak (20.7%).[28] Meanwhile, the supply wave triggered by the COVID boom has dissipated: construction starts tumbled 75% from their September 2022 peak.[29] In our view, firming demand and dwindling supply will strengthen fundamentals later this year. Over the medium-term, we believe that further growth in e-commerce (rising to 30% of retail sales in 2030) and efforts to strengthen supply chains will perpetuate the sector's outperformance.

Residential (Overweight): Apartment fundamentals have surpassed our expectations in recent quarters. Although vacancy rates have increased – and rent growth stalled – as record levels of supply have come on-line, the setback has been blunted by a sharp rebound in demand after a post-COVID slump.[30] Apartment vacancies are around their 20-year average, but overall rental vacancies (including single-family and non-institutional property) are still well below historical norms, underscoring persistent housing shortages.[31] Moreover, apartment supply has crested, with construction starts down 63% from their June 2002 high.[32] Combined with the prohibitive cost of homeownership, we believe that these conditions will support strong residential performance over the next several years, particularly for lower-density product (single-family rentals and garden apartments) in suburban areas.

Retail (Overweight): Retail was the best-performing major sector in 2023, and we believe it will remain so in 2024.[33] Not only are the sector's yields relatively attractive; its fundamentals are among their strongest in recent history.[34] Vacancy rates for neighborhood and community centers are at their lowest since at least 2005 and for power centers since 2006.[35] Conditions at malls are lagging, but also trending toward historical balance.[36] The outlook is positive, in our view, amid negligible supply, sustained service-oriented demand (entertainment and health care), and integration into the e-commerce ecosystem (i.e., pick-up and delivery from, and return to, stores). Retail property rarely delivers the rental gains that are sometimes achieved in the industrial and residential sectors, but we believe that it is well positioned to produce competitive, relatively stable returns over the next cycle.

Office (Underweight): Widespread adoption of hybrid working models has driven vacancy rates to their highest levels (19%) since the early-1990s, and there are few signs of any meaningful recovery.[37] There are exceptions: Medical Office is less vulnerable to remote work and supported by rising outpatient health care spending; south Florida has benefitted from an influx of corporate tenants; and a flight-to-quality has buoyed trophy buildings.[38] Overall, however, we believe that anemic demand will weigh on market conditions well into 2025. The sector will eventually recover, in our view, as job creation soaks up surplus space

[27] CBRE-EA. As of March 2024.
[28] Census Bureau. As of March 2024.
[29] CoStar. As of March 2024.
[30] CBRE-EA. As of March 2024.
[31] CBRE-EA (apartments); Census Bureau (rental vacancies). As of March 2024.
[32] CoStar. As of March 2024.
[33] NCREIF. As of March 2024.
[34] NCREIF (yields); CBRE-EA (fundamentals). As of March 2024.
[35] CBRE-EA. As of March 2024.
[36] CBRE-EA. As of March 2024.
[37] CBRE-EA. As of March 2024.
[38] NCREIF (medical office); CBRE-EA (south Florida, trophy buildings). As of March 2024.

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(particularly in high-growth Sun Belt markets), and some buildings are converted to residential use. However, given the near-term challenges, we believe that the sector is generally not yet attractive on a risk-adjusted basis.

Self-Storage (Market Weight): The self-storage sector has cooled as stagnant home sales have stifled mobility-related demand, and supply sparked by an earlier pandemic boom has completed.[39] However, as in other sectors, lower prices and tighter financing have curtailed construction starts.[40] Moreover, we believe that remote work, Millennial household formation, and high housing costs will promote increased utilization of self-storage properties over the medium term.

Real Estate Debt (Overweight): Spreads on senior real estate loans are in line with historical averages and well below COVID and Global Financial Crisis (GFC) peaks.[41] However, following a rally in listed credit markets, the gap between yields on real estate debt and BAA corporate bonds widened to their highest levels on record (since 1990), outside a brief period during the GFC.[42] In our view, high yields, attractive relative spreads, and limited competition from banks (which account for 50% of outstanding mortgages) have created favorable conditions for real estate debt investors.[43]

[39] GSA. As of January 2024.
[40] GSA. As of January 2024.
[41] CBRE (current); ACLI (history). As of March 2024.
[42] CBRE (current); ACLI (history); Moody's (BAA); DWS calculations. As of March 2024.
[43] Federal Reserve (bank share). As of March 2024.

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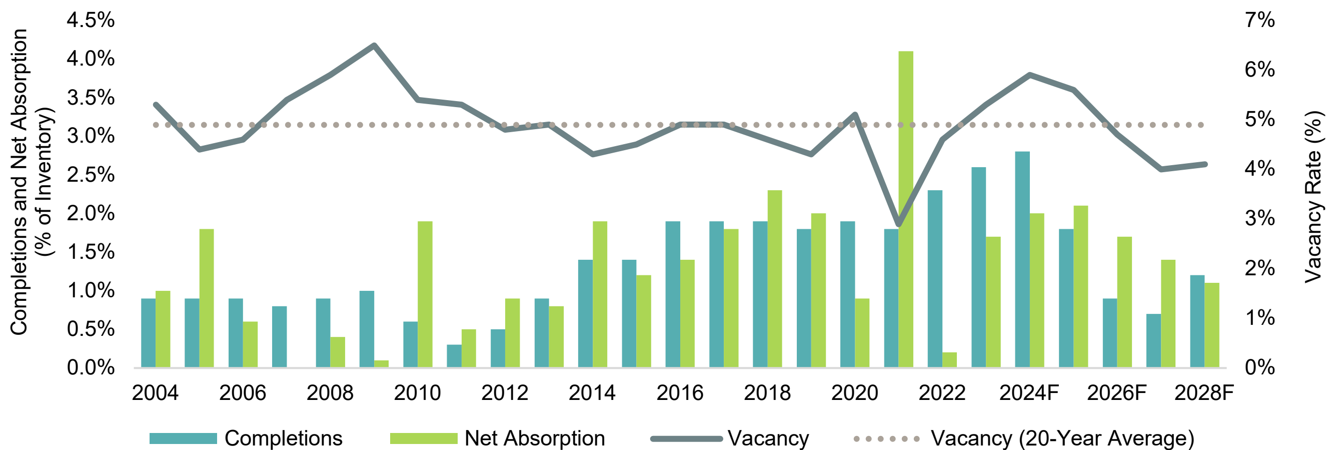
3 / Residential Outlook and Strategy

3.1 Current Conditions

The nation's residential sector appears to have avoided the worst of the ominous consequences on vacancy and rents that many predicted as a result of potential overbuilding. Instead, residential demand indicators continue to signal meaningful progress. Fueling this demand strength is a convergence of factors, including a solid job market, persistent wage growth, demographic tailwinds and affordability challenges that have forced many would-be homebuyers to stay in the rental market. The number of occupied rental units for DWS's 31 Investable Markets ("Investable Markets", "Investable Universe") surged by nearly 43,100 units from January through March 2024, the strongest first quarter net absorption in more than 20 years, outpacing the long-term first-quarter average of 14,400 units by 3x.[44] Led by Austin, Dallas, Orlando, Phoenix and Tampa, the Sun Belt and Mountain West markets accounted for almost 70% units absorbed in the first quarter of 2024. Additionally, rolling four-quarter demand accelerated to 262,600 units, the highest level since the second quarter of 2022. This abnormally robust start to 2024, with traditionally strong spring and summer months still to come, should put net absorption on track to reach a three-year high.

EXHIBIT 5: RENTAL NET ABSORPTION AND COMPLETIONS AS A % OF INVENTORY AND VACANCY RATE (2004 – 2028)



Source: CBRE-EA; Yardi-Matrix, RealPage(history) / Moody's Analytics, & DWS (forecast). As of June 2024.
Note: F = forecast. Aggregate of DWS's investable universe of markets. Past performance is not indicative of future results. No assurance can be given that any forecast or target will be achieved.

Despite these favorable demand trends, construction remains a major influence on current conditions. New supply continues to break records as 62,500 units were delivered in the first quarter of 2024, breaking the previous largest quarterly sum in the third quarter of 2023.[45] Eight markets (Austin, Charlotte, Jacksonville, Nashville, Orlando, Phoenix, Raleigh-Durham, and Salt Lake City) had annual inventory growth of over 4.0% during the yearlong span ended in March 2024. The near-term supply surge in these markets, however, is offset by strong economic and household growth, resulting in a relative alignment between development and demand. New deliveries are expected to continue to accelerate in the second and third quarters of 2024, before decelerating in the fourth quarter of 2024 as the rapid falloff of construction starts in recent quarters is realized. About 350,000 apartments opened in 2023 adding 2.6% to the overall rental stock, the most in 40 years. Based on what is currently under construction, completions are expected to climb to an all-time high this year, surpassing the 2023 total by almost 35,000 units and eclipsing

[44] CBRE-EA & DWS. As of June 2024.
[45] CBRE-EA, Yardi-Matrix & DWS. As of June 2024.

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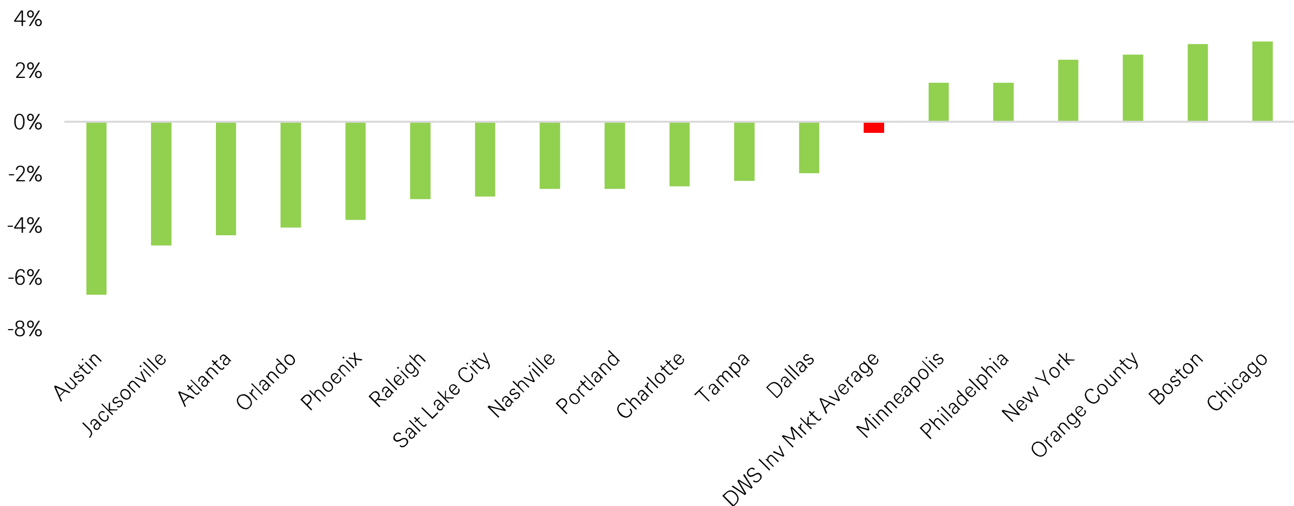
the trailing-decade annual average by over 150,000 units. The vacancy rate in the first quarter for the Investable Universe, a key indicator of the rental market's health and competitiveness, rose 60 basis points from a year earlier to 5.4%, marginally above the historic long-term average.[46] This is the eighth consecutive quarterly increase in vacancy; however, the pace of increases is slowing: the first quarter recorded the smallest increase in nearly two years. Strong demand and stabilizing vacancy – yet tepid-at-best rent growth – highlights the current imbalance of supply and demand across the nation. Market rent growth for the Investable Universe has lingered near zero since last summer and we expect much of the same throughout the remainder of 2024.

The nation's residential market has become a tale of two supply scenarios. The Investable Markets that recorded substantial rent growth coming out of the pandemic and are now receiving high volumes of new supply are posting stagnant or falling market rents. High-supply markets (generally in the Sun Belt and Mountain West) generally posted the deepest rent cuts as of March.[47] Conversely, Investable Markets with modest supply tended to grow rents at the fastest pace. The Midwest and Northeast recorded the highest rent growth, led by Chicago and Minneapolis and a cluster of markets along the eastern seaboard, including Boston, New York/Newark, Philadelphia and Washington, DC. Outside these regions, southern California's Orange County stood out as the best performing market along the West Coast.

EXHIBIT 6: ANNUAL RENT GROWTH BY MARKET



Source: CBRE-EA, Yardi-Matrix, & DWS. As of March 2024.

The historic supply surge won't last much longer as residential completions have surpassed construction starts. According to CoStar, apartment starts have slowed sharply, down 63% since their peak in the summer of 2022. Also, key forward-looking indicators for construction spending are continuing to show signs that the pullback is not finished.[48] This is not surprising given the interrelated set of obstacles that developers are facing, including the cost and reduced availability of debt, as well as high land and construction costs that are making it difficult to finance new properties.

Homeownership remains a key objective for younger Americans, but buying a home today has arguably never been more challenging. Despite higher mortgage rates, the median price for existing homes sold last April was $407,600 – a record high for that

[46] CBRE-EA & DWS. As of June 2024.
[47] CBRE-EA, Yardi-Matrix & DWS. As of June 2024.
[48] U.S. Federal Reserve's Senior Loan Officer Opinion Survey, American Institute of Architects' Architecture Billings Index & National Association of Home Builders/Wells Fargo Housing Market Index & DWS. As of June 2024.

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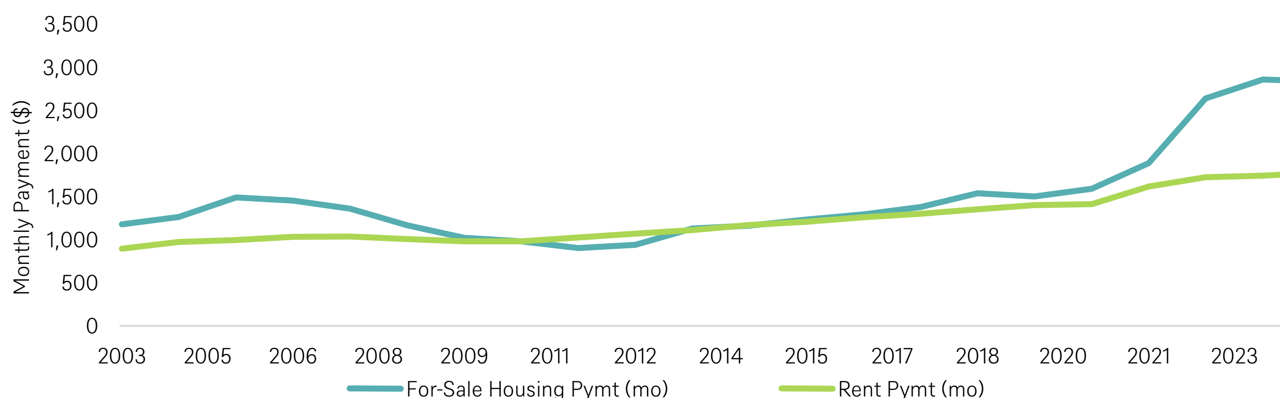
month – which was up 5.7% from a year ago, marking the tenth consecutive month of year-over-year price increases.[49] A home-buyer with the current median U.S. income would have to spend a record 42% of earnings on monthly housing costs – the norm is around 30%[50]. Keep in mind that the monthly housing payment on an existing median-priced home has risen from around $1,900 at the end of 2021 to about $2,850 in April 2024 – an increase of 51%, or $950 per month.[51] By comparison, the average monthly apartment rent has only risen by 8.7% during that same two-year span, an increase of just $140 per month.[52] A combination of low inventory, high prices and high mortgage rates are keeping renters on the sidelines waiting for more favorable conditions.

Since the pandemic, the U.S. housing market has been undergoing a major shift. The combined effect of higher mortgage rates and home price appreciation has tipped the cost of buying a home versus renting decidedly in favor of renting. The "buy premium" – the difference between the monthly cost of a new home purchase versus a new apartment lease – was 38% in April 2024 – a spread of over $1,100 per month after a rapid increase that began in the summer of 2022.[53] For perspective, the buy premium was at its 20-year average of 10% in 2020, with a spread of just $180 per month. Not surprising, a recent survey found that a growing number of renters are happy to stick with their rentals; 84% think it is more affordable than owning a home and 66% are satisfied with their rental experience.[54]

EXHIBIT 7: FOR-SALE HOUSING PAYMENT VS. RENT PAYMENT



Note: For-sale housing payment includes an assumed 20% down payment, prevailing interest rate, property taxes & insurance.
Sources: Yardi-Matrix, Moody's Analytics, Freddie Mac Mortgage Market Survey, & DWS. As of June 2024.

3.2 Outlook and Strategy

The number of new apartment units completing construction across the Investable Universe is projected to be approximately 384,000 in 2024 (adding around 2.8% to the year-end 2023 base), the highest number in decades.[55] New supply will continue to exceed demand over the next two to three quarters, capping market rents during the remainder of this year. Suburban coastal markets located in Boston, Northern Virginia, Seattle, Orange County, and San Diego should benefit from significantly less competitive new supply coming online than in the Sun Belt and Mountain West.[56]

[49] National Association of Realtors & DWS. As of December 2023.
[50] National Association of Realtors, Freddie Mac Primary Mortgage Market Survey, FRED Economic Data, & DWS. As of December 2023.
[51] National Association of Realtors, Freddie Mac Primary Mortgage Market Survey, Moody's Analytics, & DWS. As of December 2023.
[52] Yardi-Matrix & DWS. As of December 2023.
[53] Yardi-Matrix, National Association of Realtors, Freddie Mac Primary Mortgage Market Survey, Moody's Analytics, & DWS. As of December 2023.
[54] Freddie Mac/Rhino & DWS. As of December 2023.
[55] Yardi-Matrix, CBRE-EA, RealPage, & DWS. As of December 2023.
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A mid-rise apartment building, currently the most popular building type for developers, takes almost two years to complete, meaning every unit not started today is a unit not available to lease 24 months from now.[57] The current oversupply is likely to be absorbed by then and the apartment market could swing back to a condition of undersupply, leading to favorable market fundamentals and accelerating rent growth for the next several years (until 2028) and beyond depending on the timing of supply coming back online.

The country's housing market is undergoing a major shift. Driven by an increase in home prices and higher mortgage rates, renting continues to be significantly more economical than owning a home.[58] These market forces have forced many young people to prioritize renting until there is a greater sense of equilibrium in the housing market. One could then assume that a decreased sense of confidence and stability in homeownership may well cause an increased reliance on the rental housing market and demand for apartments. The average renter thinks there is a 60% chance they will still be in the rental market in 2027, according to the Federal Reserve Bank of New York's recently released 2024 SCE Housing Survey, up 4.3 percentage points from last year to the highest reading since the study began in 2015.

With supply pressures expected to recede in 2025, our attention has shifted to underwriting demand. Market demand is a function of job growth, migration trends and the outlook on the broader economy. All considered, renter demand indicators suggest apartments and rental housing should continue to see strong growth in 2024. As a result, the expectation from a demand perspective is that the nation's economy will continue to generate enough momentum to provide some tailwinds for household formation. We continue to look for growth in the more tech-heavy markets such as Boston, Northern Virginia, San Jose, Seattle, and Austin.[59] Also, we favor the Sun Belt and Mountain West markets that are projected to capture significant job and population growth.[60]

See Exhibit 8 for central themes that are shaping our residential strategy:

EXHIBIT 8: DWS RESIDENTIAL STRATEGY

Housing Trends Continue to Support the Suburbs	Suburban rental demand should continue to benefit over the long term from ongoing migration trends, demographic tailwinds, evolving lifestyle preferences, and significant barriers to homeownership; all pre-pandemic demand drivers that remain in place. The development of more urbanized suburbs and the ability to work from home should support rental demand over the long term as well, and lead to outperformance. In terms of asset selection, investors should focus on modern, well-amenitized garden-style and mid-rise apartments, as well as build-for-rent communities. These properties should be located near jobs, well-rated schools, and neighborhood amenities. Also, given demographic trends and the strong demand for more space, investors should target larger floor plans and an abundance of open and outdoor amenity space.
Student Housing Remains Resilient	At Tier 1/Power 5 universities, demand is expected to remain strong for modern, purpose-built properties that are walkable to campus and have bed-bath parity. As was the case pre-COVID, as well as throughout the pandemic, modern product that is walkable to campus continued to see the highest occupancy levels this past school year, as well as the strongest pre-leasing velocity and rent growth for the upcoming school year.[61]
Relative Underperformance in Urban Core	High-rise properties have seen improved performance recently as residents return to city centers. However, large supply pipelines, ongoing migration to the suburbs, flexible

[57] CoStar & DWS. As of December 2023.
[58] Yardi-Matrix, Moody's Analytics, Freddie Mac Mortgage Market Survey, & DWS. As of December 2023.
[59] Moody's Analytics & DWS. As of December 2023.
[60] Moody's Analytics & DWS. As of December 2023.
[61] Yardi-Matrix, Real Page & DWS. As of December 2023.

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	hybrid work trends, and an increasingly high cost of living continues to drive relative underperformance. Long term though, performance in the urban core is expected to stabilize as supply comes more into balance with demand and the impact of hybrid working becomes better understood. Gen Z is also expected to backfill Millennials as they graduate college and seek out a live-work-play lifestyle.
Structural Housing Shortage Signals Need for Development	It is more difficult for young households to access homeownership today than for generations prior. While financial market conditions will present ongoing challenges for new development currently, build-for-rent (BFR) is uniquely positioned to benefit from the expected increase in demand for high quality rental housing from those priced-out of homeownership. Investor interest for BFR product continues to gain steam, both from an investment—as well as a development—perspective. Over the long term, demographic and structural market trends will likely strengthen SFR's tailwinds, advancing its standing within the housing market.

Source: DWS. As of December 2023.

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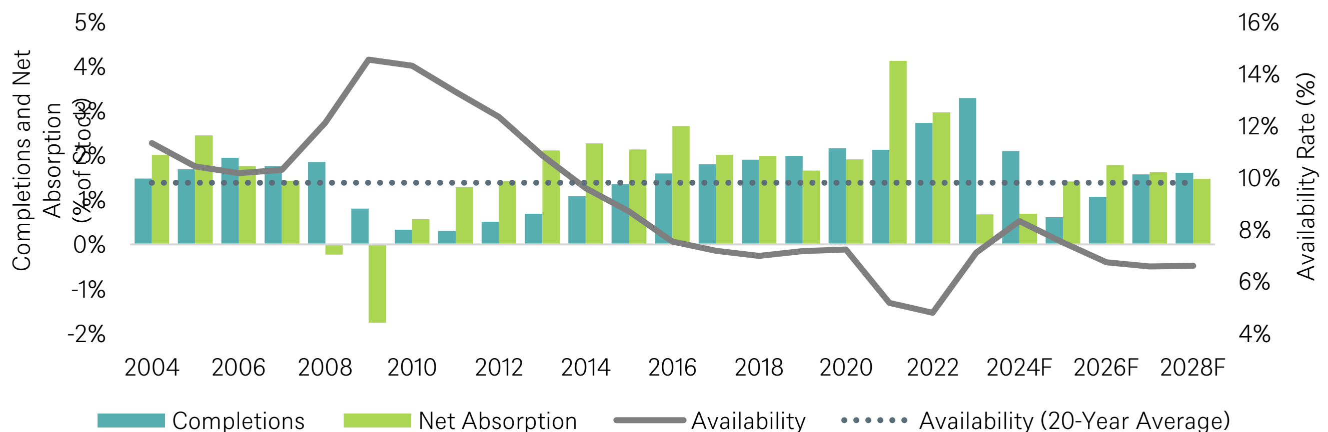
4 / Industrial Outlook and Strategy

4.1 Current Conditions

The U.S. industrial market is now several quarters into a moderate downcycle.[62] Market conditions began to cool notably in early 2023 and the trend settled in by year-end, punctuated by low levels of new leasing demand and sizable development pipelines across most markets.[63] Elevated construction activity had been seeded by the prior few years of record demand levels (COVID response), record low vacancy rates and robust rental rate growth. [64]

Retailers, wholesalers, and third-party logistics firms paused their capacity expansions and, in some cases, partially unwound them. Sublease space availability has nearly doubled in the past four quarters, adding about one percentage point to total availability in the first quarter of 2024. [65] This dynamic produced modest negative absorption across markets during various quarters in the past year. It was not uniform, but rather a mix of negatives and positives across markets and quarters. Net absorption measured 105 million square feet in 2023 (about one-third the pace of typical growth cycle levels). [66] Construction deliveries totaled about 525 million square feet in 2023 (two-times typical). Market availability increased 230 basis points, ending 2023 at 7.1%. [67]

EXHIBIT 9: INDUSTRIAL NET ABSORPTION AND COMPLETIONS AS % OF STOCK AND AVAILABILITY RATE (2004 – 2028)



Source: CBRE-EA (history) & DWS (forecast). As of June 2024.
Note: F = forecast. Forecast for US top 54 markets. There is no guarantee the forecasts shown will materialize. Past performance is not indicative of future results. No assurance can be given that any forecast or target will be achieved.

Industrial fundamentals trends have become more consistent across markets in the first quarter of 2024, with 38 of 62 markets tracked by CBRE-EA posting negative net absorption.[68] Generally, negative absorption across markets were very modest (averaging only 0.2% of stock). Softening trends can mostly be attributed to excess new supply. Construction deliveries totaled 104 million square feet in their sum of markets total, while absorption in the first quarter of 2024 measured -27 million square feet. [69]

[62] DWS and CBRE-EA. As of March 2024.
[63] DWS, CoStar and CBRE-EA. As of March 2024.
[64] DWS and CBRE-EA. As of March 2024.
[65] Newmark and CBRE-EA. As of March 2024.
[66] DWS and CBRE-EA. As of March 2024.
[67] DWS and CBRE-EA. As of March 2024.
[68] DWS and CBRE-EA. As of March 2024.
[69] DWS and CBRE-EA. As of March 2024.

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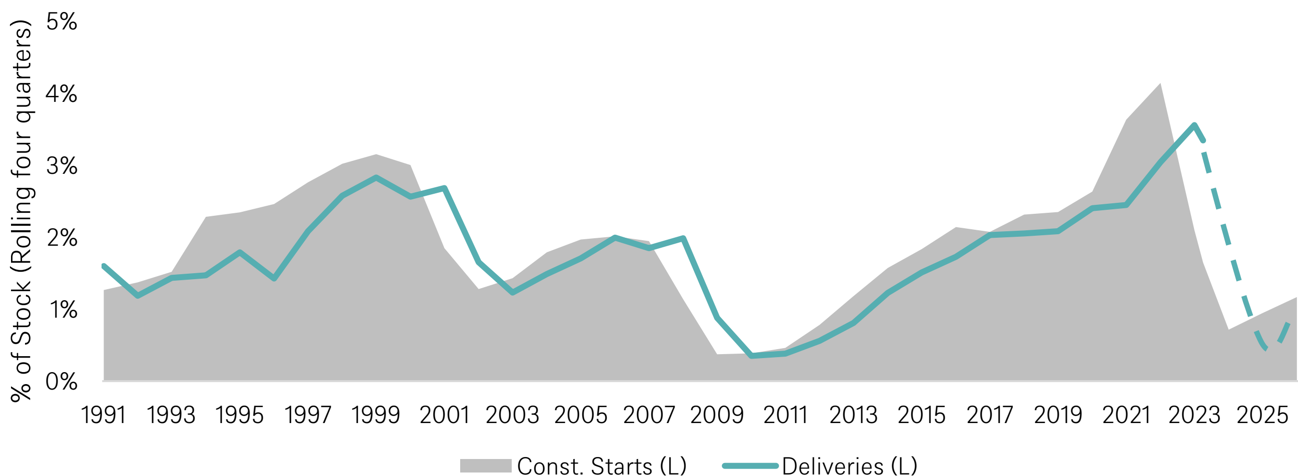
The market availability increased 70 basis points in the first quarter, to 7.8%, and vacancy lifted to 5.4% (both still below long-term averages).[70]

The past year presented some challenges for industrial space occupiers and owners. But within a longer-term, multi-cycle context, trends have been mild and outcomes relatively favorable. We believe that resilient economic trends (healthy job gains and consumption) supported industrial occupancy and rent fundamentals in institutional class properties.

The vacancy rate among NPI industrial assets has increased only 110 basis points year-over-year to just 2.6% in the first quarter of 2024.[71] With few exceptions, market rental rates have been stable to moderately down in recent quarters, with rent growth estimates ranging from 0% to -4% year-over-year. Declines appear to have been stronger in southern California, while South Florida achieved moderate gains. Recent rent movements represent only a small fraction of the 35%-40% average gains achieved over the past five years, and perhaps a smaller piece of gains that were achieved in southern California and New York/New Jersey. NOI growth of 9.5% year-over-year supports this thesis.[72]

The current development pipeline remains elevated, with estimates of about 350 to 400 million square feet of projects underway and potentially delivering in 2024 through early 2025.[73] It is possible that this estimate is high, given lending and capital markets constraints and the potential that some phased projects have delayed the start of latter phase buildings (which is difficult to quantify). Future years deliveries should drop sharply, in-line with construction starts, which have plummeted by 75% from peak in the first quarter of 2024.[74] We expect that a higher portion of new construction starts this year will be build-to-suit activity.

EXHIBIT 10: US INDUSTRIAL CONSTRUCTION STARTS AND DELIVERIES



Source: DWS, CoStar, & CBRE-EA. As of June 2024.

On the plus-side, pre-leasing within the pipeline appears to have picked up in early 2024 compared the second half of 2023 (about 42% compared to 35%). Notable e-commerce related leases have added some stimulus to the market in recent months (in the

[70] DWS and CBRE-EA. As of March 2024.
[71] NCREIF. As of March 2024.
[72] NCREIF. As of March 2024.
[73] DWS, CoStar and CBRE-EA. As of March 2024.
[74] DWS and CoStar. As of March 2024.

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larger bulk warehouse segment). We believe that the market balance between supply and demand will begin to stabilize over the next few quarters. It is notable that e-commerce sales grew 9% year-over-year in the first quarter of 2024.

Industrial performance in NCREIF firmed up in the first quarter of 2024, posting an income return of 1% and appreciation of 0.1%, the first positive quarterly total return since the third quarter of 2022. [75] The industrial sector returned -3.2% in the trailing four quarters as of first quarter 2024. Appreciation returns measured -6.6% and income returns were 3.7% during the same period. Appreciation returns were negative across all markets (excepting only Miami and Fort Lauderdale) in the trailing four quarters as of first quarter 2024. [76] The strongest negative appreciation occurred in California markets, comprising seven of the top 10 markets, where capital values fell 8.0% to 11.8% in the trailing four quarters as of first quarter 2024. [77]

Despite recent capital markets movements, we believe that industrial properties will continue to provide good relative investment performance, supported by resilient property market fundamentals and persistently strong mark-to-market activity on lease renewals. Recent price volatility and worries of oversupply, which we believe will be temporary, may enhance opportunities to invest new high-quality assets over the coming year.

4.2 Outlook and Strategy

We estimate that the next several quarters will be competitive, where landlords vie to keep existing tenants and developers compete to attract tenant migrations into new construction deliveries. But if economic growth continues as we suspect it will, industrial space demand should grow to more typical quarterly levels in the second half of 2024. This short period of rebalance could prove to be an excellent investment vintage year, especially for modern assets in strategic locations within our target market universe.

Broader macro drivers of industrial demand remain intact and support our favorable view of future performance. We believe that e-commerce will continue to grow at a high single-digit pace and international trade will remain vibrant (despite shifts among trading partners). Federal investments aimed at stimulating domestic manufacturing may also support warehouse leasing in certain markets. Federal incentives and tax credits potentially derived from the CHIPS and Science Act and the Inflation Reduction Act passed in 2022, amount to more than $400 billion in available funds through 2030. These investments stand to benefit markets by adding strength and diversity to local economies through high-wage jobs, as well as stimulating demand through ancillary uses. The multiplier effects on personal consumption and business occupancy and spending could be significant.

On the supply side of the equation, we believe the persistent march of obsolescence within the industrial base of coastal markets will continue to erode the base of properties, promoting scarcity and stimulating expensive replacement stock, but near-term recovery may be less robust. Rapid land absorption, plus jurisdictional restraints on new development, could also serve to constrain competitive new supply in markets with lower land-supply barriers. Within this context, we believe that long-term prospects for core industrial properties remain bright, but we believe that markets with relatively strong economic growth in the near term will outperform into the new growth cycle.

New construction is forecast to outpace absorption in 2024, potentially with 340 million square feet of deliveries and less than half of that being absorbed. Market availability is expected to trend into the low-8% range by year-end if demand picks up in the second half of the year and absorption totals about 120 million square feet for the year. Over the longer term, the industrial sector appears to have the advantage of demand support from cyclical growth (employment, population and income growth fueling

[75] NCREIF. As of March 2024.
[76] NCREIF. As of March 2024.
[77] NCREIF. As of March 2024.

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consumption) and secular/structural drivers (e-commerce and rapid fulfillment putting continued upward demand pressure on an aging industrial stock).

See Exhibit 11 for central themes that are shaping our industrial investment strategy:

EXHIBIT 11: DWS INDUSTRIAL STRATEGY

Strong Relative Performance	This pro-cyclical sector slipped in 2023, but we believe that within a context of historical cycles, the industrial sector will maintain relatively good performance. We believe that the upside of longer-term performance potential is more favorable than the downside risk of near-term fundamentals and capital markets performance.
Fast Growth Locals & Regional Hubs	There are near-term oversupply risks in the smaller fast-growth local markets and regional hubs, but we believe that they will capture demand share and recover. The larger logistics hubs of Dallas and Atlanta have become more hybrid in nature; fast growth with increasing land supply constraints at close-in locations. This should benefit infill logistics facilities.
Rent Growth Interrupted	Target well-located core properties in target markets. We believe that higher going-in cap rates and preserved rent gains of the past several years will provide for favorable market-to-market dynamics and total returns.
Large Population Centers Underserved by Modern Logistics	Demand trends have turned negative in the Northeast and West regions, but they remain supply-constrained and are chronically underserved by modern logistics. Despite moderating trade and slower forecasted economic growth compared to other markets, they should perform well as demand conditions normalize and scarcity of space is reestablished.

Source: DWS. As of June 2024.

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5 / Office Outlook and Strategy

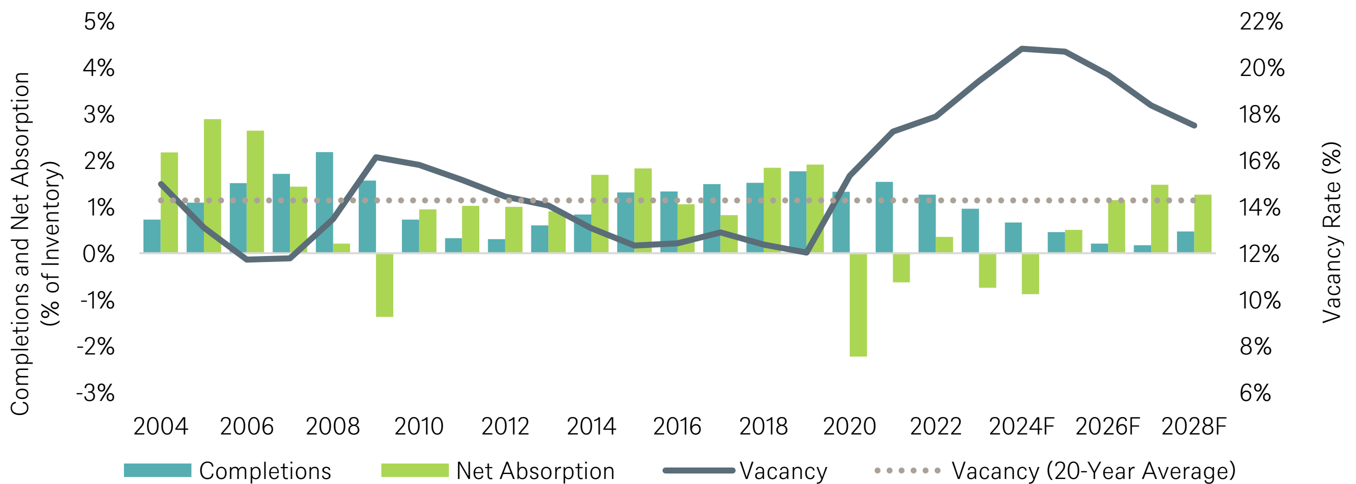
5.1 Current Conditions

The U.S. office market continue to struggle. While the economy remains resilient and unemployment is low, only about 7% of the jobs created in 2024 were in office-using categories versus a long-term average of over 25%[78]. Office tenants are actively managing their head count and operating expenses amid moderating growth expectations. Hybrid work is also putting downward pressure on office demand.

The technology sector, and particularly megacap technology companies, had accounted for the largest office leasing post the global financial crisis (GFC), but a significant pullback from Big Tech over the past 18 months has driven technology down to the third-largest contributor, trailing banking, finance and legal services, which have generated 16% and 12% of gross leasing activity since 2023, respectively. Legal services has been the most active major industry in recent quarters: over the past 12 months, legal firms have leased 5% more space than 2019 levels.[79] Over time, we expec tech leasing to pick up as earnings growth reaccelerates.

Office occupancy across U.S. markets continued to weaken. National vacancy increased to 19% in 1Q 2024, about 300 bps higher than the peak (16.9%) during the GFC.[80] Net absorption was negative 10.2 million square feet for the quarter (0.2% of inventory), with leasing concentrated in smaller deals and high-quality assets.[81] Near term, we expect softness in fundamentals to persist as the economy slows under the weight of higher interest rates and the effects of hybrid work continue to filter through.

EXHIBIT 12: OFFICE NET ABSORPTION AND COMPLETIONS AS A % OF INVENTORY AND VACANCY RATE (2004 – 2028)



Source: CBRE-EA (history) & DWS (forecast). As of June 2024.
Note: F = forecast. Aggregate of DWS's investable universe of markets. Past performance is not indicative of future results. No assurance can be given that any forecast or target will be achieved

Most U.S. office markets register higher vacancy levels compared a year ago. Both downtown and suburban vacancy rates continue to increase, with the former now exceeding the latter. Large gateway metros (like San Francisco, Manhattan, Seattle and

[78] Moody's Analytics. As of 1Q 2024.
[79] JLL. As of 1Q 2024.
[80] CBRE-EA. As of 1Q 2024.
[81] CBRE-EA. As of 1Q 2024.

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Los Angeles) and markets with strong supply (like Charlotte and Austin) have seen vacancies increase more than 1,000 bps since Q1 2020. Miami and Fort Lauderdale are notable exceptions, having returned to pre-pandemic conditions.[82]

Asking rents have held firm, increasing by 1.4% year-over-year, but executed rental rates on signed leases are beginning to decline. However, the appetite for high-quality space remains strong: the fourth quarter of 2023 saw the largest number of leases executed at rental rates above $100 per square foot of any quarter on record, and more than 40 such leases were executed in the first quarter of 2024, up nearly 20% from the year before.[83]

Weak fundamentals, higher interest rates and a slow return to offices have undermined the sector's investment performance. Total returns continued to deteriorate and were the weakest among major property types in the first quarter of 2024 (-16.7% on a trailing four-quarter basis), amid high vacancies and concerns over the effects of remote work.[84] Suburban office fared better than central business districts (CBDs) (-12.7% vs. -22.0%, respectively), although both suffered.[85]

5.2 Outlook and Strategy

Most U.S. office markets register higher vacancy levels compared a year ago. Both downtown and suburban vacancy rates continue to increase, with the former now exceeding the latter. Large gateway metros (like San Francisco, Manhattan, Seattle and Los Angeles) and markets with strong supply (like Charlotte and Austin) have seen vacancies increase more than 1,000 bps since Q1 2020. Miami and Fort Lauderdale are notable exceptions, having returned to pre-pandemic conditions.[86]

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New supply is likely to remain muted, and we are expecting considerably lower completions than in the past decades, which serves as a tailwind for the sector and is signaling future supply constraints for tenants. About 100 million square feet of office space is currently under construction, representing 1.5% of stock. Life science and Sun Belt markets have the most active pipelines, but activity has eased even in those segments. Office starts have slowed greatly in 2023, with 36.5 million square feet commencing development through the end of November 2023, down more than 40% from the level of starts seen through the same period in 2021 and 2022.[90]

While we currently maintain an underweight view to the sector, long term, we continue to favor metros with an expanding tech and life science presence and strong job and population growth. Those include mature markets like San Jose and Boston, as well as Sunbelt markets such as South Florida, Austin, Charlotte, Nashville, Dallas and Atlanta. Core gateway markets such as San

[82] CBRE-EA. As of 1Q 2024.
[83] JLL. As of 1Q 2024.
[84] NCREIF and BLS. As of 1Q 2024.
[85] NCREIF and BLS. As of 1Q 2024.
[86] CBRE-EA. As of 1Q 2024.
[87] JLL. As of 1Q 2024.
[88] NCREIF and BLS. As of 1Q 2024.
[89] NCREIF and BLS. As of 1Q 2024.
[90] Yardi Matrix. As of September 2023.

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Francisco, New York, Washington D.C., Los Angeles, and Chicago are expected to produce weaker performance due to high vacancy levels and lagging demand.

Going forward, we remain cautious in the near-term as it relates to office investments. As market conditions improve and values adjust, we would consider pursuing opportunities that offer attractive pricing for properties that would be well-positioned for the sector's expected recovery. Stable rent roll and limited tenant risk are recommended, as well as higher quality assets with credit leases and low near-term capital requirements. In our view, office fundamentals will continue to be weak, and performance is likely to remain modest but, progress in return-to-office plans, increasing tenant requirements, declining sublease additions, low new supply, and a tightening market for high-end space all point to sector stabilization over the next few years.

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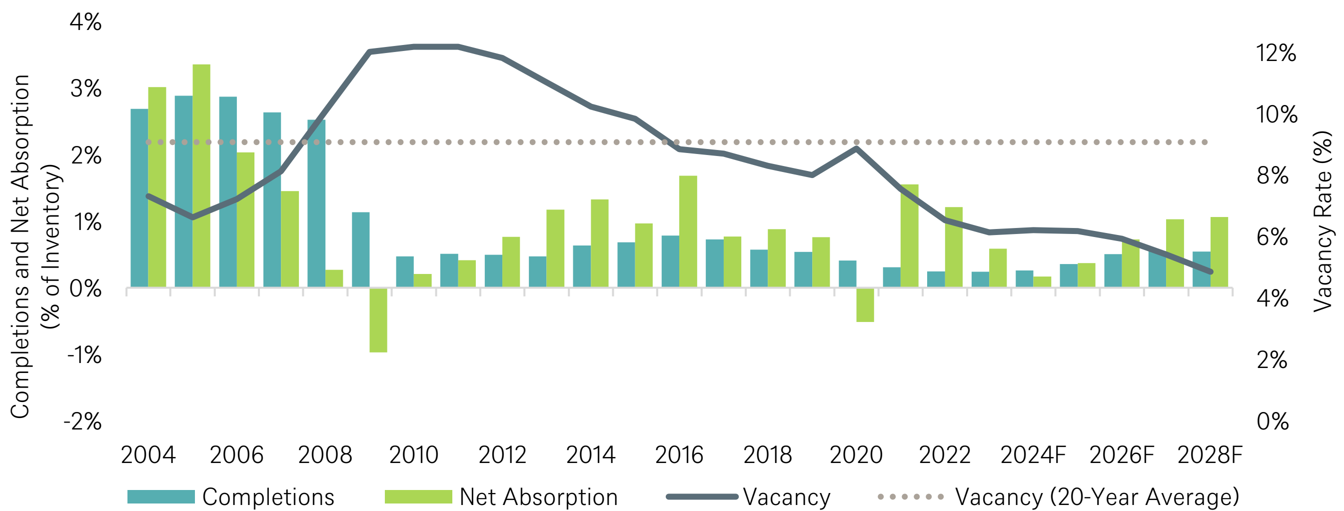
6 / Retail Outlook and Strategy

6.1 Current Conditions

The retail sector continued to post robust performance in 2024, supported by healthy retail spending. Over 16.6 million square feet of retail space was filled over the past four quarters, pushing the U.S. retail availability rate to a multi-decade low. At 6.5%, the retail availability rate is nearly 250 basis points below its 20-year historical average. [91] The primary constraint on leasing has been a lack of available space, due to limited new deliveries and the demolition of 145 million square over the last five years.[92]

EXHIBIT 13: RETAIL NET ABSORPTION AND COMPLETIONS AS % OF STOCK AND AVAILABILITY RATE (2004 – 2028)



Source: CBRE-EA (history) & DWS (forecast). As of June 2024.
Note: F = forecast. (1) Forecast for Neighborhood and Community centers. (2) Aggregate of DWS's Investable Universe of markets. There is no guarantee the forecasts shown will materialize. Past performance is not indicative of future results. No assurance can be given that any forecast or target will be achieved.

Retailers across numerous sectors are in active expansion mode, resulting in a greater number of store openings than closings for the third year in a row. Net openings through May 2024 are estimated at just over 3,400 stores.[93] With consumers steadily seeking value in response to higher prices, discount brands accounted for 34% of gross store openings.[94] However, the pipeline of store openings is not limited to discounters: retailers in the apparel, footwear, beauty and accessories segments are expanding for the first time in years. Brands that traditionally occupied inline mall space are moving into open-air shopping centers near their target customers. Even department and big box stores are pivoting toward smaller format stores in suburban neighborhood shopping centers.[95]

Demand growth has been widespread across the nation. Sun Belt locations such as Phoenix, Orlando and Austin were the clear outperformers, as retailers targeted markets that have seen strong buying power gains amid a surge of inward migration. The handful of markets that have seen retail demand losses over the past four quarters are predominantly on the West Coast, including

[91] CBRE-EA. As of 1Q 2024.
[92] JLL. As of May 2024.
[93] JLL. As of May 2024.
[94] Coresight Research. As of May 2024.
[95] JLL. As of My 2024.

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Seattle and San Francisco. Each of these underperforming markets continues to be affected by shifting population trends coming out of the pandemic and the perception of higher crime in certain key primary corridors.[96]

Numerous sectors are driving the growth in demand for retail space, including food and beverage, fitness, experiential, discount, health and beauty and medical services. Each of these expanding sectors has benefited from the pivot in consumer spending toward value, wellness and experiences. Given a preference among retailers for efficient spaces closer to the consumer, most of the demand has flowed into freestanding or neighborhood retail properties. In total, these retail property types accounted for 95% of all retail demand growth over the past several quarters.

The retail experience is centered around convenience. Having a physical store increases retailer's customer acquisition rates as consumers like to transition effortlessly between physical stores and e-commerce platforms. Moreover, having a physical store boosts online sales in the trade area surrounding that location by 6.9% on average in the immediate weeks following the opening of the store. And the online halo effect is twice that percentage for emerging, direct-to-consumer (DTC) retailers that open physical stores in the same trade area. The converse is true when stores shut down physical locations as closing a store reduces online sales in the trade area surrounding that store by 11.5%.[97]

With virtually no new supply on the horizon, healthy fundamentals are expected to persist in 2024 and beyond. We expect availability rates to fall further, supporting healthy rent gains.[98] Near-term risks include higher borrowing costs, yet consumers are likely to continue to spend on household priorities. Over the forecast, we expect shifts in post-pandemic buying patterns to benefit neighborhood and community centers. Migration from cities to the suburbs, population growth in lower-cost markets, and more flexible workplace strategies should continue to sustain demand at suburban shopping centers.

6.2 Outlook and Strategy

The U.S. retail space market entered 2024 with the tightest conditions on record. The vigorous post pandemic rebound in retail fundamentals was aided by both supply- and demand- side factors, which should continue to play a role in limiting store space options for expanding retailers in 2024. On the supply side, increased financing costs, coupled with reduced capital availability and still-elevated input costs, including land, labor and materials, conspired to constrain retail construction starts in 2023, with activity steadily falling throughout the year, and paling in comparison to prior periods. At the same time, the demolition of obsolete retail space continues to further whittle available stock from the market. With new construction starts continuing to fall and very little space remaining available in under-construction retail projects, supply pressure is unlikely to be a problem in for the foreseeable future.[99]

On the demand side, steady new retail leasing activity, coupled with a long list of retailers announcing store opening plans for 2024, appear to position the sector for positive gains over the forecast. Retail sectors likely to underpin growing demand for space include the discount, off-price, food and beverage, medical care and experiential sectors. Store closures are expected to remain below the peak seen during the "retail apocalypse" years of 2018 through 2020. Retail bankruptcies are the primary driver of store closures, and while weakness in certain segments such as pharmacy could contribute to an increase in move-outs in the year ahead, the overall risk from bankruptcy-related closures appears to be lower at this point than during 2018 through 2020. In addition, plenty of demand exists for quality space in prime retail corridors, as retailers looking to expand quickly have snapped up the leases that became available. Viewed in conjunction with the sparse supply outlook, the probability remains high that the U.S. retail space market will remain tight in the year ahead, a favorable outlook for retail investors.

[96] CBRE-EA. As of May 2024.
[97] ICSC. As of December 2023.
[98] DWS. As of May 2024.
[99] Costar. As of May 2024.

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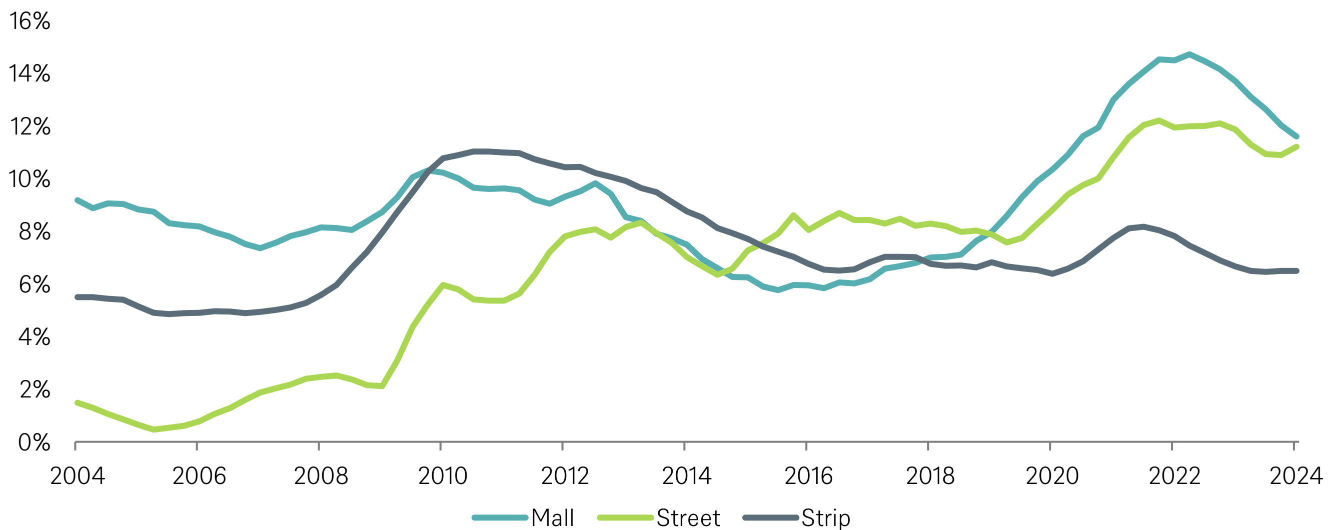
With the rise of remote work, workers began spending more money closer to home, forging new and lasting shopping habits. Strip centers, generally embedded in population centers, have been the primary beneficiary of this shift in consumer patterns. Worth noting, strip centers captured increased tenant interest since 2016 and have maintained healthy fundamentals throughout the past decade (Exhibit 14).[100] Moreover, open-air shopping remains in high demand. Retailers are strategically optimizing their footprints to cater to consumer preferences while controlling expenses and maximizing productivity. Open-air centers maintain an edge over traditional malls due to their proximity to residential areas, presence of essential retailers like grocery stores, and more diverse mix of consumer services.[101]

EXHIBIT 14: RETAIL VACANCY BY SUBTYPE



Source: NCREIF. As of March 2024.
Note: ***Mall:*** *A retail center that provides a variety of goods comparable to those of a central business district, over 400,000 SF in size. Consists of regional malls and super-regional malls.*
Street: *Located in the lower floors of, or adjacent to an office or multi-family building. Limited setback from the street and has access to heavy pedestrian and vehicle traffic.*
Strip: *An anchored or unanchored open-air shopping center, an aggregation of in-line stores with a common parking area. An anchor tenant (if any) may be a supermarket, discount store, major department store, or a specialty retailer. The center usually ranges in size from 30,000 to 400,000 SF but can be smaller or larger in some instances. This category typically consists of unanchored strip retail, neighborhood centers, community centers, fashion/specialty (lifestyle) centers and power centers.*

With excess savings largely depleted, consumers will become reliant on job and income growth to maintain spending habits. A softer job market may soften spending, but households are adapting by focusing on value. Centers with discount stores, grocery stores and superstores may lure more shoppers looking for value. Credit card debt surpassed the $1 trillion mark for the first time during the second quarter of 2023, and the rate of growth was the fastest since 2001. The ability to pay off debt will be challenged in a high interest rate environment, and credit card delinquency rates are now higher than at any time since 2012. An increase in delinquent auto loans and the resumption in student loan payments for more than 26 million borrowers could add another layer of risk. Fortunately, debt obligations relative to income are on par with pre-pandemic levels and still 25% below the 2007 level. The relationship between consumer debt and income will be the key metric to watch in the coming months.[102]

Going forward, we remain optimistic about retail sector for several reasons. In our view, the retail sector is better prepared for a potential economic slowdown, with a pipeline of healthy retailers ready to absorb oncoming vacant space. Also, tenant demand risk is concentrated within a small number of firms, and the corporate retail sector is better capitalized than in prior economic cycles. Limited new retail construction means prime space will remain scarce, presenting opportunities for healthy retail brands

[100] CBRE-EA, NCREIF. As of 1Q 2024.
[101] JLL. As of 1Q 2024.
[102] C&W. As of May 2024.

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to secure high-quality locations and strengthen market share, potentially with less competition. Established retailers and emerging Digitally Native Brands (DNBs) are continuously directed to brick-and-mortar stores. The increasingly diverse tenants occupying retail space are placing a greater emphasis on community needs, such as healthcare and fitness services, dining and leisure activities. This will help to insulate the sector from spending fluctuations.

Moreover, retail remains highly attractive on a relative basis compared to the other asset classes, with cap rate spreads of 260 bps over the 10-yr Treasuries (versus 176 bps for industrial and 111 bps for multifamily).[103] We may see this pricing spread moderate as institutional investors and REITs begin to re-enter the market in a meaningful way over the next few quarters. For the time being, however, retail investors will continue to see accretive risk-adjusted returns. While we observe a clear distinction in performance driven by geography, property subtype (Exhibit 15), and strength of the tenant line-up, we maintain our recommendation to target grocery-anchored retail located in high growth regional markets.

See Exhibit 15 for central themes that are shaping our retail strategy:

EXHIBIT 15: DWS RETAIL STRATEGY

Target Necessity-based Retail	Our conviction around daily needs and grocery-anchored retail remains high, as it is relatively immune to e-commerce pressures. Open-air suburban centers also benefit from increasing local consumption of goods and services.
Proceed with Caution on Power Centers	There is a risk that demand for electronics, furniture, appliances, and other household goods has been satiated (for now) following the COVID housing boom, and these categories are more vulnerable to online competition. Still, we believe that power centers will evolve into last-mile distribution locations over time.
Avoid Malls and Transitional Assets	We expect e-commerce penetration will continue to grow in the apparel and commodity goods sector, which impacts malls, class B/C assets and high street retail the most. Some malls may thrive in the future as redeveloped mixed-use or entertainment-infused destinations, but the cost of managing the transition may detract from investment performance.

Source: DWS. As of June 2024.

[103] RCA. As of June 2024.

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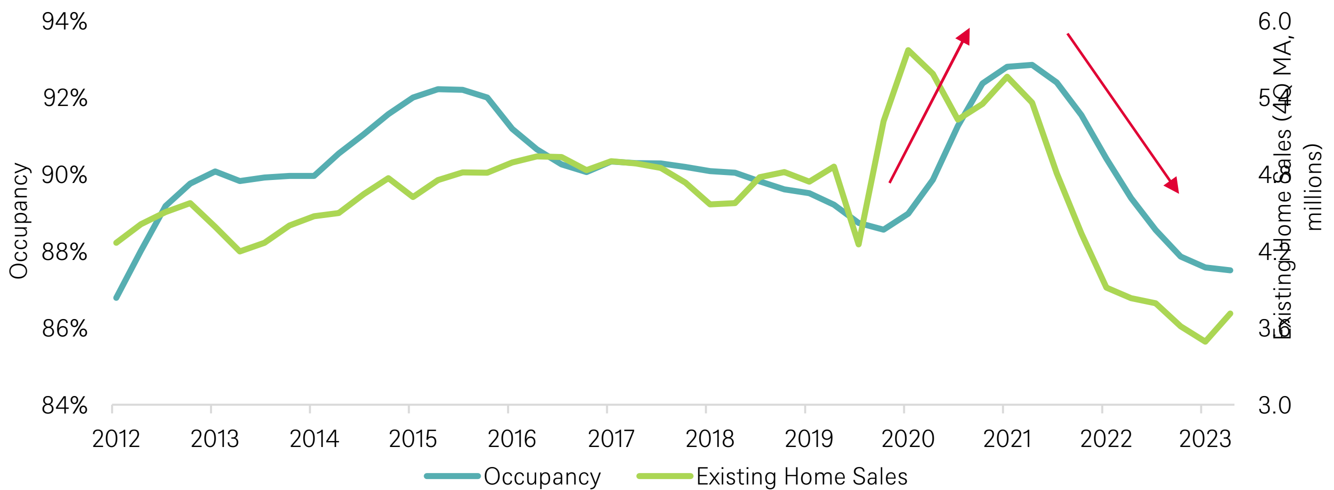
7 / Self-Storage Outlook and Strategy

Over the past two years, self-storage has seen fundamentals normalize as the pandemic induced boost in demand has subsided. Higher mortgage rates have led to a decline in home sales, a pivotal seasonal demand driver and a proxy for population mobility (Exhibit 16). With sellers reluctant to trade lower in place mortgages and buyers facing high home ownership costs, home sale volume is at a decade low.[104] For reference, 77% of outstanding mortgages are below 5%, around 200 bps below where mortgage rates are currently.[105] Simultaneously, new completions continued to enter the market post-COVID.[106] Given that self-storage properties take longer to stabilize, new supply can strain fundamentals for an extended period relative to other property types. Both supply and demand related factors have put downward pressure on occupancy and move-in rates.

EXHIBIT 16: OCCUPANCY AND EXISTING HOME SALES



Source: NCREIF (occupancy) & NAR (existing home sales). As of March 2024.

Despite these challenges, 2023 NOI growth for the property type was a positive 3.9%.[107] This was primarily due to existing customer rental increases (ECRIs), a revenue maximizing mechanism unique to self-storage. Over time, existing customers are hit with frequent rent renewals offsetting the negative impact of declining move-in rents on revenue. This mechanism is particularly effective in self-storage for a few reasons. First, self-storage leases are monthly, allowing for frequent rent resets. Second, tenants tend to be sticky with 50% of existing customers staying longer than a year; this is a 10% increase since pre-COVID.[108] Last, self-storage rents, on average, make up about 2% of monthly median household income. As such, large increases in renewals can be absorbed by a sticky customer.[109]

Going forward, we expect a recovery in self-storage fundamentals over the medium term due to a combination of demand and supply related factors. From a demand perspective, expected rate cuts should provide some relief to low home sale volume,

[104] NAR. As of March 2024.
[105] FHFA. As of December 2023. Primary Mortgage Market Survey (PMMS). As of May 2024.
[106] Green Street. As of January 2024.
[107] Green Street. As of January 2024.
[108] Self-Storage Almanac. As of December 2023.
[109] Yardi-Matrix; U.S. Census Bureau. As of December 2023.

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encourage population mobility, and lead to stronger seasonal demand. We expect this relief to materialize not just as a normalization of the home sale market, but also potentially as a release of pent-up demand created due to today's high mortgage rates. Pent up demand could create a period of slightly higher-than-average home sale activity. On the supply side, project sponsors are reporting a difficult and expensive construction-financing environment.[110] A combination of declining supply and recovering demand should create a ripe environment for the property type over the medium-term. Separately, longer than expected lease up periods, declining move-in rates, and maturing construction loans are creating opportunities to acquire newly delivered self-storage properties at an attractive basis.

Structural demand drivers also remain intact. First, we are seeing improved household formation rates among millennials, a demographic that is using self-storage at higher rates than other generations.[111] Second, with office attendance still half what it was pre-Covid, hybrid work seems like it is here to stay for the foreseeable future, creating demand for more space.[112] This is especially important as apartment developers did not consider the need for this new lifestyle preference prior to the pandemic. As a result, the existing overweight of small unit sizes and lack of multiple bedroom designs may not meet the needs of dwellers and could continue to generate additional demand.

[110] Yardi-Matrix. As of March 2024.
[111] Green Street. As of January 2024.
[112] Kastle Back to Work Barometer. As of May 2024.

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8 / Debt Outlook and Strategy

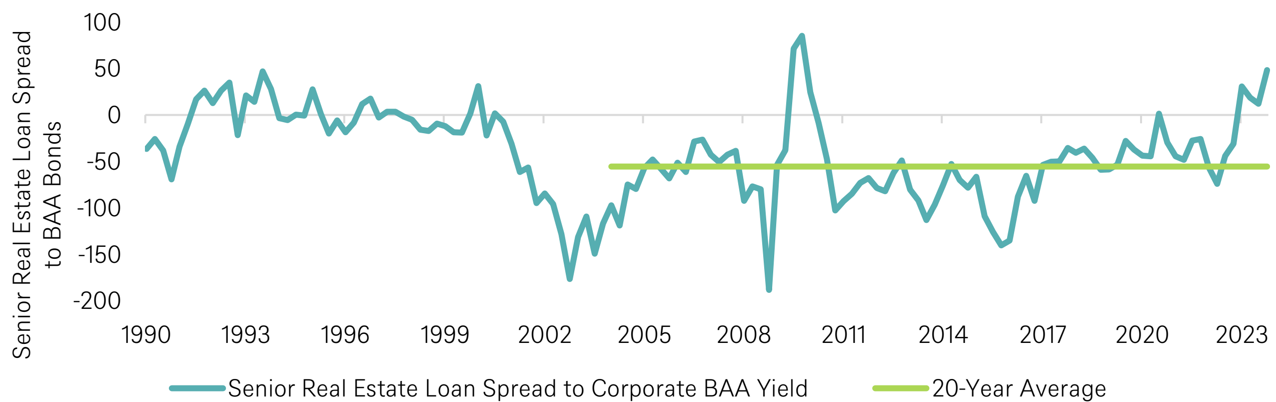
Total returns on senior real estate loans cooled at the beginning of 2024 as modest spread compression failed to compensate for rising Treasury yields. Still, after a strong year-end 2023, total returns were 2.7% on a trailing four-quarter basis, up sharply from -9.0% in calendar year 2022.[113]

Delinquency rates on real estate loans edged higher in the banking sector, although they remained low (1.2%).[114] Deterioration was more visible in the commercial mortgage-backed securities (CMBS) market (almost entirely concentrated in the office sector), where delinquency rates jumped to 5.4% in April 2024 from under 3% in 2022.[115]

Mortgage originations remained muted in the first quarter of 2024, matching subdued real estate transaction volumes.[116] However, activity has stabilized at lower levels (originations and volumes were in line with year-earlier totals). Relative to the third quarter of 2023 (an apparent inflection point), more banks reported increasing demand for real estate credit, and fewer reported a tightening of lending standards.[117]

Spreads on senior real estate loans eased slightly in the first quarter, averaging approximately 220 bps on commercial property and 180 bps on apartments.[118] Overall, spreads remain in line with historical averages and well below COVID and Global Financial Crisis (GFC) peaks.[119] However, following a rally in listed credit markets, the gap between yields on real estate debt and BAA corporate bonds widened to their highest levels on record (since 1990), outside a brief period during the GFC (Exhibit 17).[120]

EXHIBIT 17: SENIOR REAL ESTATE LOAN SPREAD TO CORPORATE BAA YIELD



Source: ACLI (real estate) & Moody's (BAA). As of December 2023.

In our view, high yields, attractive relative spreads, and limited competition from banks (which account for 50% of outstanding mortgages) have created favorable conditions for real estate debt investors.

[113] Giliberto-Levy. As of March 2024.
[114] Federal Reserve. As of March 2024.
[115] Moody's. As of April 2024.
[116] MBA (originations); MSCI (transactions). As of March 2024.
[117] Federal Reserve. As of March 2024.
[118] CBRE. As of March 2024.
[119] ACLI and CBRE. As of March 2024.
[120] ACLI and CBRE (real estate); Moody's (BAA); DWS calculations. As of March 2024.

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Appendix 1: U.S. House Portfolio

The DWS House Portfolio represents our opinion of the allocation by property sector for core portfolios in the United States which we believe would outperform the NFI-ODCE. We develop the House Portfolio as an unlevered portfolio of properties without regard to tax consequences. The House Portfolio is formulated using both quantitative and qualitative modeling, integrated with our House View. The resulting weights, we believe, aid in providing long-term risk-adjusted outperformance to our portfolios versus the market as a whole and against relevant benchmarks and indices. The analysis focuses on the four major property sectors and excludes hotels. The following table summarizes our conclusions on weightings in comparison with the NFI-ODCE.

Sector	Expanded NPI Weights	ODCE Weights	House Portfolio	Active Bet (vs ODCE)	Range
Apartment	28%	29%	34%	+5%	29% - 39%
Industrial	32%	34%	43%	+9%	38% - 48%
Office	22%	18%	6%	(12%)	1% - 11%
Retail	13%	11%	15%	+4%	10% - 20%
Other	6%	9%	2%	(7%)	0% - 7%

Note: NPI weights calculated as gross real estate value excluding ownership share. ODCE weights calculated as gross real estate value at ownership share. Totals might not add up to 100% due to rounding.
Sources: NCREIF; DWS. As of March 2024.

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Appendix 2: Real Estate Target Markets

Investable Metros: We screened top U.S. metros, which represent 90% of the NCREIF Property Index, and identified the investment markets for each property sector that we believe have the best prospects during the market cycle or a portion of it. This metro selection is based on property market size, liquidity, growth characteristics, income, historical returns and other factors indicative of future performance. The list of these metros remains generally static, although some metros may be added or subtracted over time due to structural market changes.

Target Investable Metros: These are a subset of the universe of investable metros and include markets that we expect to outperform or market perform during the next three to five years.

INVESTABLE AND TARGET MARKETS

↑ Overweight ↓ Underweight ↔ Market Weight

Market	Apartments	Industrial	Office	Retail
Allentown		↑		
Atlanta	↑	↑	↑	↑
Austin	↑	↔	↑	↑
Baltimore		↑		
Boston	↔	↑	↔	↔
Charlotte	↑	↔	↑	↑
Chicago	↓	↓	↓	↓
Dallas	↑	↑	↑	↔
Denver	↑	↓	↑	↑
Fort Lauderdale	↑	↑	↑	↑
Harrisburg		↔		
Houston	↓	↓	↓	↔
Jacksonville	↑			↑
Las Vegas		↑		
Los Angeles	↓	↔	↓	↔
Miami	↑	↑	↑	↑
Minneapolis	↓			↓
Nashville	↑	↔	↑	↑
New York	↓	↔	↓	↓
Oakland / East Bay	↓	↔	↔	↔
Orange County	↔	↔	↓	↔
Orlando	↑	↑		↑
Philadelphia / Central PA	↓	↔		↓
Phoenix	↑	↔	↔	↑
Portland	↓	↔	↔	↔
Reno		↔		
Raleigh	↑			↑
Riverside	↑	↔		↔
Salt Lake City	↑	↔		
San Diego	↔	↔	↔	↑
San Francisco	↓	↓	↓	↓
San Jose	↔	↔	↔	↔
Seattle	↔	↑	↔	↑
Tampa	↑			↑
Washington DC	↓	↑	↓	↔
West Palm Beach	↑			↑

Source: DWS. As of June 2024. 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.

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Appendix 3: Performance over the past 5 years (12-month periods)

	3/23-3/24	3/22-3/23	3/21-3/22	3/20-3/21	3/19-3/20
Expanded NCREIF Property Index (NPI)	-6.9%	-1.2%	21.5%	2.7%	5.3%
Residential	-6.1%	-0.1%	23.8%	2.6%	5.0%
Industrial	-3.1%	2.3%	51.7%	13.9%	12.8%
Office	-16.7%	-8.1%	7.0%	1.6%	6.4%
Retail	-0.7%	1.0%	6.8%	-6.0%	-1.9%
Other	-1.2%	5.0%	20.8%	2.8%	5.9%
Residential: Apartment	-6.5%	-0.4%	24.2%	2.6%	5.0%
Residential: Student Housing	2.4%	6.0%	14.4%	2.6%	4.8%
Residential: Single Family Rental	-3.6%	3.8%	N/A	N/A	N/A
Residential: Manufactured Housing	9.0%	8.8%	N/A	N/A	N/A
Office: CBD	-22.0%	-11.5%	4.1%	-0.3%	6.0%
Office: Suburban	-12.6%	-6.4%	12.4%	3.1%	5.9%
Office: Urban	-16.4%	-7.9%	6.1%	2.1%	6.9%
Office: Secondary Business District	-12.5%	-7.2%	8.8%	2.8%	4.6%
Office: Life Science	-7.9%	2.1%	25.3%	15.7%	14.4%
Office: Medical Office	-2.5%	1.2%	12.5%	7.6%	8.2%
Industrial: Warehouse	-3.5%	2.0%	52.0%	14.0%	12.8%
Industrial: Specialized	0.5%	4.7%	50.2%	12.8%	13.5%
Industrial: Flex	-0.4%	6.9%	47.6%	12.3%	11.5%
Industrial: Manufacturing	-3.8%	7.8%	49.1%	14.4%	12.0%
Industrial: Life Science	-2.6%	5.0%	21.1%	10.4%	18.0%
Retail: Mall	-1.4%	-0.1%	5.3%	-8.7%	-3.7%
Retail: Strip	1.3%	3.1%	9.6%	-2.0%	0.5%
Retail: Street	-9.2%	-4.3%	1.7%	-8.8%	-3.1%
Other: Self-Storage	-2.2%	6.7%	37.8%	9.1%	7.2%
Other: Senior Housing	-3.1%	1.1%	4.4%	0.1%	6.0%
Other: Other	-0.1%	4.1%	13.8%	4.4%	6.2%

	3/31/2024	3/31/2023	3/31/2022	3/31/2021	3/31/2020
NASDAQ Composite Index	34.0%	-14.1%	7.4%	72.0%	-0.4%
S&P 500 Index	27.9%	-9.3%	14.0%	53.7%	-8.8%
FTSE NAREIT All Equity REITs	10.4%	-19.2%	26.2%	37.7%	-21.0%

Sources: NCREIF, Bloomberg, NAREIT, and DWS. As of March 2024.

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