

U.S. Real Estate Strategic Outlook

January 2024

IN A NUTSHELL

- From a macro perspective, real estate performance is a function of the economy and interest rates, in our view. Typically, the former carries more weight than the latter. However, in this post-COVID cycle, interest rates have dominated, weighing on returns despite healthy economic conditions.¹
 - By extension, we believe that real estate will perform better in 2024, despite a potential recession, as interest rates plateau and possibly decline. Moreover, the effects of the prior interest-rate shock – higher cap rates and reduced construction – may pay dividends for years to come.
 - We favor the industrial and residential sectors, which benefit from structural tailwinds, as well as grocery-anchored retail, which has overcome e-commerce challenges. We underweight the office sector pending a normalization of demand and more attractive valuations.
 - Geographically, we generally favor markets in the Sun Belt and Mountain West, which will profit from outsized population and job growth for the foreseeable future, in our view.
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1 / Real Estate Outlook

Real estate has historically been synchronized with the economy (see Exhibit 1). Total returns were negative in the savings- and loan (early-1990s) and global financial (2008-09) crises and weak in the dot-com (2001) and COVID (2020) recessions.² Interest rates were mildly correlated with the economy (rising in expansions and falling in contractions), arguably muting the real-estate cycle, but never stopping it.³

¹ NCREIF. As of September 2023.

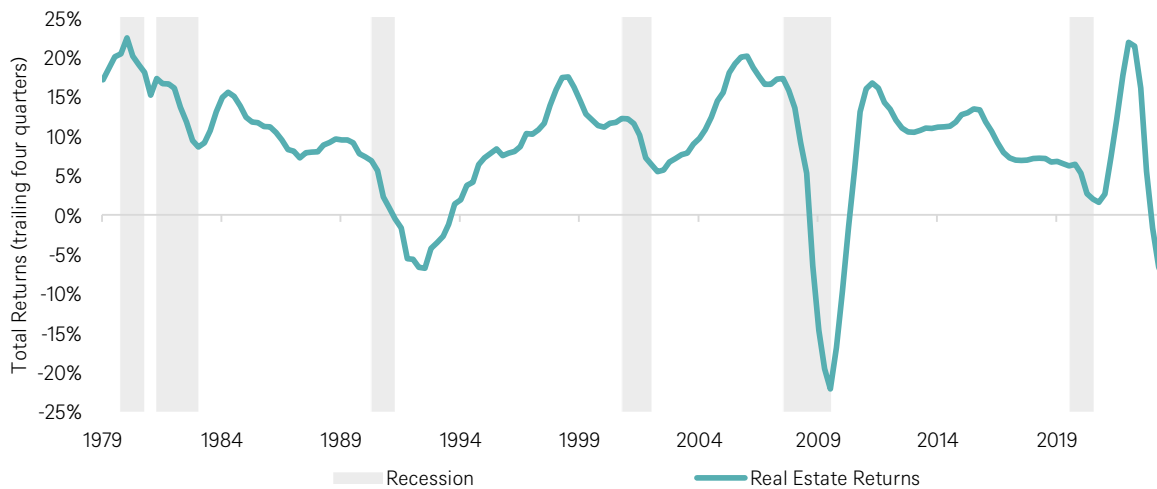
² NCREIF. As of September 2023.

³ Bureau of Economic Analysis (GDP); Federal Reserve (Treasuries); DWS. As of September 2023.

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EXHIBIT 1: REAL ESTATE RETURNS AND RECESSIONS

Sources: NCREIF (real estate); National Bureau of Economic Research (recessions). As of September 2023.

This pattern dissolved in 2023, as real estate values fell despite strong economic growth (GDP was up 3% year-over-year in September).⁴ The distinguishing factor, in our view, was the magnitude of the interest-rate shock: 10-year Treasury yields increased from under 1% in 2020 to 5% in October 2023, the largest jump since 1980.⁵ Unlike in past cycles, the detrimental impact of higher interest rates trumped the salutary effects of a buoyant economy.

To be sure, real estate dynamics were also at play. In the residential and industrial sectors, demand cooled from a COVID-fueled spike, just as supply sparked by the initial surge materialized.⁶ The office sector reeled from the effects of hybrid work, exacerbated by layoffs in the technology industry.⁷ Still, vacancy rates across sectors remained near an all-time low in the third quarter of 2023 (5.7%) and net operating income (NOI) increased an inflation-beating 5.6% year-over-year.⁸

In our view, interest rates are pivotal to the near-term outlook. Since 1980, 10-year Treasuries have been strongly correlated (0.74) with inflation, which is on a downward trajectory thanks to a shrinking money supply (driven by Federal Reserve (Fed) policy) and a resolution of COVID-related imbalances (labor and factories are back to work) (see Exhibit 2).⁹ It is not the only consideration: Burgeoning fiscal deficits and the Fed's efforts to shrink its balance sheet arguably exert upward pressure on interest rates, while an abundance of global savings, courtesy of an ageing population, could push them lower.¹⁰ The reality may lie somewhere in the middle. With inflation under control, Treasury yields could settle above levels prevailing in the 2010s (around 2.5%) but below those of the 2000s (4.5%) – perhaps around 3.5%.¹¹

⁴ NCREIF (real estate); Bureau of Economic Analysis (GDP). As of September 2023.

⁵ Federal Reserve. As of December 2023.

⁶ CBRE-EA. As of September 2023.

⁷ CBRE-EA (office); Bureau of Labor Statistics (tech). As of December 2023.

⁸ NCREIF. As of September 2023.

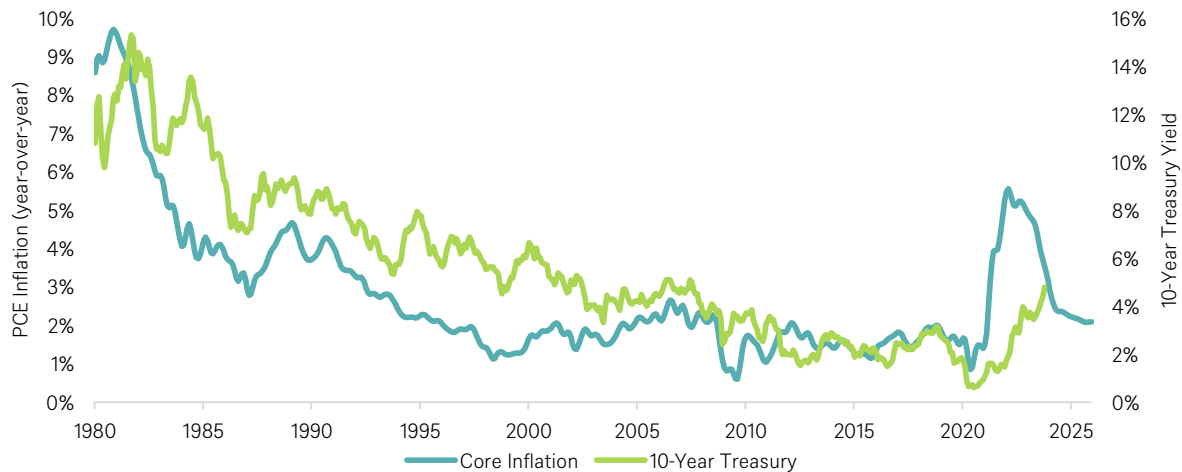
⁹ Federal Reserve (Treasuries, money supply, supply chains); Bureau of Labor Statistics (labor); Bureau of Economic Analysis (inflation). As of October 2023.

¹⁰ Congressional Budget Office (deficits); Federal Reserve (balance sheet); DWS (savings). As of November 2023.

¹¹ Federal Reserve; DWS. As of November 2023.

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EXHIBIT 2: INFLATION AND TREASURY YIELDS



Source: Moody's Analytics (inflation); Federal Reserve (Treasury). As of November 2023.

If this interest-rate perspective is correct, market cap rates have likely peaked, while appraisal-based cap rates, which respond with a lag, may stabilize in the first half of 2024. This would represent a sea change for real estate: At worst, it would remove a major headwind to valuations; at best, it would create tailwinds for future performance, should cap rates follow interest rates lower.

Though a secondary consideration in this cycle, fundamentals should not be ignored. The yield curve, which has inverted 1-2 years before each of the past eight recessions, points to an economic downturn in 2024 (having inverted in the summer of 2022).¹² Buffers built up during the pandemic – \$2 trillion in surplus savings and pent-up demand for vehicles and other goods – have run down, exposing the economy to the lagged effects of higher interest rates.¹³ The weaker confidence and spending power associated with recessions typically stifle real estate demand.¹⁴

However, any pullback may be limited. In our view, the recession will be short and mild, thanks to robust consumer finances (wealth is elevated and financial obligations are low relative to incomes).¹⁵ Structural drivers, including population growth and prohibitive homeownership costs (residential) as well as e-commerce and supply-chain resilience (industrial), may act as a counterweight. Finally, lower prices and restrictive financing have curtailed construction: Starts plunged 65% from their 2022 peak in the third quarter of 2023 (see Exhibit 3).¹⁶ Existing projects will come to fruition in 2024, but thereafter, supply is poised to evaporate. Overall, we believe that rents will hold roughly steady in 2024 (they fell 5%-10% in the dot-com bust and global financial crisis), before accelerating sharply in 2025 and 2026.¹⁷

¹² Federal Reserve (yield curve); National Bureau of Economic Research (recessions). As of November 2023.

¹³ Census Bureau and DWS. As of November 2023.

¹⁴ CBRE-EA. As of September 2023.

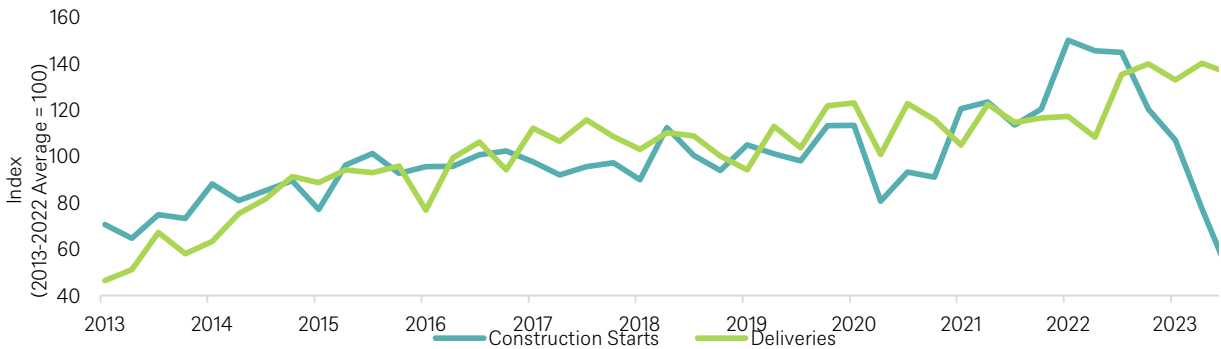
¹⁵ Federal Reserve. As of September 2023.

¹⁶ CoStar. As of September 2023.

¹⁷ CBRE-EA; DWS. As of September 2023.

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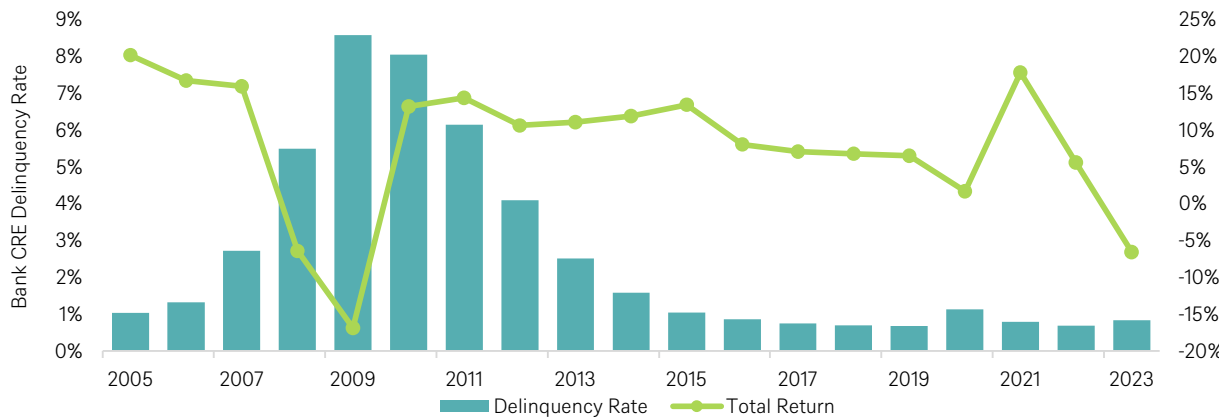
EXHIBIT 3: CONSTRUCTION STARTS AND DELIVERIES



Source: CoStar and DWS. As of September 2023. Weights: Industrial (35%), Multifamily (30%), Office (20%), Retail (15%).

We believe that 2024 will mark a turning point for U.S. real estate, as easing financial conditions offset a soft patch for fundamentals. The year will not be without challenges. Some borrowers may struggle to service or refinance debts secured at much lower interest rates. However, history shows that distress can coincide with a market recovery, as fresh capital looks to exploit emerging opportunities. In 2010, delinquency rates were high and nearly 20% of all transactions were “distressed” (per Real Capital Analytics), yet real estate produced double-digit returns (see Exhibit 4).¹⁸

EXHIBIT 4: BANK REAL ESTATE DELINQUENCIES AND REAL ESTATE TOTAL RETURNS



Source: Federal Reserve (delinquency rate); NCREIF (total returns). As of September 2023.

Beyond 2024, prospects for real estate are increasingly bright, in our view. Lower values and rising cash flows are pushing income returns to their highest level in more than a decade.¹⁹ Fundamentals are essentially sound, and supply shortages may propel strong rent growth over the next several years. If interest rates ease, cap rates could follow suit, adding further support to capital appreciation. In short, we believe that 2024 will provide an attractive entry point to capitalize on the coming cycle.

¹⁸ Real Capital Analytics (distress); FDIC (delinquencies); NCREIF (returns). As of September 2023.

¹⁹ NCREIF; DWS. As of September 2023.

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2 / Investment Strategy

Interest rates, for better or worse, affect all kinds of real estate. Yet from a relative perspective, sectors and markets are largely differentiated by fundamentals, especially occupational demand. COVID and its aftermath have scrambled fundamentals in ways both temporary and persistent, in our view. The challenge is to distinguish the signal from the noise.

Demand for apartments and warehouses has softened over the past two years. This is noise, in our view: a temporary reset following a pandemic surge. We believe that the longer-term drivers of residential (population growth, housing shortages, and affordability challenges) and industrial (e-commerce and supply-chain resilience) property remain intact. In contrast, the office sector's travails may be more of a signal. In our view, although office utilization may gradually increase, companies will continue to reduce footprints as their leases mature. The resilience of grocery-anchored retail is also a signal, in our view, reflecting the rise of service-based demand, increased spending in suburban areas (due to migration and remote work), and a dearth of new supply.

Anomalies have also surfaced at the geographic level. Apartment and office conditions have generally held up better this year in Chicago and New York than in many Sun Belt markets (e.g., Phoenix, Dallas, Atlanta, Nashville, and Tampa) and tech-driven cities (e.g., Seattle, San Jose, and Austin). This too, we believe, is noise, stemming from a partial reversal of the pandemic wave of digitalization and migration, and the lagged supply response it induced. Over the long-term, we believe that the underlying forces driving migration (demographics and financial and lifestyle factors) and digital growth (artificial intelligence and other innovations) will prevail, benefiting Sun Belt and tech-driven markets.

Industrial (Overweight): Industrial absorption was weak in the first three quarters of 2023, totaling less than 80 million SF, down nearly 75% from the year before.²⁰ The slowdown, coupled with nearly 350 million SF of new supply (a vestige of the earlier demand boom), increased vacancy rates.²¹ We believe that these trends will continue in the first half of 2024, causing rent growth to decelerate toward zero from 9.6% year-over-year in the third quarter of 2023.²² Thereafter, however, we believe the sector will experience a sharp rebound as absorption revives and supply throttles back. In our view, industrial demand has nearly returned to trend levels, providing scope for longer-term structural drivers – e-commerce and efforts to bolster supply chains – to reassert themselves. Meanwhile, construction starts have collapsed – down 75% year-over-year in the third quarter – portending space shortages in the second half of next year as a new demand cycle takes hold.²³

Residential (Overweight): Apartment demand fell in 2022, unwinding a COVID spike, when remote working (and healthy bank accounts) motivated people to split from families and roommates and rent second homes.²⁴ Demand returned to trend levels in the second and third quarters of 2023, heralding an end to the post-pandemic adjustment.²⁵ Rental traction will be limited in 2024, in our view, as new buildings already underway deliver to the market. However, a 60% year-over-year drop in construction starts in the third quarter of 2023 implies that the supply pipeline will diminish sharply in 2025.²⁶ As supply pressures ease, we believe that population growth (which has picked up as immigration has resumed) and chronic housing shortages (marked by the lowest vacancies and for-sale affordability since the 1980s) will support strong rental growth.²⁷

Retail (Overweight): Retail vacancies fell to their lowest levels since at least 2005 in 2023.²⁸ Demand for grocery-anchored centers is supported by migration from urban to suburban areas, a trend that began nearly a decade ago as Millennials aged, and accelerated during the pandemic with increased homeworking.²⁹ Strip centers are largely service-oriented, and therefore relatively insulated from e-commerce; to the extent that they dispense goods (e.g., groceries), they can help to fulfill online

²⁰ CBRE-EA. As of September 2023.

²¹ CBRE-EA. As of September 2023.

²² CBRE-EA. As of September 2023.

²³ CoStar. As of September 2023.

²⁴ CBRE-EA. As of September 2023.

²⁵ CBRE-EA. As of September 2023.

²⁶ CoStar. As of September 2023.

²⁷ Census Bureau (population, vacancies); National Association of Realtors (affordability). As of September 2023.

²⁸ CBRE-EA. As of September 2023.

²⁹ Census Bureau. As of September 2023.

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orders (i.e., delivery or pickup from store).³⁰ While retail property rarely delivers the rental gains that are sometimes achieved in the industrial and residential sectors, we believe that it is well positioned to produce competitive, relatively stable returns over the next cycle.

Office (Underweight): Demand for office properties was weak in 2023, pushing vacancy rates to their highest levels since the early 1990s (and above their Global Financial Crisis peaks).³¹ Two factors have contributed to the malaise, in our view: First, although the economy has performed well, the technology industry, which has accounted for about 40% of office leasing in recent years, has retrenched.³² Second, the rise of remote work has inspired some companies to reduce their space requirements. Recent optimism around artificial intelligence provides hope that tech-sector headwinds will abate. However, given the long-term nature of office leases, it will take time for companies to recalibrate to new working models.³³ We believe that the office sector will eventually recover as labor-force growth fills the gaps and some buildings are converted for residential use. However, this process will extend at least through 2025, in our view, and market values have not yet sufficiently adjusted to the new reality.

³⁰ REIT filings and WS. As of September 2023.

³¹ CBRE-EA. As of September 2023.

³² Newmark (leases); Bureau of Labor Statistics (tech jobs). As of September 2023.

³³ Kastle Systems. As of September 2023.

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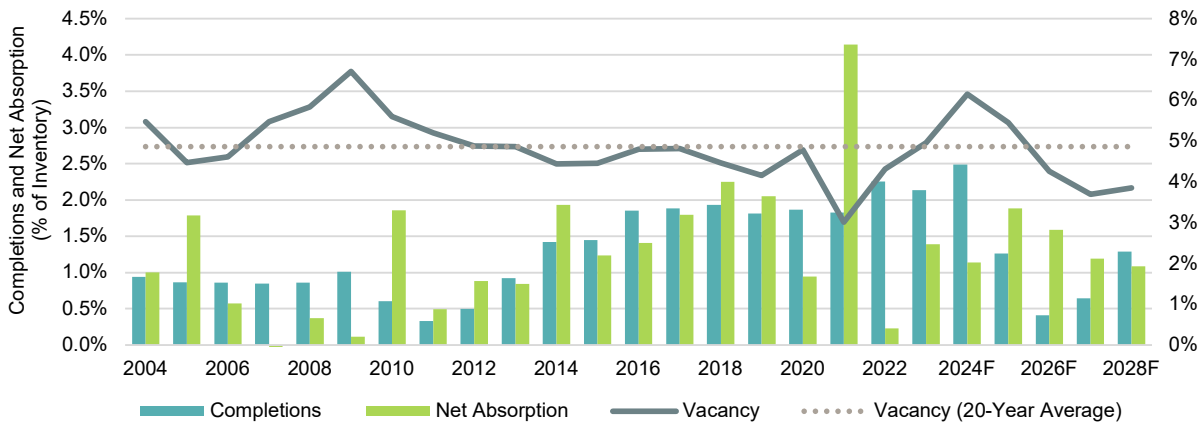
3 / Residential Outlook and Strategy

3.1 Current Conditions

While there has been a resurgence in renter demand to levels consistent with strong pre-pandemic years, the nation’s residential market is expected to see rising vacancies in 2024. Apartment demand in 2023 was driven largely by strong (although slowing) job growth, improving consumer sentiment and a rising cost of homeownership that has forced many would-be homebuyers to stay in the rental market. Though there is a lot of leasing demand, it’s just not enough to keep pace with the country’s largest apartment construction surge in 30 plus years. With supply outpacing demand, average rent growth for DWS’s 31 Investable Markets (“Investable Markets”, “Investable Universe”) fell to around 0.5% in December 2023 from a year earlier, down from 6.9% at the end of 2022 – reflecting the tail end of the post-pandemic bull run.³⁴ The apartment vacancy rate, a key indicator of the rental market’s health and competitiveness, stood at 5.0% last September, which is in line with its long-term average – yet another indicator that the market is working back toward normal performance.³⁵

The strong performance of apartments coming out of the pandemic, coupled with the long-term need for housing, sparked a major development cycle. Over 95,000 units were delivered to the Investable Universe during the third quarter of 2023, representing the largest quarterly sum on record.³⁶ Due to the unusual surge in new supply, more developers and landlords are offering enticements to lease up their properties, from a month of free rent to a reduction in fees and deposits.³⁷ Approximately 570,000 units currently under construction in the DWS Investable Universe are projected to be delivered over the next handful of quarters, adding almost 4.0% to the existing base.³⁸ New supply outpaced demand by 75,000 units during the first nine months of 2023. Still, this marked a significant improvement from the first three quarters of 2022 (201,000 units of excess new supply over demand).³⁹

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 December 2023.
 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.

Developers and investors have been focused on expanding apartment holdings in the Sun Belt, even before the explosion of demand and rent growth that occurred in 2021. But the region has seen an outsized increase in development activity of late.

³⁴ CBRE-EA & DWS. As of December 2023.
³⁵ CBRE-EA & DWS. As of December 2023.
³⁶ CBRE-EA & DWS. As of December 2023.
³⁷ CoStar, Yardi Matrix, CoStar & DWS. As of December 2023.
³⁸ Yardi-Matrix, CBRE-EA, Real Page, & DWS. As of December 2023.
³⁹ CBRE-EA, DWS. As of December 2023.
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In 2019, major Sun Belt markets accounted for 41% of new supply for the DWS Investable Universe, but in 2023 and 2024, the Sun Belt's share of newly completed units will jump to 53% and 56%, respectively.⁴⁰ There is a handful of markets that did not experience a run-up in construction; completions in Boston, Orange County, San Diego, San Jose, Portland, and Seattle were flat or down over past three years.⁴¹

Performance continues to be mixed by region. The Midwest and Northeast fared the best in 2023, with annual rent growth slowing only marginally, while Sun Belt and Western markets decelerated.⁴² Markets that have not experienced large supply-demand imbalances have maintained respectable rent growth numbers. The DWS Investable Markets that now occupy the top spots for rent growth include Boston, Chicago, New York, and Northern New Jersey. In contrast, record apartment completions combined with soft demand created the perfect storm of negative market conditions, especially in Sun Belt locations. Sun Belt markets that led the explosive rent growth during 2021 have witnessed rent deceleration two or three times faster than the nation. Atlanta, Austin, Jacksonville, Nashville, and Phoenix stand out as the DWS Investable Markets that have watched rent growth slow the most over the past six quarters.

Though peak deliveries are expected to come online during the first half of 2024, key forward-looking indicators for construction spending are showing signs that a major pullback is underway. These leading indicators include: the Fed's Senior Loan Officer Opinion Survey (tight lending standards), American Institute of Architects' Architecture Billings Index (declining billings) and the National Association of Home Builders/Wells Fargo Housing Market Index (still low sentiment). Multi-family construction starts have started to slow, down 33.1% year-over-year in October 2023.⁴³ The missed construction starts is not surprising given the interrelated set of obstacles that developers are facing, highlighted by the cost and reduced availability of debt as well as high land and construction costs that are making it difficult to finance new properties. Some analysts are suggesting a further 30% to 50% decline in starts for 2024.⁴⁴

While the projected economic soft landing appears to have been largely achieved thus far, the nation's job growth is expected to continue slowing in 2024. Though an uncertain economic outlook persists, residential demand is boosted by long term structural influences that are not likely to fade. These structural influences include positive demographic trends, housing deficit, shifting lifestyle preferences, and better relative affordability. The age group most likely to form new households – those from 25 to 34 years old – is now the largest in history, increasing by 3.7 million in the past decade.⁴⁵ As of October 2023, the current level of U.S. household formation is 1.9 million, which is up from 1.2 million a year ago and its highest point since the pandemic.⁴⁶

This rebound in households has been an important contributor to a considerable increase in housing demand. While demographic growth is creating a need for new housing, new construction is not keeping up. For example, construction starts on single-family and multifamily housing projects topped 1.5 million units last November, resulting in a potential shortfall of almost a half million units in housing demand for 2023.⁴⁷ Potential homebuyers are currently not finding much on the market either with the available inventory of existing homes for sale in November representing a 3.5-month supply at the current sales pace – a six-month supply is considered a balanced market.⁴⁸ Despite an uncertain economic outlook, low supply will likely keep home price declines minimal in 2024.

Though homeownership still remains a key benchmark for younger Americans, it has not been a stellar period to purchase a home – 2023 was the least affordable year for homebuying on record.⁴⁹ Despite higher mortgage rates, the median price for existing homes sold last November was \$387,600 – a record high for that month – which was up 4.0% from a year ago and

⁴⁰ Yardi-Matrix, CBRE-EA, RealPage, & DWS. As of December 2023.

⁴¹ Yardi-Matrix, CBRE-EA, RealPage, & DWS. As of December 2023.

⁴² Yardi-Matrix, CBRE-EA, CoStar, & DWS. As of December 2023.

⁴³ U.S. Census Bureau & DWS. As of December 2023.

⁴⁴ GlobeSt & DWS. As of December 2023.

⁴⁵ Joint Center for Housing Studies of Harvard University & DWS. As of December 2023.

⁴⁶ U.S. Census Bureau & DWS. As of December 2023.

⁴⁷ U.S. Census Bureau & DWS. As of December 2023.

⁴⁸ National Association of Realtors & DWS. As of December 2023.

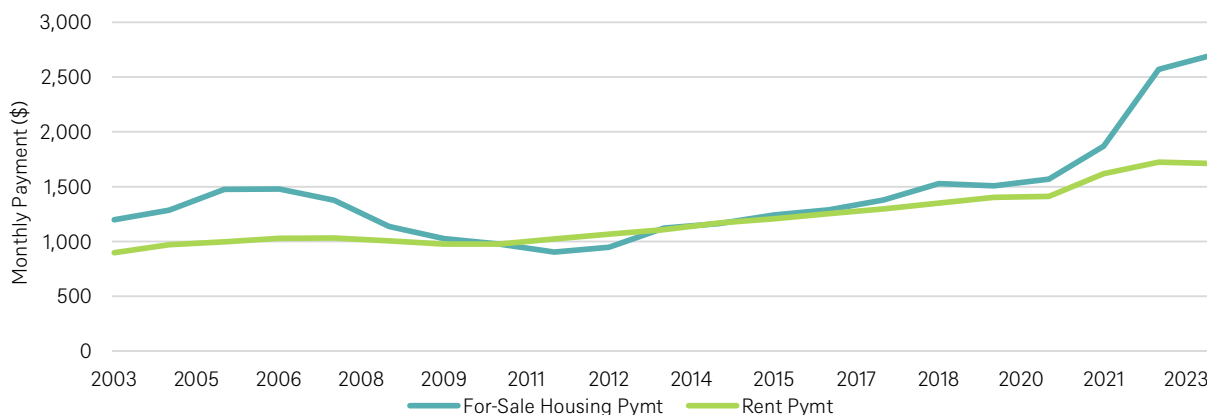
⁴⁹ Redfin & National Association of Realtors & DWS. As of December 2023.

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marked the fifth consecutive month of year-over-year price increases.⁵⁰ While housing prices have soared, inflation and Fed hikes pushed mortgage rates to 20-year highs in October 2023.⁵¹ Mortgage rates have fallen from their October peak but remain higher than they were in 2022.⁵² A homebuyer 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%.⁵³ Keep in mind that the monthly housing payment on an existing median-priced home has risen from around \$1,800 in November 2021 to about \$2,640 in November 2023 – an increase of 47.1%, or \$850 per month.⁵⁴ By comparison, the average monthly apartment rent has only risen by 6.5% during that same two-year span, an increase of just \$105 per month.⁵⁵ A combination of low inventory, high prices and high mortgage rates are keeping renters on the sidelines waiting for more favorable conditions.

As steep prices and mortgage rates keep home ownership out of reach for many Americans, the housing market is undergoing a major shift. The “buy premium” – the difference between the monthly cost of a new home purchase versus a new apartment lease – reached a historical high of 36% in November; a spread of \$980 per month after a rapid increase that began in the summer of 2022 (see Exhibit below).⁵⁶ Not surprising, a recent survey found that a growing number of renters are happy to stick with their rentals, 84% think it’s more affordable than owning a home and 66% are satisfied with their rental experience.⁵⁷

EXHIBIT 6: 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 December 2023.

Population trends are returning to pre-pandemic norms as migration reverted to patterns not seen since before 2020.⁵⁸ The expansion of the Southern region accounted for 87% of the nation’s population growth in 2023, as the region adding over 1.4 million new residents. The large coastal markets lost population in 2023 but the declines were considerably reduced from the prior years. Renters between the ages of 25 and 34 continue to migrate out of high-cost coastal markets to areas with a lower cost of living, particularly the mid-sized DWS Investable Markets that include Austin, Salt Lake City, Charlotte, Nashville, Raleigh, Orlando, and Tampa.⁵⁹

⁵⁰ National Association of Realtors & DWS. As of December 2023.
⁵¹ Freddie Mac Primary Mortgage Market Survey, Moody’s Analytics & DWS. As of December 2023.
⁵² Freddie Mac Primary Mortgage Market Survey. As of December 2023.
⁵³ National Association of Realtors, Freddie Mac Primary Mortgage Market Survey, FRED Economic Data, & DWS. As of December 2023.
⁵⁴ National Association of Realtors, Freddie Mac Primary Mortgage Market Survey, Moody’s Analytics, & DWS. As of December 2023.
⁵⁵ Yardi-Matrix & DWS. As of December 2023.
⁵⁶ Yardi-Matrix, National Association of Realtors, Freddie Mac Primary Mortgage Market Survey, Moody’s Analytics, & DWS. As of December 2023.
⁵⁷ Freddie Mac/Rhino & DWS. As of December 2023.
⁵⁸ U.S. Census Bureau & DWS. As of December 2023.
⁵⁹ U.S. Census Bureau & DWS. As of December 2023.
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3.2 Outlook and Strategy

It's still all about supply. The number of new apartment units completing construction across the DWS Investable Universe is projected to be approximately 337,000 in 2024 (adding around 2.5% to the year-end 2023 base), the highest number in decades.⁶⁰ Over the next two to three quarters, supply is expected to outstrip renter demand, which should keep upward pressure on vacancy rates. The prospects for weak market rent growth are likely to carry through most of 2024 as the risk of recession hangs over the nation's economy and many markets are experiencing over-supply. Suburban coastal markets located in Boston, Seattle, San Jose, Orange County, and San Diego should benefit from significantly less competitive new supply coming online than in the Sun Belt and Mountain West.⁶¹

The AIA/Deltek Architecture Billings Index for firms that specialize in multifamily residential declined for the 16th consecutive month in November to 45.3.⁶² The billings index fell below the significant 50-point threshold in the fourth quarter of 2022, indicating a national decline. Lead time between design activity and construction activity runs between 9 and 12 months. Therefore, the billings index is pointing to signs of a significant slowdown in construction activity in the third or fourth quarter of 2024 and setting the stage for rent increases in the future. 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 until 24 months from now.⁶³ The current oversupply is likely to be absorbed by then in view of structural demand trends, but unless financing conditions improve in 2024, which appears unlikely, the apartment market could swing back to a condition of undersupply in 2026 or 2027, leading to favorable market fundamentals and accelerating rent growth.

The country's housing market is undergoing a major shift. For the first time in decades, it's looking better to rent than to buy a home. Driven by an increase in home prices and higher mortgage rates, renting continues to be significantly more economical than owning a home.⁶⁴ Coupled with the rising cost of homeownership is the chronic shortage of housing, especially for entry-level single-family homes.⁶⁵ 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. A recent National Association of Realtors report notes that the average age of a first-time homebuyer has risen to 36 years old – a new record high.

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 see stable demand 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 San Jose, Seattle, Austin, and Boston.⁶⁶ Also, we favor the Sun Belt and Mountain West markets that are projected to capture significant job and population growth.⁶⁷ Though these high growth markets will need some time to absorb their pending oversupply and bring supply-and-demand conditions back towards equilibrium.

See Exhibit 7 for central themes that are shaping our residential strategy:

⁶⁰ Yardi-Matrix, CBRE-EA, RealPage, & DWS. As of December 2023.

⁶¹ Yardi-Matrix, CBRE-EA, RealPage, & DWS. As of December 2023.

⁶² American Institute of Architects. As of December 2023.

⁶³ CoStar & DWS. As of December 2023.

⁶⁴ Yardi-Matrix, Moody's Analytics, Freddie Mac Mortgage Market Survey, & DWS. As of December 2023.

⁶⁵ National Association of Realtors & DWS. As of December 2023.

⁶⁶ Moody's Analytics & DWS. As of December 2023.

⁶⁷ Moody's Analytics & DWS. As of December 2023.

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EXHIBIT 7: 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.⁶⁸

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 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.

⁶⁸ Yardi Matrix, Real Page & DWS. As of December 2023.

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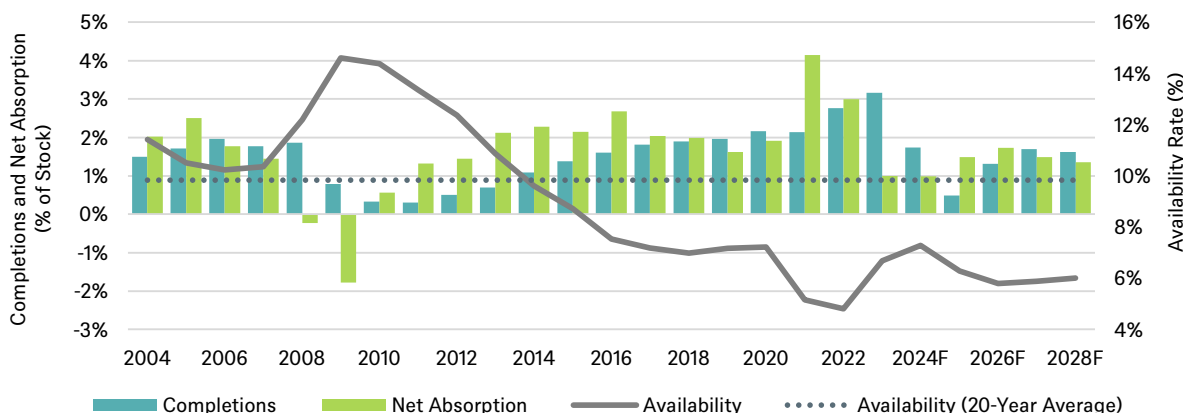
4 / Industrial Outlook and Strategy

4.1 Current Conditions

U.S. industrial market hit a soft patch in 2023 as a pandemic-driven development pipeline came to fruition just as industrial space demand cooled.⁶⁹ Traditional and internet retailers, as well as third party logistics firms slowed or paused their capacity expansions, instead choosing to digest the substantial growth achieved over the past two years, and in some cases offered excess space for sublease.

Although economic growth has surprised to the upside in recent quarters, Asian import flows have been tepid and concerns over a near-term recession are probably weighing on 2024 growth sentiment.⁷⁰ Despite mixed demand trends across markets, national net absorption has remained positive through the third quarter of 2023 and will likely continue through the year,⁷¹ but the Covid overhang (supply outpacing demand) will likely persist into mid-2024. Even so we remain constructive on the prospects for the sector in the near term, as well as in the coming cycle.

EXHIBIT 8: INDUSTRIAL NET ABSORPTION AND COMPLETIONS AS % OF STOCK AND AVAILABILITY RATE (2004 - 2028)



Source: CBRE-EA (history) and DWS (forecast). As of November 2023.
 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.

Demand has generally tracked into growth regions and national hubs, while the more mature western and northeastern markets have experienced negative churn (space occupiers leaving for cost and efficiency considerations) amid uncertain economic environments.

Demand momentum across markets was uneven, with 20 of our 50 major markets reflecting negative absorption (totaling about -50 million square feet), while 30 markets posted positive absorption (about 129 million square feet).⁷²

About half of negative trends occurred in Southern California, while stronger positive momentum occurred in the national logistics hubs of Chicago and Dallas, as well as in emerging regional hubs and sunbelt markets like Charlotte, Savannah, Nashville, Phoenix, Las Vegas and Reno.

The development pipeline remains elevated this year, but new construction starts have plummeted (by 75% year-over-year in the third quarter), so we expect a sharp drop-off in deliveries in the years to follow.³ Construction deliveries measured

⁶⁹ DWS and CBRE-EA. As of September 2023.

⁷⁰ Moody's Analytics and Journal of Commerce, Piers data. As of September 2023.

⁷¹ DWS and CBRE-EA. As of September 2023. CoStar Analytics. As of December 2023.

⁷² DWS and CBRE-EA. As of September 2023.

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about 355 million square feet through the September 2023 and could reach record levels by year-end, (2.9% of stock, set in 1989).⁷³

We estimate that the development pipeline measures about 520 million square feet and is about one-third pre-leased. A portion was slated to deliver in the fourth quarter of 2023 and the rest by mid-2024.⁷⁴ This may cause some imbalances in a few locations, but we believe that they will be short-lived when demand recovers, and most markets will remain healthy.

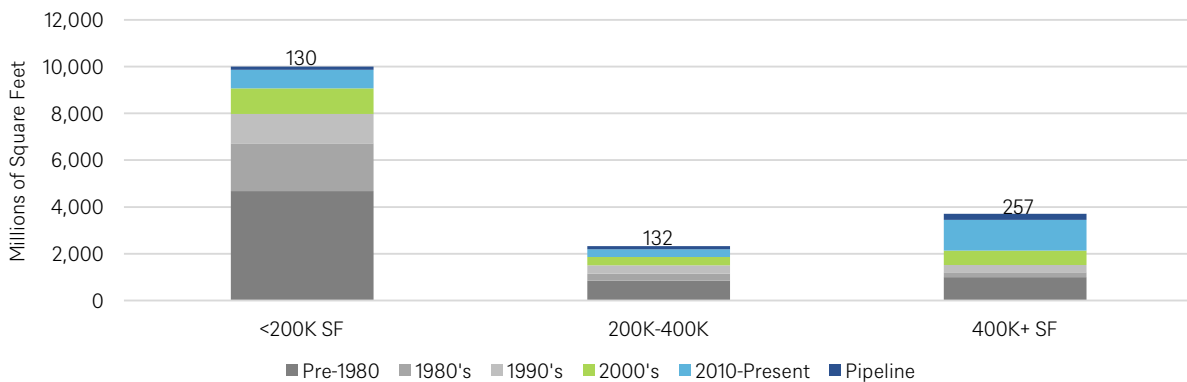
The pluses and minuses in current trends seem to be playing out in a fairly balanced way across markets and within property subsegments. For instance, space givebacks have tended to occur in the most highly constrained markets (West Coast and the Northeast), but with few exceptions vacancy rates have remained relatively low compared to most markets.⁷⁵ Meanwhile, markets with the largest development pipelines (traditionally a risk indicator heading into recession) have absorbed the most space in recent quarters, at least mitigating part of that risk.

A similar supply/demand dynamic has held true between size segments: more than half of the construction deliveries in 2023 occurred in large bulk warehouses (400,000-plus square feet in size), but this segment also commanded about 75% of total absorption in the year.⁷⁶ Smaller and mid-sized buildings (smaller than 200,000 square feet in size) incurred modest negative absorption in 2023, but new development as a share of stock was much lower and the vacancy rate of this segment remained low, 270 basis points below that of the bulk warehouse segment.

It appears that the market is rebalancing in an orderly way, with development and normal market churn lifting space availability across markets, but not enough to create distress. Market conditions have moved from being overheated to balanced, with low but moderately rising vacancy rates and what might be considered normal leasing competition. Landlords of existing properties may have to compete to retain tenants, but in-place tenants are still reticent to leave, as better space choices remain scarce within their target areas.

The chart in Exhibit 9 below gives context to the current dynamics. Structurally, the US industrial market is mostly comprised of smaller, older buildings (left bar). But recent trends, fueled by big-box retailer and e-Commerce growth, have stimulated great amounts of demand for large bulk warehouses (right bar, teal stack). We believe recent deliveries and the current pipeline is not enough to create a prolonged oversupply of logistics space. It more likely amounts to replacement stock.

EXHIBIT 9: US INDUSTRIAL STOCK AND DEVELOPMENT PIPELINE BY SIZE AND DECADE BUILT



Source: DWS, CoStar and CBRE-EA. As of July 2023.

The capital markets downcycle has been more severe than the property market fundamentals cycle. Investment sales volumes fell by 33% year-to-date through September 2023, but this was boosted by an extraordinarily strong September (\$20

⁷³ DWS and CoStar Analytics. As of September 2023.

⁷⁴ DWS and CoStar Analytics. As of December 2023.

⁷⁵ DWS and CBRE-EA. As of September 2023.

⁷⁶ DWS and CoStar Property Analytics. As of December 2023.

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billion). We believe that the fourth quarter sales will be very weak, stifled by a spike in US treasuries at that time. Preliminary data indicate transactions in the fourth quarter of close to \$10 billion, or about one third the average quarterly volume of 2021 and 2022.

The industrial subsector returned -5.3% in the trailing four quarters as of third quarter 2023.⁷⁷ Appreciation returns measured -8.5% and income returns were 3.4% during the same period.⁷⁸ Appreciation returns were negative across all markets (excepting only Miami) in the trailing four quarters as of third quarter 2023.

The current value cap rate in the NPI industrial subsector remained at 3.9% in the third quarter, up about 50 basis points since the second quarter of 2022. Spot market indicators suggest a 100-basis point upward movement for top-quartile transactions during the same period.⁷⁹

Despite recent capital markets movements, we believe that industrial properties will continue to provide good relative investment performance, supported by persistently strong mark-to-market activity on renewals and stable rates on new leases. In fact, recent price volatility and the size of the near-term development pipeline may enhance opportunities to invest new high-quality assets over the coming year.

Market rents on average have remained stable, holding on to the 35%-40% gains of the past five years. Coastal high-barrier markets should be able to increase rents significantly more than that.⁸⁰ Potential income growth is compelling, exhibited by the 9.8% NOI growth in the subsector over the past four quarters and 9.4% average annual NOI growth over the past five years.⁸¹

4.2 Outlook and Strategy

We maintain our favorable long-term view for the industrial sector; however, we believe near-term cyclical trends, new supply competition and a potential recession in 2024, may cause market fundamentals to soften in coming quarters.

We expect that space absorption should remain positive in 2023 and 2024 (albeit at below average levels), with absorption measuring about 150 million square feet per year, just about half of the pace exhibited in the seven years prior to 2021.⁸²

New construction deliveries are forecast to outpace absorption in 2024, but we believe the second half of the year will see a turnaround in quarterly trends as deliveries fall off sharply, aligned with the sharp decline in starts in mid-2023.

Our outlook includes supply gap beginning in mid-2024 and extending at least through 2025, at a time when we also expect demand to strengthen and absorption patterns to return to growth-cycle norms. We believe a timely demand rebound should enable the market to maintain relatively healthy conditions in the interim period, with below average vacancy and stable-to-growing market rents over the next two years.

Over the longer term the industrial sector has the advantage of being supported by both steady cyclical growth (employment, population and income growth fueling consumption) and also secular/structural drivers (e-Commerce and rapid fulfillment putting continued upward demand pressure on an aging industrial stock).⁸³

The future growth of domestic advanced manufacturing may be additive to industrial market fundamentals in the coming decade. 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 2030.⁸⁴ 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.

⁷⁷ NCREIF. As of September 2023

⁷⁸ NCREIF. As of September 2023

⁷⁹ Real Capital Analytics, Trends, Trades, Volume and Pricing Report. As of December 2023

⁸⁰ DWS and CBRE-EA. As of September 2023.

⁸¹ NCREIF. As of September 2023.

⁸² DWS. As of December 2023.

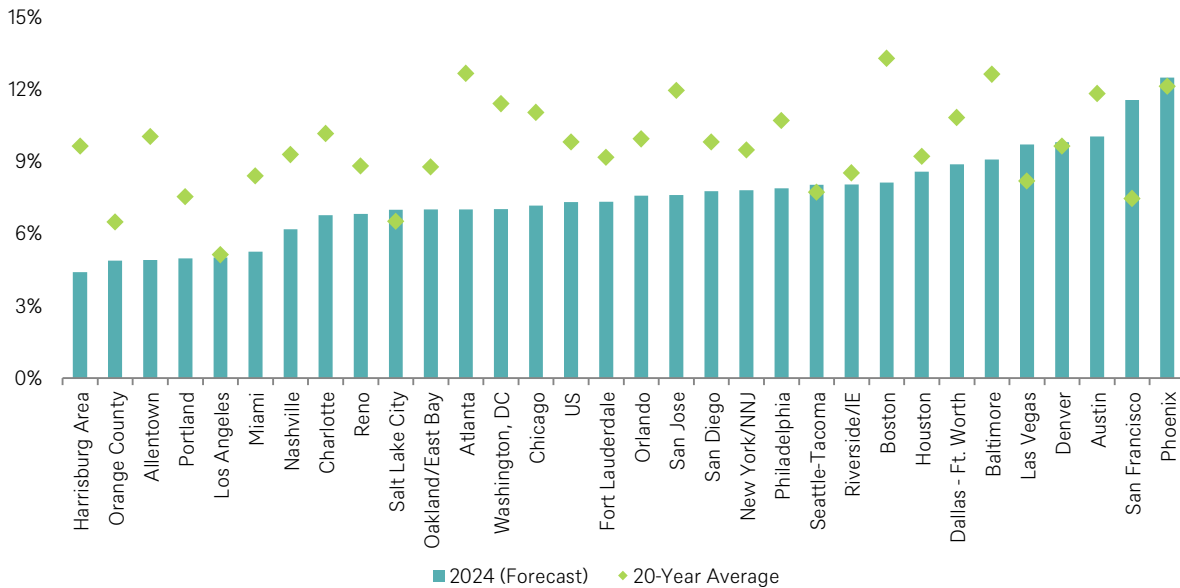
⁸³ DWS and CBRE-EA. As of September 2023.

⁸⁴ Newmark, Manufacturing Momentum Report. As of September 2023.

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Our investable universe of markets is expected to maintain healthy availability rates, well below their long-term averages, and allowing for relatively balanced market conditions (see Exhibit 10).⁸⁵ However, we are forecasting several markets, including Austin, Dallas/Ft. Worth and Phoenix, to see softer or at least bifurcated market conditions in the near term, due to outsized construction pipelines. The recent push of development to ex-urban locations may cause varied fundamentals across submarkets, with closer-in locations performing relatively well, and outlying ones potentially lagging.

EXHIBIT 10: AVAILABILITY RATES ACROSS MARKETS (2022 VS. THE 2024 OUTLOOK)



Source: DWS, CBRE-EA. As of December 2023.

In our view, still-positive absorption in the coming year will support stable industrial market conditions across our target market universe. We are forecasting flat rent growth in 2024, with some markets posting single digit rent declines and others modest gains. Rapid availability rise in Riverside, Phoenix, Salt Lake City and Seattle could soften conditions for older less functional properties more than average as tenants migrate in a flight to quality.

In terms of property segments, we believe that functional smaller and mid-sized warehouses located in core submarkets will weather near-term challenges relatively well, but larger bulk warehouses in ex-urban locations could face greater challenges in 2024, as a large portion of new construction deliveries are in this segment. Our outlook calls for stronger demand, declining vacancy and rent growth to accelerate again in 2025, aligned with economic recovery.

⁸⁵ Newmark, Manufacturing Momentum Report. As of September 2023. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions, and hypothetical models that may prove to be incorrect. Investments come with risk. The value of an investment can fall as well as rise and your capital may be at risk. You might not get back the amount originally invested at any point in time. Source: DWS International GmbH.

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

EXHIBIT 11: DWS INDUSTRIAL STRATEGY

Strong Relative Performance	This pro-cyclical sector has slipped in 2023, but industrial landlords should continue to benefit from strong mark-to-market opportunities in their rent rolls. In our view, this potential NOI boost is the strongest among the NPI subsectors and will lead to favorable returns.
Regional Hubs	The Northeast and West regions remain underserved by modern logistics. We believe that the trends of the past cycle will be renewed upon economic recovery, benefitting Lehigh Valley, Las Vegas, Phoenix, and Reno, as well as in selected Southeast markets such as Charlotte and Orlando.
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	Growth trends and absolute demand levels are currently mixed in the large coastal population centers, but over the longer term, even modest growth with persistent constraints will continue to support relatively strong occupancy and rent growth in these markets, so maintain market-weight and overweight positions in these larger, globally linked metros.

Source: DWS. As of December 2023.

5 / Office Outlook and Strategy

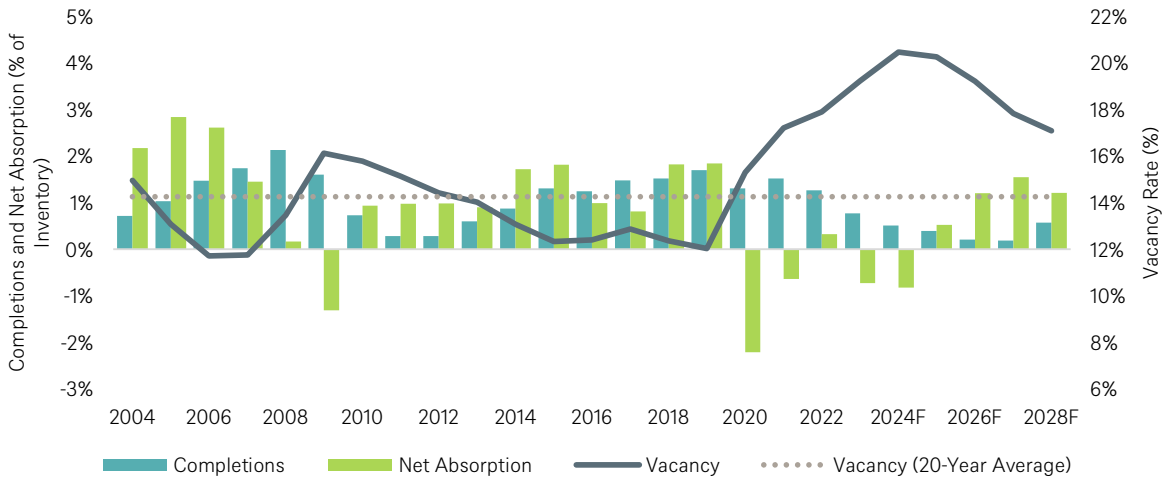
5.1 Current Conditions

U.S. office markets continue to soften under cyclical headwinds created by interest rate hikes and weak office demand. The economy remains strong: GDP growth touched a solid annual rate of 4.9%⁸⁶ in 3Q 2023 and the labor market added more than 2 million jobs in 2023, holding the unemployment rate below 4%.⁸⁷ However, this bright economic picture does not accurately reflect the operating environment for many office tenants.

Much of the recent strength in GDP has been consumption related, and job creation has been in the leisure and hospitality, healthcare, education and government sectors, not in the office leasing sector such as information and financial services. Office tenants are actively managing their head count and operating expenses in times of weak or negative growth expectations. Hybrid work patterns are also putting downward pressure on office demand.

Office occupancy across U.S. markets continued to weaken. National vacancy increased to 18.4% in 3Q 2023, 150 bps higher than the peak (16.9%) during the GFC.⁸⁸ Net absorption was negative 28 million square feet in 2023 or 0.7% of stock⁸⁹ while leasing activity was concentrated in smaller deals with tenants continuing to favor quality assets over commodity stock. The overall gross leasing for the four quarters ending in the third quarter of 2023 was 281 million square feet, down 24% year-over-year.⁹⁰ Sublease space remains high, but it is starting to decrease.

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



Source: CBRE-EA (history); DWS (forecast). As of December 2023.
 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

Large gateway metros (like San Francisco, Manhattan, Seattle and Los Angeles) along with markets with strong supply (like Charlotte and Austin) contributed the most to the vacancy increase. Vacancy increased by more than 1,000 bps since Q1 2020 in San Francisco, Charlotte, Austin, Portland and Seattle. Metros with vacancy that recovered to pre-pandemic levels are mostly small Sun Belt markets like Miami and Fort Lauderdale.⁹¹

⁸⁶ Bureau of Economic Analysis. As of September 2023.

⁸⁷ BLS. As of September 2023.

⁸⁸ CBRE-EA. As of September 2023.

⁸⁹ CBRE-EA. As of September 2023.

⁹⁰ JLL. As of September 2023.

⁹¹ CBRE-EA. As of September 2023.

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Vacancy is expected to climb further as the economy cools and companies continue to adjust space usage to new working models. In our view, the vacancy level is expected to exceed 20% by the end of 2024, the highest level on record. Yet, as office tenants' growth outlook improves vacancy is expected to decline starting 2025.

Asset quality matters more than ever. Over the past three years, the newest, highly amenitized and best located assets have experienced positive net absorption (Exhibit 13). Excluding buildings in lease-up, occupancy in top-tier assets is more than 300 bps higher than the overall U.S. office market. In the six gateway markets, top-tier asset occupancy is 700 bps higher.⁹²

EXHIBIT 13: URBAN OFFICE ASSET PERFORMANCE BY CLASS

Direct Vacancy (9/30/2023)				Net Absorption (Q1 2021 through Q3 2023)			
CBD	Premier Buildings	Non-Premier Buildings	Variance	CBD	Premier Buildings (MSF)	Non-Premier Buildings (MSF)	Variance (MSF)
Boston	8.1%	11.2%	3.1%	Boston	3.3	(2.3)	5.6
Washington, DC	13.3%	16.3%	3.0%	Washington, DC	1.8	(3.2)	5.0
San Francisco	13.8%	26.1%	12.3%	San Francisco	(2.1)	(5.5)	3.4
Seattle	16.2%	19.2%	3.0%	Seattle	(2.5)	(2.5)	0.0
Manhattan	10.7%	12.2%	1.5%	Manhattan	7.4	(16.1)	23.5
Average	12.4%	17.0%	4.6%	Average	7.9	(29.6)	37.5

Source: CBRE-EA, BXP Company Presentation. As of December 2023.

Office investors face material uncertainties in both office demand as well as the cost and availability of debt financing. Office transactions have been muted in 2023 as liquidity and investor interest drained. Most U.S. lenders are trying to reduce their exposure to commercial real estate loans and have limited available lending capacity for repayments. Moreover, liquidity in the capital markets is a major headwind. Distress has already started to climb. According to Trepp, 6.1% of office CMBS loans were delinquent in November 2023, up from 1.7% in November of 2022 and 1.9% in December 2019.⁹³ Some \$9.8 billion of CMBS loans on offices, or 8.3%, were in special servicing as of September 2023.⁹⁴ How much office property distress will grow depends on the extent of interest rate level and how long rates remain elevated.

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 third quarter of 2023 (-17.1% on a trailing four-quarter basis), amid high vacancies and concerns over the effects of remote work.⁹⁵ Suburban office fared better than CBDs (-13.0% vs. -20.5%, respectively), although both suffered.⁹⁶

5.2 Outlook and Strategy

While interest rates hikes have paused in December 2023, the storm that battered the office sector is not over yet. Office values have been falling since 2022, reflecting higher interest rates and weak fundamentals, but more losses are possible if cap rates continue to climb. Since peaking in mid-2022, office-property values are down 12%, based on the appraisal-based NCREIF Index, and down 11% on the transaction-based MSCI Real Capital Analytics Commercial Property Price Index.⁹⁷ If office-property cap rates rise another 100 bps or more to match the move implied by office REIT share prices, that could lower private property values as much as 20% from current levels.⁹⁸ That drop in values may accelerate once transaction markets reactivate.

⁹² CBRE-EA. As of September 2023.

⁹³ CRE Finance Council & Trepp. As of September 2023.

⁹⁴ CRE Finance Council & Trepp. As of September 2023.

⁹⁵ NCREIF and BLS. As of July 2023.

⁹⁶ NCREIF and BLS. As of September 2023.

⁹⁷ NCREIF and RCA. As of September 2023.

⁹⁸ Bloomberg Intelligence. As of September 2023.

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Despite the recent spike in office cap rates, they are not at levels that reflect the true pricing in the sector. U.S. office cap rates are about 100 bps above their mid-2022 low, based on MSCI Real Capital Analytics' database of deals closed in the three months ended October 2023, and they could rise another 100-200 bps once transaction volume accelerates. A wide bid-ask spread has muted transaction volume as potential buyers await a repricing amid elevated debt costs, but sellers have not yet capitulated. In 2014-19, office cap rates were on average about 425 bps above the 10-year Treasury yield, with a low of about 325 bps. That spread is currently only 220 bps, requiring either higher cap rates or lower interest rates for mean reversion. In early 2010, the last time capital markets were this stagnant, office cap rates jumped to nearly 9%, more than 500 bps above the 10-year Treasury yield.⁹⁹ Meaningful value declines are expected as prices reach a balance between buyer and seller demands.

Demand for office space will likely continue to struggle as most metrics indicate utilization has plateaued at around 50-60% of pre-pandemic levels.¹⁰⁰ Many tenants have downsized footprints, and although some companies are taking a tougher stance on return-to-office policies, we remain a couple of years away from a post-pandemic equilibrium. Weakened demand has given tenants increased leverage in lease negotiations, often getting landlords to pay for improvements and amenities. Other costs, such as insurance and maintenance, have also been increasing, depleting net operating income. Consequently, delinquencies are rising.¹⁰¹

In our view, overall office vacancy rates will remain elevated over the near term and above historical averages until return to office becomes broader-based and economic uncertainty fades. Effective rent losses are expected to continue as long as vacancies are elevated and competition from less expensive sublet space lingers. Rising costs of capital will increasingly hamper landlords' ability to offer large concession packages, which could push market rents toward (lower) effective rents, particularly for aging product.

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 2022.¹⁰²

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 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.

⁹⁹ MSCI Real Capital Analytics, Bloomberg Intelligence. As of November 2023.

¹⁰⁰ Kastle Systems. As of September 2023.

¹⁰¹ Yardi Matrix. As of September 2023.

¹⁰² Yardi Matrix. As of September 2023.

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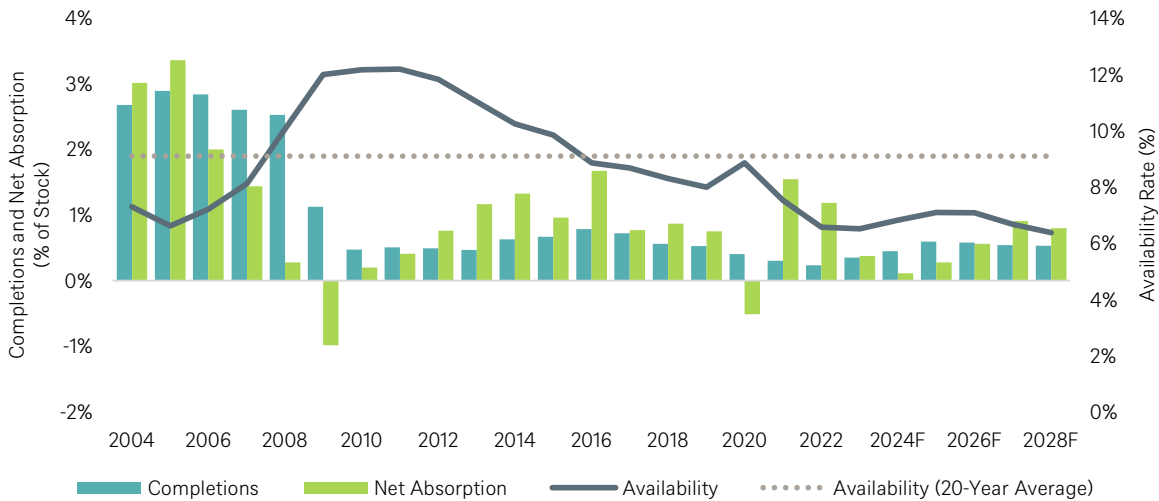
6 / Retail Outlook and Strategy

6.1 Current Conditions

The retail sector continued to post robust performance in 2023, supported by strong consumer confidence and healthy retail spending. The labor market continued to expand, despite headwinds from higher interest rates, concerns over inflation and uncertain economic prospects. As worried as people may say they are about the economy, they do not appear all that worried about losing their jobs. The Federal Reserve Bank of New York’s monthly survey of consumers showed that people put the average chance of losing their job within the next 12 months at 12.7%. That compares with an average of 14.3% in 2019, just before the pandemic.¹⁰³ Confident consumers supported strong annual retail sales which increased by a solid annual rate of 4.1% in November 2023.¹⁰⁴

Over 69 million square feet of retail space has been filled over the past four quarters,¹⁰⁵ which has pushed the average retail availability rate across the U.S. to a multi-decade low. At 6.5%, the retail availability rate is nearly 250 basis points below its 20-year historical average. The primary constraint on leasing activity remains the lack of available space in desirable locations. Moreover, retail real estate is experiencing a significant shortage of available space, due to limited new deliveries and 145 million square feet demolished in the last five years.¹⁰⁶

EXHIBIT 14: RETAIL NET ABSORPTION AND COMPLETIONS AS % OF STOCK AND AVAILABILITY RATE (2004 – 2028)



Source: CBRE-EA (history) and DWS (forecast). As of December 2023.
 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 closing announcements for the third year in a row. Net openings through September 2023 are estimated at just under 1,100 stores.¹⁰⁷ With consumers steadily seeking value in response to higher prices, it is not surprising that discount brands accounted for 30% of gross store openings in 2023 and will add over 16 million square feet of occupied retail space.¹⁰⁸ 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

¹⁰³ Federal Reserve Bank of New York. As of October 2023.
¹⁰⁴ Federal Reserve Bank of New York. As of October 2023.
¹⁰⁵ Costar. As of December 2023.
¹⁰⁶ JLL. As of December 2023.
¹⁰⁷ JLL. As of December 2023.
¹⁰⁸ JLL. As of December 2023.

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their target customers. Even department and big box stores are pivoting toward smaller format stores in suburban neighborhood shopping centers, further contributing to net store openings.¹⁰⁹

Demand gains have been widespread across the nation, despite limited available supply and concerns over the ability of consumers to continue to spend at current levels. Sun Belt locations, Phoenix and Austin were the clear outperformers as retailers continued to target high-growth 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. Los Angeles, Orange County, Seattle and Portland all saw demand for space fall over the past four quarters. San Francisco also recorded falling demand for retail space during this period. 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.¹¹⁰

Numerous sectors continue 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 year. On the other end of the spectrum, demand for space within the mall segment fell by more than 4 million square feet over the past year and the segment remains highly divided and moving in opposite directions.¹¹¹

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%.¹¹²

With virtually no new supply on the horizon, healthy fundamentals are expected to persist in 2024 and beyond. We expect availability rates to remain near record lows and support healthy rent gains.¹¹³ Consumers are likely to continue to behave more thoughtfully yet continue to spend on household priorities. For the past few months, real spending on essentials such as food, transportation and housing has been outpacing real spending on discretionary purchases such as home furnishings, recreational goods and food away from home. This dynamic of favoring essentials over discretionary purchases highlights the cautiousness of the U.S. consumer.¹¹⁴

Near-term risks to the outlook include higher borrowing costs, decreasing affordability due to inflation and an overhang of excess inventory – particularly in the apparel, furniture, home goods, and department store segments. However, the outlook for necessity-based retail remains solid. Over the forecast period, we expect the results of retail's transformation in post-pandemic buying patterns to benefit neighborhood & community centers. Structural and demographic trends should continue to support spending if economic drivers remain supportive. 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 enters 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

¹⁰⁹ JLL. As of December 2023.

¹¹⁰ Costar. As of December 2023.

¹¹¹ Costar. As of December 2023.

¹¹² ICSC. As of December 2023.

¹¹³ DWS. As of July 2023.

¹¹⁴ U.S. Department of Commerce and Wells Fargo. As of December 2023.

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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 2024 (Exhibit 15).¹¹⁵

On the demand side, steady new retail leasing activity in the second half of 2023, 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 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.

EXHIBIT 15: RETAIL CONSTRUCTION STARTS



Source: CBRE-EA (history) and DWS (forecast). As of December 2023.
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With excess savings largely depleted, consumers will become reliant on job and income growth to maintain spending habits. A softer job market will temporarily curtail spending, but households are adapting by focusing on value. Centers with tenants, such as discount stores, grocery stores and superstores may lure more shoppers looking for value. While we anticipate a mild economic slowdown in 2024, retail vacancy rates are expected to remain tight. Although the retail sector is expected to be resilient, there is a downside risk stemming from the credit cycle that is underway. Household 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

¹¹⁵ Costar. As of December 2023.
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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.¹¹⁶

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 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.

We continue to favor an increased allocation to necessity-based retail. The outlook is positive and we believe the sector fundamentals will continue to perform well given continuous retail demand and low vacancies. Moreover, retail remains highly attractive on a relative basis compared to the other asset classes, with an average spread of 300 bps over the 10-yr Treasuries (versus 185 bps for industrial and 95 bps for multifamily).¹¹⁷ 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, and strength of the tenant line-up, we maintain our recommendation to target grocery-anchored retail located in high growth regional markets.

See Exhibit 16 for central themes that are shaping our retail strategy:

EXHIBIT 16: DWS RETAIL STRATEGY

Target Necessity-based Retail

Our conviction around daily needs and grocery-anchored retail remains high as the drivers and fundamentals are poised to remain stable through the early years of the forecast. Grocery-anchored-retail will likely be more resilient and less impacted over the long-term when compared to other types of retail. Moreover, these daily needs shopping centers may benefit from increasing local consumption of goods and services.

Proceed with Caution on Power Centers

While we believe that power centers will evolve into last-mile distribution locations over time, we continue to recommend an underweight to the segment. Caution is warranted in the near-term due to the interest-rate sensitivity of long-term leases. There is also a risk that demand for electronics, furniture, appliances, and other household goods has been satiated (for now) during the COVID housing boom. Shifting consumer preferences are less threatening to neighborhood and community centers, which are more oriented to daily necessities (e.g., food) and services.

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 December 2023.

¹¹⁶ C&W. As of December 2023.

¹¹⁷ JLL. As of December 2023.

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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	NPI Weights	ODCE Weights	House Portfolio	Active Bet (vs ODCE)	Range
Apartment	29%	29%	34%	+5%	29% - 39%
Industrial	34%	33%	43%	+10%	38% - 48%
Office	23%	19%	7%	(12%)	2% - 12%
Retail	14%	10%	14%	+4%	9% - 19%
Other	0%	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.
Sources: NCREIF; DWS. As of September 2023.

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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

Market	↑ Overweight	↓ Underweight	↔ Market Weight	
	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 December 2023. 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)

	9/22-9/23	9/21-9/22	9/20-9/21	9/19-9/20	9/18-9/19
NCREIF Property Index (NPI)	-8.4%	16.1%	12.2%	2.0%	6.2%
NPI-Apartment	-7.6%	18.2%	13.4%	2.3%	5.4%
NPI-Industrial	-5.3%	34.6%	32.4%	10.1%	13.6%
NPI-Office	-17.1%	3.2%	4.9%	2.8%	6.5%
NPI-Retail	-1.4%	6.7%	0.7%	-6.3%	1.4%
NPI-Apartment: High-Rise	-8.4%	14.9%	9.7%	1.1%	4.1%
NPI-Apartment: Low-Rise	-6.2%	19.0%	13.9%	3.3%	5.8%
NPI-Apartment: Garden	-6.5%	24.2%	21.2%	4.6%	8.1%
NPI-Office: CBD	-20.5%	0.8%	2.3%	1.8%	5.9%
NPI-Office: Suburban	-13.0%	6.3%	8.5%	4.3%	7.5%
NPI-Retail: Malls	-4.1%	2.9%	-4.1%	-8.2%	-0.3%
NPI-Retail: Power	0.7%	9.7%	4.0%	-2.6%	1.3%
NPI-Retail: Neighborhood & Community	-0.4%	8.7%	7.1%	-1.2%	4.6%
	6/30/2023	6/30/2022	6/30/2021	6/30/2020	6/30/2019
NASDAQ Composite Index	43.4%	-33.1%	21.4%	43.6%	35.2%
S&P 500 Index	24.2%	-19.4%	26.9%	16.3%	28.9%
MSCI US REIT Gross TR Index	13.7%	-24.5%	43.1%	-7.6%	25.8%

Sources: NCREIF, Bloomberg, NAREIT, and DWS. As of December 2023.

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