Marketing Material*

ITALY REAL ESTATE STRATEGIC OUTLOOK

First Quarter

IN A NUTSHELL

_ The outlook for Italy is mixed. While the economy is lagging, there are parts of the real estate market that could still prosper.

_ We expect logistics to be an outperformer, particularly around Milan. Increased home working means the outlook for offices is less certain.

_ Hotel pricing is likely to tighten again once travel restrictions are eased, but retail is expected to suffer further as online sales have been accelerated by the pandemic.

The outlook for Italy presents a mixed picture. We expect logistics to be a clear outperformer in terms of both yield compression and rental growth, particularly in the Milan region. The outlook for offices is increasingly uncertain as working from home in Italy moves from a rarity to commonplace and the full implications of this change are yet to feed through to market pricing. Government-imposed restrictions on movement across Europe have resulted in outward yield movement for hotels, but pricing is likely to return to pre-lockdown levels once travel restrictions are eased. Retail continues to suffer from increasing online sales, a trend which has been accelerated by the forced closure of physical stores in the spring and one which is likely to persist post-pandemic.

Extension of restrictions brings further economic challenges

Following an easing of restrictions in the third quarter of 2020, Italy is now facing another wave of Covid-19 infections, causing a tightening of restrictions again and renewed economic contraction. The outlook for the remainder 2021 is more positive, however, with the rollout of a vaccination programme and the distribution of the E.U. recovery fund. This will be a key part of the Italian economic recovery, given the limited room for further expansionary fiscal policy at a national level following the additional public debt incurred in 2020. The withdrawal of the Viva party from the current coalition government, leaving the coalition without a majority in the Senate, adds political instability to the economic challenges, and is likely to undermine the effort to distribute E.U. funds efficiently.

The long-term outlook for Italian growth is weaker than the Eurozone average due to a growing dependency ratio and limited gains in productivity.

Milan has a relatively low proportion of its workforce in sectors which have been impacted heavily by the pandemic.[1] Rome has been more affected due to a greater reliance on tourism.[2] However, in both cities, unemployment has increased and is not forecast to return to pre-pandemic levels until at least 2022.[3]

The concentration of service sectors, finance, and tourism in Milan have historically allowed the city's economy to grow faster than the national figure. The long-term outlook for Milan is also more positive thanks to more favourable demographics and a faster-growing service economy.

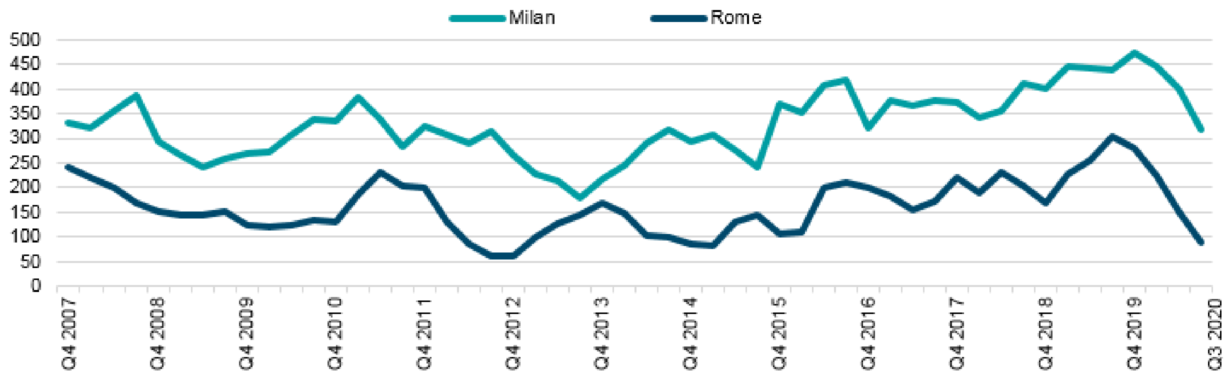
Weaker economic activity holding back demand

Lockdowns and economic uncertainty resulted in a marked slowdown in take-up in the Milan office market in 2020.[4] Last year saw occupiers continue to choose to upgrade to higher quality offices, which are in short supply, rather than move to larger premises. Assuming this trend continues, net absorption is likely to be low over the medium term. We expect the release of second-hand space last year, coupled with an uptick in completions in 2021 and 2022, to push vacancy up to around 16% by 2023. Our outlook for rental growth is therefore weak, at 0.8% per annum between 2021 and 2025, lagging behind the European average.

With prime CBD rents 9% above their pre-GFC peak, cost-conscious occupiers may look for space in more affordable submarkets. The area to the south of the city centre could provide this opportunity, and we expect it to outperform given the additional improvement to transport connectivity in 2023 with the arrival of the M4 metro line.

Rome is experiencing a similar slowdown in take-up. A full recovery in demand is looking increasingly unlikely given the unprecedented rise in home working, which will probably outlast the pandemic in light of the announcements of several key firms, including Leonardo and TIM Italia, to reduce their office footprint.[5] Given the weak outlook for demand, and currently high levels of vacancy, our forecast for rental growth is weaker than Milan and well below the European average.

Office Take-up, 000M²



Source: CBRE, December 2020.

E-commerce continues to erode in-store sales

Difficulties in the retail sector are set to continue as both Covid-19 and the growth of online retailing reduce sales on high streets and in shopping centres. Until rental and capital values adjust, we see limited opportunity to allocate capital to

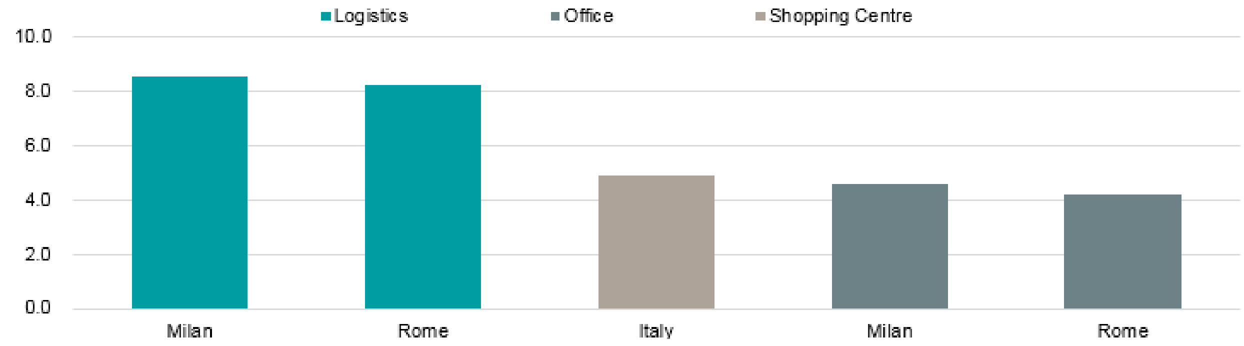
[1] Cerved, L'impatto del COVID-19 sullo stato di salute delle città metropolitane', May 2020
[2] Oxford Economics, December 2020
[3] Oxford Economics, December 2020
[4] PMA, December 2020
[5] PMA, December 2020

this sector. We anticipate that the turning point in values may be in 2023, and while select opportunities may then start to emerge, the sector is likely to face ongoing headwinds.

The logistics sector, however, is benefitting from the acceleration in online retailing. The Milan region has a larger and more affluent consumer market than Rome, and is therefore more attractive for logistics occupiers. The market is also more supply constrained and there is a reported dearth of modern stock, so we expect strong rental growth here over the next five years.

In anticipation of this performance, yields are moving in quickly. Over 2020, prime logistics yields compressed by at least 20 basis points, and for urban logistics, by almost 100 basis points. We anticipate the current low interest rate environment and structural tailwinds benefiting the sector to result in further yield compression over the next three years.

Prime Total Return (% P.A., 2021-25F)



Source: DWS, January 2021. F = Forecast. There is no guarantee the forecasts shown will materialise. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect. Forecasts are not reliable indicators of future returns.

Opportunity in hotels sector

Yields moved out last year even for prime leased hotels, but we would expect this trend to be short-lived. The exception is likely to be business hotels, which could take longer to recover than leisure-oriented assets. Although the window of opportunity in pricing may close quickly, there are longer-term opportunities in the sector which were underway before the pandemic. International travel was on a strong growth trajectory and obsolete office buildings are being converted to hotels, such as “The Pantheon Iconic Rome Hotel”.[6]

Overall we feel the most attractive opportunities in Italy remain in the logistics sector, where investor demand continues to drive down yields and rental growth is boosted by limited supply growth and increasing occupier demand. There may also be select investment opportunities in the office sector, particularly in outperforming submarkets and for assets which meet the latest occupier requirements.

[6] Colliers, December 2020

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- Adverse changes in law and regulation including environmental laws and regulations, zoning laws and other governmental rules and fiscal policies;
- Environmental claims arising in respect of real estate acquired with undisclosed or unknown environmental problems or as to which inadequate reserves have been established;
- Changes in the relative popularity of property types and locations;
- Risks and operating problems arising out of the presence of certain construction materials; and
- Currency / exchange rate risks where the investments are denominated in a currency other than the investor's home currency.

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