GERMANY REAL ESTATE STRATEGIC OUTLOOK

First Quarter

IN A NUTSHELL

_ We expect continued economic turbulence to have a negative impact on the real estate market in the short term. However, our outlook remains positive.

_ Retail is likely to struggle, while office market trends are becoming more heterogeneous, with top quality stock in good locations outperforming.

_ Urban logistics and residential commuter locations are our top picks, with expected outperformance both in terms of rent growth and yield compression.

Despite the bounce back in GDP and renewed hopes around vaccination in the second half of 2020, the economic recovery still has some way to go. We expect this to have a negative impact on the German real estate market in the short term. However, our outlook remains positive. In our view, retail is likely to struggle for at least two more years, while office market trends are becoming more heterogeneous, with top quality stock in good locations outperforming. At the same time, investor sentiment for residential and logistics assets remains strong. On the back of generally healthy occupier markets and fuelled by low interest rates, prime yields are set to compress further. Urban logistics and residential commuter locations are our top picks, with expected outperformance both in terms of rent growth and yield compression.

Delayed economic recovery, but positive outlook

After entering into recession at mid-year 2020, the German economy saw a significant bounce back in the third quarter. Business sentiment and consumer confidence remained below pre-crisis levels, but almost reached neutral territory later in the year, fuelled by a global trade rebound[1] and comparatively generous government support.

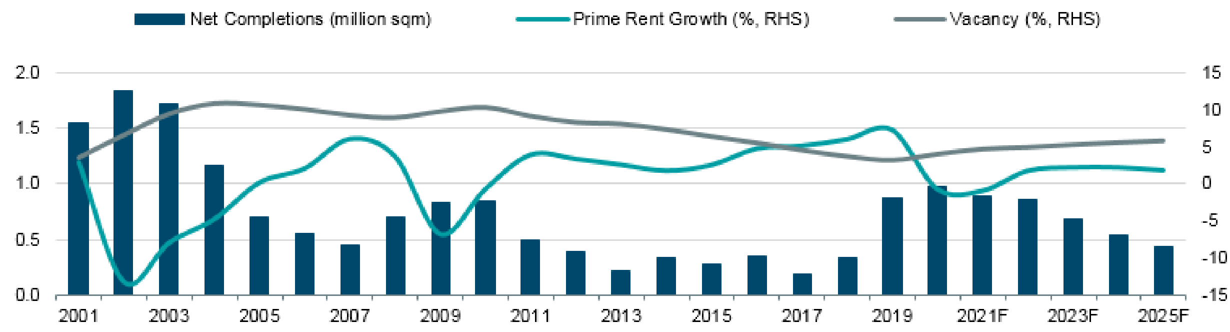
However, despite the positive news on vaccination, the gradual tightening and extension of lockdown measures are forecast to be a drag on economic performance in 2021. While we expect the economic recovery to take longer, thus negatively impacting real estate markets in the short term, we still have a positive outlook, with GDP growth of 4.5% forecast this year.

[1] Oxford Economics, January 2021

Office markets slowing, but not coming to a halt

Office occupier markets weakened towards the end of 2020. Take-up receded significantly, but the relatively low level of available stock is supporting the market. That said, we expect the trend of rising vacancy rates to continue in 2021 and beyond, suppressing near-term rent growth. While we have only seen a moderate drop in rent levels so far, we do expect some further downward pressure in the first half of 2021, with Dusseldorf, Cologne and Stuttgart possibly being the most affected among the top seven locations. Beyond this year, positive rent growth is expected to return. Moreover, market developments are becoming more heterogeneous, with top quality, well connected assets expected to outperform.

German Top 7 Office Occupier Market



Sources: PMA, DWS, January 2021. Note: F = Forecast.
Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

The office investment market has seen reduced activity as well,[2] but as the prime end of the market has become thinner, there has been limited evidence of re-pricing.[3] Prime yields even compressed slightly last year compared to 2019. Our forecast is that yield compression for prime assets will continue for the next three to four years in line with the low interest rate environment.

Retail still correcting

German retail sales volumes exceeded their pre-crisis level at the end of 2020,[4] mainly thanks to the strong performance of e-commerce, which gained market share at the expense of physical retailers. While some segments like DIY or groceries proved resilient, the bulk of physical retailers remain in distress.

In light of this trend, our outlook for shopping centre rental growth remains negative for at least the next two years. And with poor-performing letting markets, investor sentiment towards the sector is also weak. In a European context, the German shopping centre market is among those that have seen the strongest correction in values so far. While we are not recommending re-entering this market yet, Germany could in time be among the first markets to see an attractive yield premium and asset management opportunities.

Logistics a short-term outperformer

The logistics sector has been one of the main beneficiaries of the Covid-19 pandemic. While the economic contraction has hit the part of the sector with strong ties to manufacturing, overall logistics take-up at the end of 2020 was up again and recorded a two-year high.[5] E-commerce was the driving force here. Going forward, we expect a continuation of this

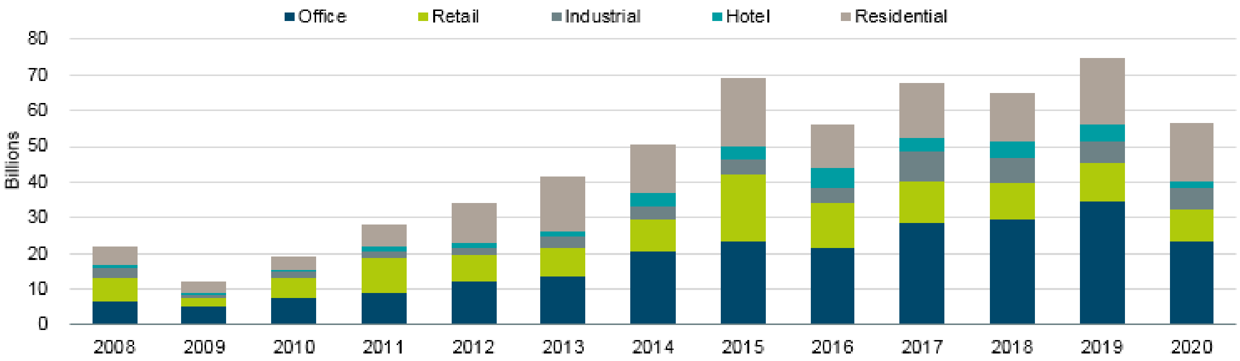
[2] RCA, January 2021
[3] PMA, November 2020
[4] Eurostat, January 2021
[5] JLL, January 2021

trend, with accelerated rent growth of more than 3% per annum over the next three years. In line with the strong occupier market performance, investment sentiment remained very positive as well. Prime yield compression also continued unabated against a more subdued trend in the wider market.

However, we envisage the investment window shrinking and the investment process becoming more selective. Prices have risen sharply and a continuation of yield compression at the same pace as last year seems unlikely beyond 2021. With stock under construction increasing further from an already high level, rent growth is expected to decelerate as well.

An exception to this is urban logistic assets in supply-constrained locations, where competition for available plots from within and outside the sector is fiercest. Given increasing consumer expectations regarding delivery times, we maintain a positive outlook, although current market dynamics in the e-commerce sector should gradually begin to moderate.

Transaction Volumes by Sector (€ Bn)



Source: RCA, January 2021.

Residential proving defensive

Thanks to its defensive characteristics, the residential sector in Germany has performed well during the crisis. A slight moderation in demand, together with an impeded and more static market situation in the first half of 2020, had a dampening effect on rent growth. However, rents remained resilient nonetheless. At the same time, investor sentiment stayed strong. Transaction volumes only dropped by around 10% year-on-year, remaining above the five-year average.[6] Also, while prime yields compressed, the share of residential investment within the overall transaction volume increased further to a remarkable 27% over the year in 2020.

Going forward we continue to expect the residential market to outperform. Given persistent demand in tight residential markets, rent growth in the top seven cities is likely to be in excess of 3% per annum in the coming three years. Well-connected commuter locations in the first ring around major agglomerations remain our top pick here. Coming from a lower rent level, these locations are more affordable, thus benefitting from growing residential space requirements triggered by the Covid-19 pandemic.

[6] RCA, January 2021

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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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