DWS

Marketing Material*

IBERIA REAL ESTATE STRATEGIC OUTLOOK

First Quarter

IN A NUTSHELL

- _ After several years of strong growth, last year brought a sharp contraction in Iberian GDP.
- _ There are some concerns over the outlook for offices, but we see opportunities in certain submarkets and assets closely aligned to the latest occupier requirements.
- _ Logistics should offer above-average returns, with last hour assets a key part of our strategy. Private rented residential fundamentals remain healthy, making the sector well placed for rental growth.

After several years of strong economic performance, Spain and Portugal saw a sharp contraction in GDP last year. Office occupiers are cautious about expansion and this is resulting in a rise in availability and a likely fall in rents in the short term. Opportunities remain in outperforming submarkets and for assets which are closely aligned to the latest occupier requirements. The logistics sector still offers attractive returns despite strong yield compression over 2020. Assets which can serve the 'last hour' of the logistics journey are a key part of our strategy, being more protected from the risk of oversupply. The retail sector has been more adversely affected by the pandemic and is likely to undergo a period of rental and capital value correction.

Economic growth outpaces the Eurozone

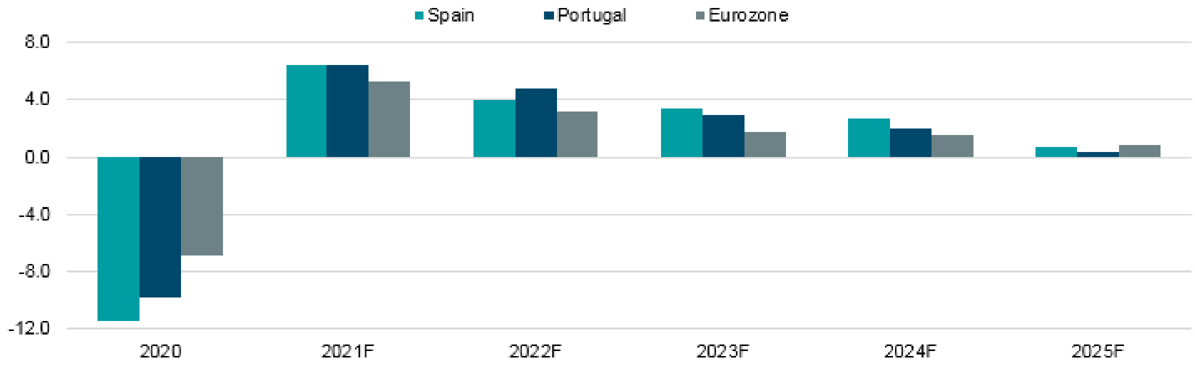
Spain has outperformed the European economy since 2015, when its economic recovery following the GFC and Eurozone crisis finally gained momentum.[1] However, growth was already slowing before the Covid-19 pandemic, and we expect the Spanish GDP decline to have been among the highest in Europe last year, as the tourism and service sectors were particularly hard-hit.[2] A strong recovery is likely to follow, boosted by a large government stimulus package, but this will also be dependent on the rollout speed of an effective vaccine.

As with Spain, the Covid-19 pandemic ended Portugal's period of recent economic expansion. Overall, we expect economic output to have contracted by around 10% in 2020.[3] The tourism sector, a major contributor to GDP, deteriorated further towards the end of the year, with tourist arrivals 70% below 2019 levels in November.[4]

The short-term prospects for recovery in Portugal remain dampened by the ongoing effects of the pandemic. Unemployment continues to trend higher, and the rollout of the vaccine is unlikely to result in a significant easing of restrictions until later in 2021. After this point, fiscal support and the European recovery package should enable a strong economic rebound.

[1] Oxford Economics, December 2020
[2] DWS, Oxford Economics, January 2020
[3] DWS, December 2020
[4] Oxford Economics, January 2021

GDP Growth (% Y-O-Y)



Source: DWS, Oxford Economics, December 2020. 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.

Residential resilient to the pandemic

Despite some rental decline in 2020, fundamentals for the private rented residential sector are still healthy. Madrid and Barcelona are expected to grow in population by 5% and 2% respectively over the next ten years, and real household incomes by almost 2% per annum. These factors come together to suggest strong demand for housing.

On the supply side, while permits are picking up, this is coming from a low base. Spain is therefore well-placed for rental growth, particularly in Madrid where rents are not constrained by regulation. We expect outperformance in submarkets such as Getafe in Madrid and Badalona in Barcelona, where populations are growing, attracted by relative rental affordability and ease of commuting into more central areas.

Weaker outlook for offices

The recent lockdowns and economic recession will have implications for the office market. The immediate effect has been a marked slowdown in take-up as occupiers put moving plans on hold. We expect that net absorption will not turn positive until next year, as 2021 is likely to be another weaker year for demand relative to supply growth, particularly in Barcelona. In this context, our forecast is for rental decline this year.

The longer-term drivers of performance are more positive. Barcelona, Madrid, and Lisbon are attracting tech companies, having relatively affordable labour costs, excellent international connections, and a high quality of life. Between 2015 and 2019, Barcelona was ranked sixth in Europe for number of start-ups funded by venture capital.[5] As the tech sector has been relatively resilient to Covid-19, it is likely to be a key driver of post-pandemic take-up. Submarkets such as 22@ in Barcelona, where tech firms are particularly concentrated, therefore look more attractive for future investment.

Covid-19 has necessitated a rise in working from home, although the longer-term impact on office markets is unclear at present. However, from analysis we have recently undertaken, Barcelona and Madrid are among the least vulnerable markets to this trend. Relative to other major European office markets, commuting times are short, so employees are less likely to want to work from home regularly, and occupancy costs are low, so occupiers are less likely to decide to cut office space. However, we have downgraded our long-term forecasts for office rental growth to reflect slightly weaker future office demand. Given this outlook, we advocate a selective approach to new acquisitions, focusing on outperforming submarkets and assets which cater to the latest occupier demands, such as efficient energy use, wellness facilities, and flexible floorplates.

[5] Atomico: 'State of European Tech' report, 2019

Barcelona to lead logistics rental growth

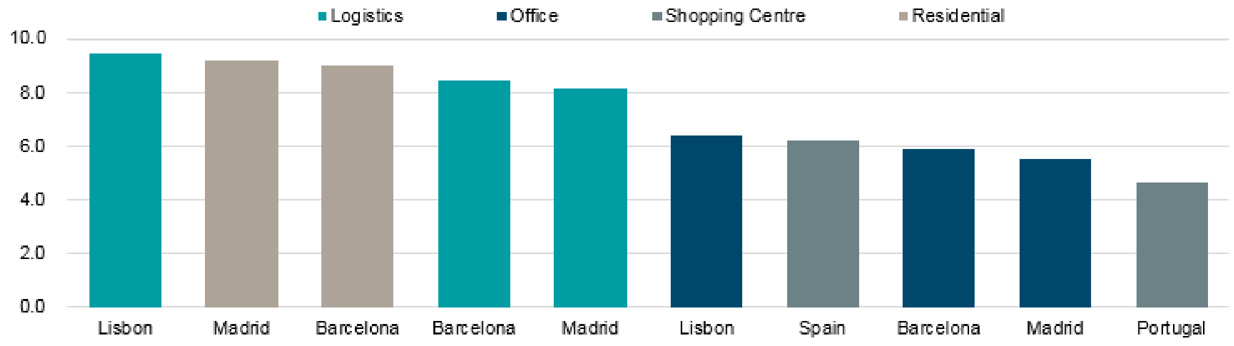
Alongside the growth in e-commerce sales, demand for logistics space in Madrid and Barcelona has also increased. Our expectation is that this will continue, driving rent growth of around 2% per annum over the next 10 years. Rental growth in Barcelona, the more supply-constrained market, is forecast to outperform Madrid over the next five years.

The logistics market in Portugal tends to generate weaker rent growth as occupiers often serve consumer markets here from warehouses in Spain. However, yields are attractive relative to Spain and we feel that hubs close to urban areas that can deliver directly to consumers are likely to outperform.

Retail rents at turning point

Retail rental performance in Spain and Portugal has been insulated to some extent from the growth of e-commerce by the relatively low online penetration rates in Iberia. However, last year was a turning point, as lockdowns forced sales online, leading to 12% growth in e-commerce sales.[6] With this rapid change in spending patterns, and instore sales hit further by greatly reduced tourist spending, we expect prime shopping centre rents to have fallen in 2020, with a further decline likely in 2021. This may be followed by slow growth in subsequent years, but in our view there will be very limited opportunity for investment over the next five years.

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



Source: DWS, December 2020. 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

[6] Savills, Q3 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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