

Marketing Material*

January 2020 / Research Report

EUROPE REAL ESTATE STRATEGIC OUTLOOK

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1 / Executive Summary

The European real estate market is in good health. Occupier markets have rarely been stronger, investment activity is robust and outside of the retail sector, capital values are moving higher. While no cycle lasts forever, there are few signs to suggest an imminent correction, and indeed we expect 2020 to be another good year.

The recent slowdown in the global economy is an area of concern, but so far European real estate has proved resilient. Vacancy is well below history, with many major cities recording shortages of good quality stock. Retail is still a clear exception. Over the next five years we expect prime rental growth to average +1.5% per annum for office, +2.1% for logistics, +2.5% for residential and -1.2% for shopping centres.

Prime property yields may have fallen to a new low, but with cuts to global interest rates and renewed quantitative easing in the Eurozone, negative 10-year Bund yields and record high levels of dry powder, we expect prime real estate yields to fall further over the coming two years. As we are forecasting prime office, logistics and residential yields to end 2024 lower than they are today, we believe the next five years should continue to offer capital growth and an attractive total return.

Paris, Warsaw and Amsterdam stand out as some of the top performing markets. We continue to have a strong overweight call on the logistics sector, and residential is also likely to remain attractive, particularly in cities like Dublin and Madrid. The European office market is later in its cycle, leading us to a neutral call. However, very low vacancy is supporting active management, while following last year's decisive election result we see a strong possibility that London and other major U.K. office markets will enjoy a period of outperformance.

Beyond tactical calls, demographics and productivity are likely to form the long-term basis for a successful real estate strategy. This pushes us towards strategies like mass market residential, student housing, new office submarkets in major urban areas and last hour logistics. Not without challenges, these strategies are underpinned by strong and sustainable occupier demand, which we believe will support long-run outperformance.

The outlook for European real estate remains positive. The world is not without uncertainty, but property fundamentals are strong. It's important though to remain proactive. While investors should be tactically positioning their portfolio to take advantage of the cycle, the recent outperformance of the logistics and residential sectors and underperformance of retail have shown the immense power of structural change.

EUROPE REAL ESTATE SUMMARY:

Occupier Market	Occupier market remains strong. Vacancy rates well below history outside retail, where conditions continue to deteriorate.
	Positive rent growth for office, logistics and residential. Retail rental decline looks to be accelerating.
	Rent levels forecast to continue to grow but fewer new jobs and more development set to slow the pace from mid-2020s.
Investment Market	Investor demand has picked up since mid-2019 and with dry powder at record high levels the market should remain liquid.
	Prime yields compressing to record lows (excluding retail) and are expected to fall further in 2020/21.
	Total return outlook revised higher to reflect expectations of further yield compression, rent growth and lower interest rates.
Investment Strategy	Overweight calls on logistics and residential. Neutral call on the office market. Strong underweight on shopping centres.
	Tactical focus on outperforming cities such as Paris, Warsaw and Amsterdam, active asset management and London office.
	Strategic focus on mass market residential, student housing, last hour logistics and the emerging submarkets of major cities.

Source: DWS, January 2020. No assurance can be given that any forecast will materialise.

2 / The Economy

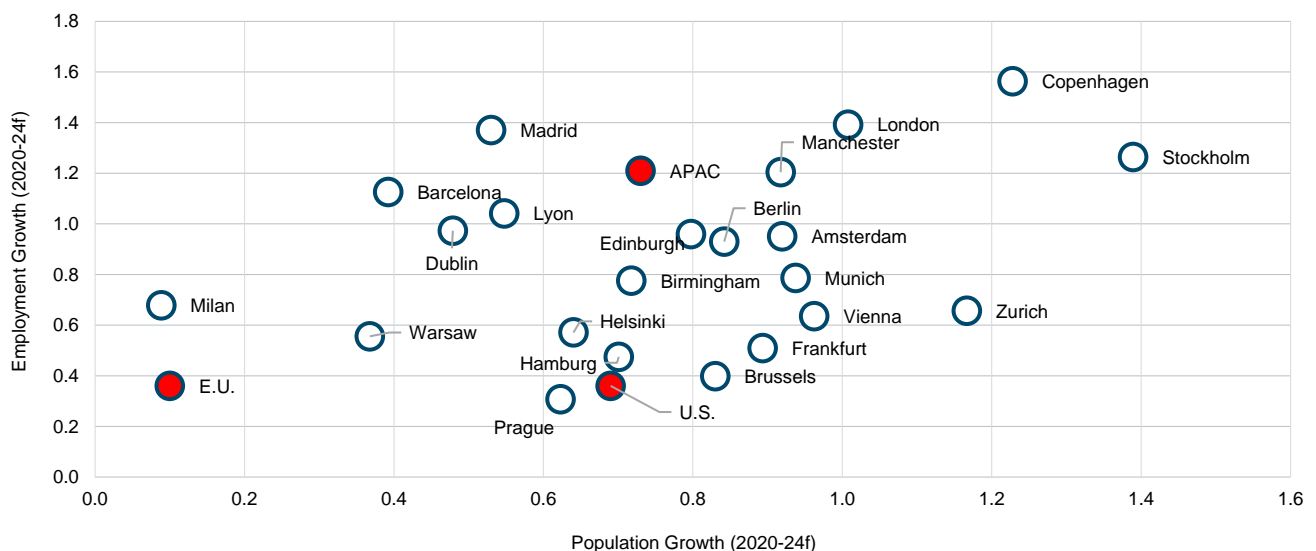
The European economy has slowed over the past 18 months. While this slowdown is certainly not unique in a global context, European GDP growth in 2019 does look to have fallen to its lowest level since the Eurozone crisis. It's important though not to overstate this weakness. This is not a recession. Growth is positive and jobs continue to be created. And while most lead indicators are showing only modest expansion, there have been signs of improvement in recent months.

Although we don't think there will be a rapid recovery from the current economic malaise, with growth running below potential we do see a gradual pick-up in activity. Over the next five years European GDP growth is forecast to average around 1.5% per annum, down by around 30 basis points on the average over the past decade.¹

This growth figure masks considerable differences across Europe, however. At the country level, Poland in particular stands out. Having expanded by around 4% in 2019, the Polish economy is forecast to perform well above the European average over the coming five years. Perhaps more important though is city-level performance. As shown in the chart below, almost all of the major cities in Europe are forecast to see population and employment growth well above the European average, with places like London and Stockholm performing in line with fast growing APAC cities such as Sydney and Kuala Lumpur,

Central banks have reacted to the recent slowdown. It's easy to forget that just over 12 months ago the ECB ended its quantitative easing programme – a move swiftly reversed nine months later. There are many questions over the effectiveness of ultra-loose monetary policy, and a growing chorus supporting fiscal stimulus as an alternative. Still, we don't see any immediate change in the outlook and operation of monetary policy. Alongside modest trend growth, we expect the 10-year German Bund – often used as the Eurozone benchmark – to remain anchored below 1% for much of the first half of this decade.²

EMPLOYMENT AND POPULATION GROWTH EUROPEAN CITIES (ANNUAL AVERAGE, %)



Source: Oxford Economics, DWS, November 2019

¹ Oxford Economics, December 2019

² Oxford Economics, December 2019

3 / Real Estate Performance

3.1 Occupier Fundamentals

The European occupier market continues to edge along the cycle, trends remaining broadly positive across the majority of locations and sectors. One factor currently supporting the market is the relative lack of new space coming online. Having been caught out in previous cycles, developers are often taking a more cautious approach this time, and levels of net completions are still comfortably below their previous peak. In the retail sector in particular, development of new space has slowed to a trickle, even accounting for the relatively large amount of space in extensions and redevelopments of existing centres. The exception here is logistics, where an unprecedented amount of space is being constructed in order to keep pace with record demand, fuelled in part by a rise in e-commerce.

There is no clear trend in occupancy across the sectors, with the occupier balance being driven by sector-specific factors rather than the wider economic cycle. Offices are benefitting from a period of strong office-using employment growth, together with relatively modest construction activity, pushing vacancy down to an 18-year low. Logistics occupancy went through a sustained period of increase between 2009 and 2016, but as construction volumes have caught up with demand, the pan-European vacancy rate has since stabilised, although still close to an all-time low. Meanwhile, the situation for retail property continues to worsen, with vacancy steadily increasing over the past decade and currently sitting at a record high.

Recent rental trends have been slightly more uniform, although the retail sector is again a significant laggard. On a pan-European basis, shopping centre rents dipped into negative territory in 2019 for the first time in five years.³ Conversely, logistics and residential are running at a steady 3.0% per annum, while offices surpassed the 4.0% growth mark for the second year in a row. Looking ahead, we expect to see continued rental growth across most sectors, with residential and urban logistics outperforming. We are forecasting a strong outturn for U.K. offices and logistics, while Central Europe is predicted to top the table for retail and we also expect Spanish residential to be an outperformer within the sector.

Office: The European office market continues to be supported by above-average job growth in the major cities, although a cut in the near-term outlook for economic growth should begin to take some of the steam out of the occupier market. Favourable conditions have allowed the pan-European vacancy rate to fall to just 6.5%, which has provided a significant boost to rents. Prime rent growth across Europe is expected to reach 4.4% in 2019,⁴ and has now averaged close to 4.0% per annum over the past five years,⁵ more than double the rate of the previous five. Growth has also been fairly widespread, although the German markets, Central Europe and Southern Europe, together with Amsterdam have been notable outperformers of late. Growth has also returned to the Central London market, but further uncertainty in 2020 may delay momentum from taking hold.

Generally speaking, developers are still cautious. Net additions exceeded 1% of stock in 2019 for the first time in nine years, but construction activity is still some way below the last peak. Building starts, which give a good idea of upcoming completions, have been remarkably stable for the past four years.⁶ But as employment growth slows over the next five years and development activity edges upwards, we expect some increase in vacancy, starting from next year and reaching a peak of around 8.0% by the middle of the decade. With this in mind, we also expect rent growth to moderate, averaging 1.5% per annum over five years, although rates above 2.0% are foreseen in Central London, Iberia, and Paris CBD.

³ Cushman & Wakefield, DWS, December 2019

⁴ DWS, December 2019

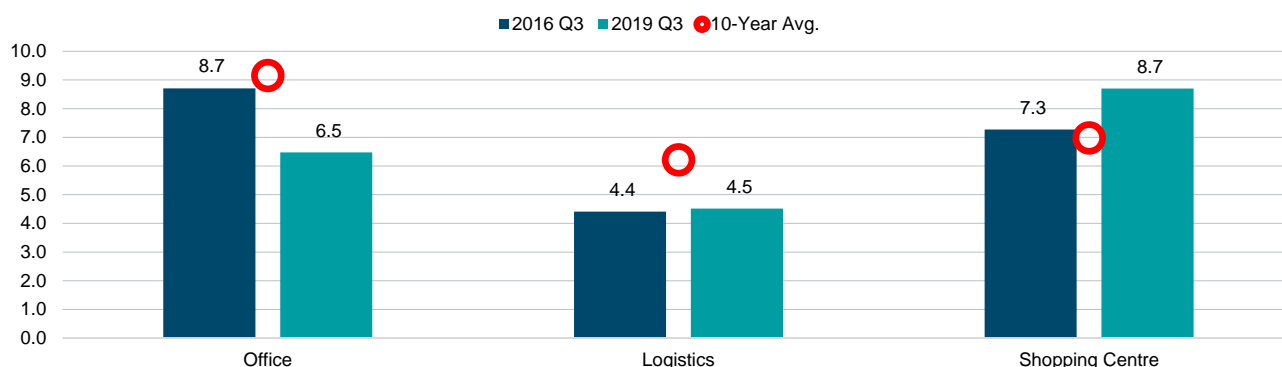
⁵ PMA, December 2019

⁶ PMA, December 2019

Logistics: Longer-term drivers, in particular the rise of e-commerce, continue to provide tailwinds to the logistics occupier market, although cyclical factors represent a risk. With a general weakening in the economic outlook, and more specifically worries over global trade, demand for logistics space is beginning to slow ever so slightly. In addition, logistics developers are increasingly turning to speculative development in an attempt to keep pace with demand. In the first half of 2019, speculative development accounted for close to 30% of total European completions, the highest rate for at least 10 years.⁷ To date, the sheer scale of demand has been enough to absorb this space, but in certain markets, such as the United Kingdom and Poland, we have already seen vacancy begin to edge out a touch.⁸ If cyclical headwinds increase more widely, we may also start to see a more pronounced slowing of demand, leading to a rise in vacancy elsewhere.

In light of particularly strong occupier fundamentals, the logistics market is seeing an unprecedented period of prime rental growth, hitting a record high of 4.1% in the third quarter of 2019. Given current low levels of vacancy and continued support from structural drivers, we also expect to see further growth looking ahead. On aggregate, we are forecasting logistics prime rents to grow at around 2.1% annually over the next five years – a slight reduction on recent years but still markedly higher than historical rates. This is in part down to the outperformance of the urban logistics sector, as distribution centres close to large population centres are scarcer and face stronger competition from other land use. As such, urban logistics rents have been easily outpacing big box logistics located in traditional corridor locations, where land is often more readily available. We expect this trend to continue, with rents for urban properties growing by as much as 3.5% per year over the forecast period, approximately double the rate for big box logistics.

VACANCY RATE BY SECTOR (%)



Source: PMA, JLL, Cushman & Wakefield, DWS, December 2019

Retail: The outlook remains difficult for physical retail stores. Online sales, which now account for around 10% of total retail sales volumes on average cross Europe, continue to grow at double digit rates. Meanwhile, instore sales, while still positive, are growing slowly.⁹ Confidence among retailers declined in the second half of 2019, but remains slightly above long-term average,¹⁰ while operating margins are being squeezed for many of the major European retailers and net store openings continue to trend downwards.¹¹ With this in mind, despite record-low new development, average retail vacancy now sits at 8.7%, the highest ever level and with the upward trend showing no sign of ending.

Rents are also coming under pressure. Pan-European shopping centre rents fell by almost 1.0% last year, with only Central and Southern Europe still seeing growth. Across the continent, headwinds are only likely to increase in the coming years. We expect pan-European in-store sales growth to turn negative by the middle of the decade as the share of online sales accelerates further. For some time, our outlook for prime shopping centre rent growth has been lagging behind the other sectors, but given the recent pace of change we have further downgraded our forecast. We now expect weighted average

⁷ PMA, December 2019

⁸ JLL, December 2019

⁹ Oxford Economics, PMA, DWS, December 2019

¹⁰ European Commission, December 2019

¹¹ PMA, October 2019

European prime shopping centre rents to fall by around 7% in total, although peak-to-trough falls of close to 20% are foreseen in the United Kingdom, Germany and France. We still expect markets such as Spain and Poland to perform slightly better, but even here it is likely that rental growth will eventually turn negative.

Residential: Demand for private residential space remains strong in Europe. Inflated house prices and political uncertainty have helped to keep average homeownership rates relatively stable across Europe, while the proportion of the population in private rented accommodation has increased gradually over the last decade. European demographics are not especially favourable when viewed as a whole; however, a continuing trend of urbanisation means that the continent's major cities continue to see significant population inflows. At the same time, development of new housing space remains fairly modest. The amount of new space being completed has been, generally speaking, on an upward trend, yet the number of planning permits granted and projects started in 2018 suggest that the rate of new completions is likely to be levelling off.

Potential for government intervention and regulatory change is clearly a bigger risk in the residential market than in the other main commercial sectors, and yet the ongoing strong performance of the private rented sector continues to push it further onto investors' radar. Rental volatility since the financial crisis has been relatively low, and while we await final data for 2019, our forecasts show a tenth consecutive year of comfortably positive prime rental growth. And looking further ahead, we expect continued disposable income growth and a healthy employment market to drive prime rental growth of 2.5% per annum over the five-year forecast period, putting residential ahead of the three main commercial sectors, with London and the Spanish cities seeing the strongest rates of growth.

3.2 Capital Markets

Investment & Pricing: There is still a significant depth of investor demand for European property. Thanks to a slower first quarter, investment volumes in the first nine months of the year were down slightly on the previous year, but the full year total will still be far above the 10-year average.¹² European investment sentiment was also up in the third quarter compared to a year earlier,¹³ while private equity fundraising for Europe-focused real estate funds was above €25 billion for the sixth year in a row¹⁴ and German open-ended funds are on course for their strongest net inflows since 2003.¹⁵

At the same time, with strengthening construction activity, particularly in the logistics and hotel sectors but also within offices and residential, investors are being furnished with new opportunities to deploy the large amounts of dry powder. What's more, with a growing consensus that interest rates are likely to stay low for some considerable time yet, achieved property yields continue to trend lower.

By sector, retail investment continues to wane. Office, logistics and hotels are still drawing in a large amount of capital, but it is the private residential sector that is proving the strongest attraction, with pan-European volumes up by 60% over the past three years.

In terms of location, renewed Brexit uncertainty in the lead-up to the December general election led to U.K. investment volumes tailing off, while in Germany continued trade worries and limited availability of suitable product may be limiting further investment growth. However, demand for French real estate – and particularly Paris offices – was boosted by record cross-border activity last year.¹⁶

Looking in more detail at pricing, the overriding trend remains one of falling yields. Downward momentum has been strongest in the logistics sector, where yields fell by an average of 20 basis points in the year to September, with the United

¹² RCA, December 2019

¹³ PMA, October 2019

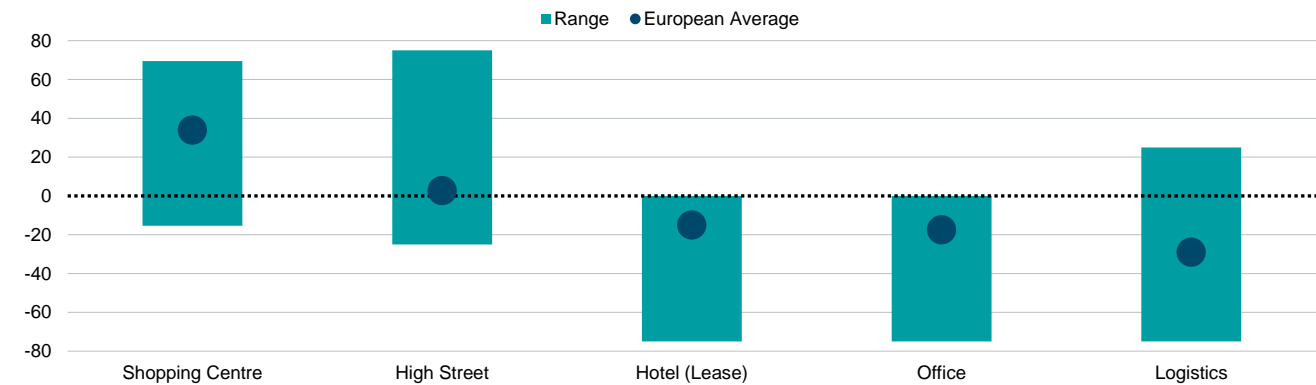
¹⁴ Preqin, December 2019

¹⁵ BVI, December 2019

¹⁶ RCA, December 2019

Kingdom the only market not to see yield compression. Yields are also still declining in the majority of office markets, with the strongest falls occurring in markets such as Lisbon, Budapest and Helsinki,¹⁷ while hotel yields are also still on a downward path, particularly so in Southern Europe and Germany.¹⁸

PRIME YIELD SHIFT BETWEEN 2018 Q4 AND 2019 Q3 (BPS)



Sources: PMA, CBRE, Cushman & Wakefield, DWS, December 2019. Past performance is not a reliable indicator of future returns.

The retail sector is once again the outlier here though. While pricing for formats more resilient to online sales competition – such as prime high streets and supermarkets – is holding up slightly better, yields for prime shopping centres moved out by an average of 25 basis points in the first three quarters of the year¹⁹ and the outward shift has been even greater for secondary retail.²⁰ Prime shopping centre pricing has so far corrected the furthest in the United Kingdom, but values are now also clearly being marked down in other large Western European markets, and even to an extent in Central and Southern Europe – the only parts of the continent still seeing positive rent growth.

Outlook: The near-term economic outlook has, broadly speaking, weakened over the past six months. And at the same time, real estate construction activity remains at or above historical levels for all except the retail sector. Yet despite some evidence of a decelerating – albeit still healthy – occupier market, stronger momentum within the investment market now looks likely to continue well into the early 2020s.

A major factor behind this has been the current and expected path of interest rates. With growth slowing and no sign of any significant pick-up in inflation, monetary policy across Europe remains accommodative. Equally, longer-term projections for interest rates have been cut significantly since the early part of 2019. Ten-year government bond yields in Germany fell into negative territory early in the year and have remained there ever since, falling as low as -0.7% at one point in the third quarter. The 10-year Bund is also now forecast to move out by just 120 basis points over the next five years, considerably less than was expected a year ago.²¹

One effect of this has been that property yield spreads have widened again and are likely to come under less pressure looking ahead, making real estate look relatively more attractive. And given attractive borrowing costs and pressure to deploy large reserves of dry powder, this may well entice more investors to buy at yields that may previously have been deemed too low.

As such, we have revised downwards our yield forecasts for every sector except retail over the next five years. We now expect prime yields for offices and private rented residential to remain broadly stable over that period, with logistics yields

¹⁷ PMA, DWS, December 2019

¹⁸ CBRE, December 2019

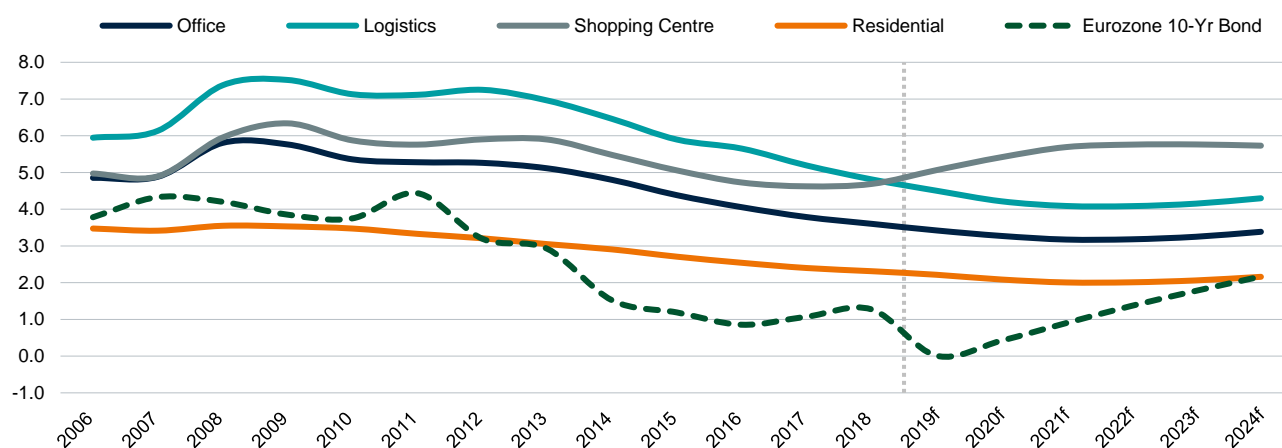
¹⁹ Cushman & Wakefield, DWS, December 2019

²⁰ CBRE, December 2019

²¹ Oxford Economics, December 2019

ending up slightly lower. And within the logistics sector, expectations of rental outperformance in the urban logistics segment should drive even stronger compression. Conversely the outlook for retail remains bleak as investors continue to shun the sector, and here we expect significant outward yield movement over the next two years.

PRIME YIELD OUTLOOK BY SECTOR (%)



Source: DWS, PMA, Cushman & Wakefield. December 2019. Past performance is not a reliable indicator of future returns. No assurance can be given that any forecast will materialise. 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.

We expect Central Europe to be an outperformer in terms of yield impact, as a strong economic outlook supports further investment market convergence with Western Europe across all sectors. In Southern Europe, outsized rental growth has been a major driver of recent yield compression, but as occupier market momentum begins to fade, we would expect the office and logistics sectors there to be relative underperformers in terms of yield-driven change in value.

A degree of added certainty following the general election should help to boost the U.K. investment market, and particularly in the office sector we could see yields begin to converge back towards Continental Europe to some extent, although this is under the assumption of leaving the European Union and agreeing a comprehensive trade deal.

3.3 Returns and Market Calls

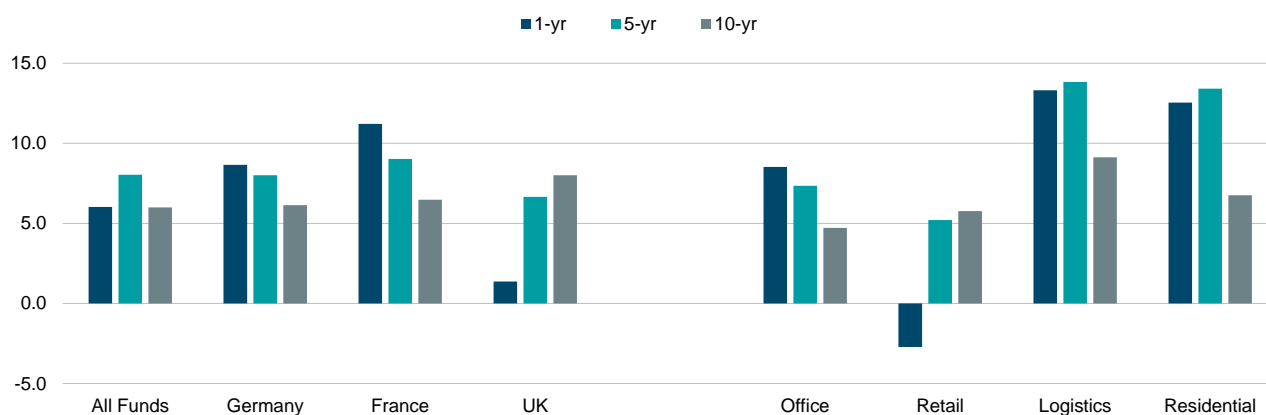
European real estate looks likely to have outperformed our expectations for 2019. In addition, predicted returns for 2020 and 2021 have seen a fairly significant upgrade, thanks in large part to the downwardly revised path for interest rates. As such, despite relatively little change to our outlook for the occupier market, we now expect annual all property prime total returns to be a little over one percentage point higher between 2020 and 2024 compared to our outlook six months ago.

Recent performance: Performance within the institutionally held real estate market continues on a positive footing. On an annual basis, total returns for the INREV All Funds index were 6.0% in the third quarter of 2019. While performance has been moderating over the past 12 months, fund-level total returns remain comfortably above their long-term average. A look at performance within the more balanced pan-European funds tells a similar story. Total returns for both the MSCI Pan-European Quarterly Property Fund Index (PEPFI) Balanced Funds and INREV Open End Diversified Core Equity (ODCE) consultation index saw total returns of close to 5.0% in the 12 months to September 2019 – in both cases around 200 basis points higher than their historical averages.

In terms of underlying asset performance, industrial is the clear winner, with property-level total returns remaining above 10%. Residential property makes up only a small proportion of the PEPFI index, but a look at the INREV All Funds index

suggests that the sector is also a clear outperformer. Retail, on the other hand, continues to fall further behind the all property average. In fact, property-level returns for retail are now only marginally above zero. By location, the Netherlands remains out in front, while German real estate is also performing well, but the UK market is still lagging some way behind.²²

ANNUAL FUND-LEVEL RETURNS TO Q3 2019 (%)



Source: INREV, December 2019

Note: Past performance is not indicative of future results.

Outlook: With the exception of retail, where the situation continues to worsen, changes to the occupier market outlook have been relatively minor. Nevertheless, a further reduction in our yield forecasts, particularly so for offices and logistics, have led to a marked improvement in expectations for real estate returns over the next five years. All property prime total returns are now forecast to be close to 5% per annum between 2020 and 2024 – an improved outlook but nonetheless one that represents a considerable moderation in returns compared to the previous five years.

One of the notable changes to our forecasts is that we now expect to see significantly positive capital value growth for at least the next two to three years across the office, logistics and residential sectors. This means that for these sectors, capital growth will now make up the greater proportion of total return over this period, compensating for lower income return as property yields continue to fall. Nevertheless, we still expect income to become the more important driver of returns as values peak towards the end of the five year forecast period.

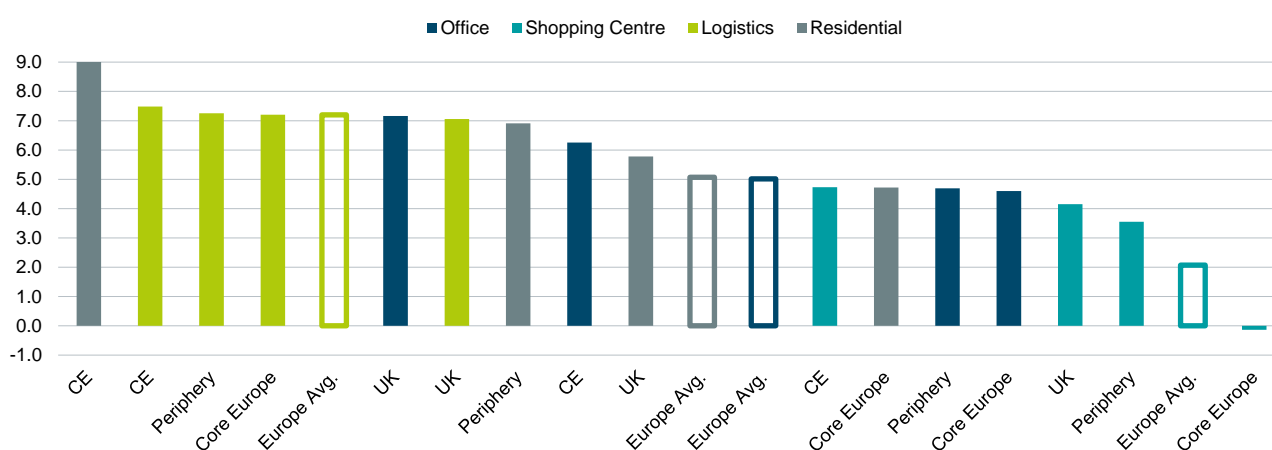
At a sector level, logistics is still predicted to be a strong outperformer overall. On the whole, we are expecting urban logistics to dominate the list of top performers within the sector, as growing requirements for space related to e-commerce and delivery lead to rising competition for near-city-centre locations. We expect prime total returns for corridor logistics locations, where it tends to be much easier to build and direct proximity to large conurbations is less important, to be slightly lower at just less than 7.0%, which is still above the all property average.

Retail is still propping up the bottom of the table, with a weakened rental growth forecast counteracting slightly lower exit yields. However, retail's place in the real estate pecking order is shifting. With European prime shopping centre values expected to be marked down by a peak-to-trough total of 25%, and an even larger total decline foreseen in secondary retail, the traditional view that retail should be one of the largest components of a diversified European portfolio is under threat. So although we think retail will be a continued drag on performance, in time its declining weight should help to offset some of the negative effect on overall portfolio performance.

²² MSCI, INREV, December 2019

On the flip side, the residential market continues to gain in importance. As more European markets are being opened up to institutional investors through new development, and as investors look for assets that benefit from longer-term structural drivers as the current real estate cycle matures, private rented residential is becoming a more important part of the commercial real estate universe. To illustrate this trend, recent pan-European transaction data shows that residential property accounted for more than 20% of total investment over the 12 months to September 2019; this compares to just 6% at around the time of the previous peak in 2007.²³ Hence, the fact that residential is due to easily outperform retail could have an even greater impact on a portfolio of European property.

PRIME TOTAL RETURNS BY SECTOR AND REGION (2020-24F, %)



Source: DWS, December 2019

Notes: f = forecast. Core Europe = Germany, France, Benelux, Nordics, Austria & Switzerland; Periphery = Iberia, Italy, Greece & Ireland; CE = Czech Republic, Hungary & Poland. There is no guarantee the forecast shown will materialise. As such, the performance and forecast shown represent hypothetical and simulated performance, which has many inherent limitations. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. No assurance is made that forecast returns will be achieved.

Geographically, returns are still set to be highest in Central Europe; however, the United Kingdom is now close behind. Brexit uncertainty has held the U.K. market back significantly for the past three years, and while the result of the December general election result hasn't fully removed uncertainty, it has helped to reduce the likelihood of a No Deal exit. Given that prices in both London and the U.K. regions currently offer a significant premium over other European markets, as soon as investors feel there is sufficient certainty over the future relationship between the United Kingdom and the European Union, the market could move fairly quickly, leading to a period of strong relative performance. Our forecasts are made based on the assumption of a trade deal being agreed and no cliff edge come the end of the transition period, although clearly there is still some uncertainty here.

Southern Europe has been the top-performing region over the past five years, and we still expect solid returns within the logistics and residential markets here over the next five. The Iberian office market also still has a good deal of momentum, but Italian offices are being held back by a poor economy.

Market calls: In the following table we summarise our key market-level calls for the three main commercial sectors and the private rented residential sector over the next five years. This provides our views on market selection based on our forecasts for prime property performance and also accounts for market risk. These views are not all encompassing within the real estate investment universe and should be considered in conjunction with the strategic themes shown in this document.

²³ RCA, December 2019

Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect. Past performance is not a reliable indicator of future returns.

	Market Summary	Market Calls
Germany	<p>Near-term economic outlook is challenging, but real estate market performing well. Lower return volatility and low-risk environment support strong liquidity, but low yields likely to limit returns.</p> <p>Our call on prime offices broadly unchanged, but Berlin no longer overweight. Retail continues to struggle; outlook downgraded to a firm underweight.</p>	<ul style="list-style-type: none"> Logistics upgraded to neutral/overweight. Berlin and Munich top picks, with strong occupier fundamentals. Opportunities in the urban logistics segment. We maintain a neutral call on offices, but would still support active management plays in markets with low vacancy, such as office and residential in Berlin, Munich and Hamburg.
France	<p>Reform programme gives upside potential to long-term economic outlook. Outlook for Paris remains strong, with positive demographics and above-average GDP growth.</p> <p>Additional boost towards 2030 as Grand Paris Express completes. We see relatively few attractive opportunities in prime segment within major regional cities.</p>	<ul style="list-style-type: none"> Paris CBD offices expensive, but we expect rental outperformance, leading to a continued overweight call. Concerns over future supply in La Défense, but infrastructure gains may support opportunities. Paris logistics remains overweight, especially urban and last mile assets; additional demand for home delivery to support further rental outperformance.
U.K. & Ireland	<p>U.K. real estate performing better than expected; pricing still attractive on a relative basis, particularly offices and retail. Risk around future trade negotiations but market likely to benefit following decisive election result.</p> <p>Dublin remains strong. Office rental affordability concerns and supply rising. Residential and logistics outperforming.</p>	<ul style="list-style-type: none"> Some additional Brexit certainty after December election; U.K. offices overweight, while we expect London to be among the best European performers (risk-adjusted). Calls on Ireland remain unchanged; Dublin residential an expected outperformer, thanks to strong population growth, housing shortages and attractive pricing.
Southern Europe	<p>Strong employment growth expected for Spanish cities. As the cycle matures, we see slightly fewer opportunities in the region. Very low vacancy supporting Lisbon office market.</p> <p>We have downgraded Italian retail, due to a weak Italian economy, political uncertainty and a wider drop in sentiment towards European retail.</p>	<ul style="list-style-type: none"> We maintain an overweight on Spanish residential, with a strong jobs market, rising disposable incomes, and low levels of development sustaining rent growth. Italian market generally underweight, although low vacancy and online sales supporting Milan logistics.
Benelux	<p>Expected to be among the best performing real estate markets in Europe over five years.</p> <p>Still significant momentum in the Netherlands; we expect this to continue in the short term, but a pick-up in development activity may begin to take some of the steam out of the market beyond 2020.</p>	<ul style="list-style-type: none"> Offices are overweight across the region; Rental outperformance foreseen in Amsterdam; Rotterdam and Brussels offer lower volatility and a yield premium. We maintain an overweight on logistics in Amsterdam and Brussels, and have upgraded Dutch residential to overweight.
Nordics	<p>Economic outlook for the region is among the best in Western Europe, but Stockholm and Oslo real estate largely underweight.</p> <p>Prime Stockholm looks expensive from both an occupier and investor viewpoint, but we still see selective opportunities in emerging submarkets outside the CBD.</p>	<ul style="list-style-type: none"> We expect Helsinki and Copenhagen prime to offer the best opportunities, particularly residential, with each offering a yield premium over other European cities. Logistics yields in both markets also remain higher than elsewhere in Europe; and we anticipate above-average rent growth here.
Central Europe	<p>Economy among best-performing in Europe. Major cities predicted to see well above-average GDP growth. We expect some of the highest absolute returns in Europe; risk-adjusted, the region still looks attractive.</p> <p>Office outlook downgraded slightly; Warsaw continues to look attractive.</p>	<ul style="list-style-type: none"> CE among the few regions in Europe still seeing positive shopping centre prime rent growth. CE retail now an overweight within the sector. Warsaw offices remain overweight, despite development. Economy and yield convergence support returns, but fewer opportunities to purchase attractively priced prime stock.

4 / Environmental, Social and Governance

As ESG continues to grow in importance, the key considerations and implications for real estate have begun to morph and expand, transforming the way the topic is assessed among properties. In addition to the continued emphasis on greater energy efficiency and reduced emissions, investors and managers are shifting attention to physical climate risk: the exposure of properties as well as communities to the acute impacts of climate change. Social topics such as affordability and health and wellness have emerged as other areas of interest within real estate.

Physical Climate Risk: The past several years have seen a rise in both the frequency and intensity of natural disasters. In the World Economic Forum's 2019 Global Risk Report, extreme weather events, natural disasters, and the failure of climate-change mitigation and adaptation figure among the top five risks, both in terms of likelihood and impact. According to the European Environment Agency, there has been nearly \$450 billion in natural disaster losses between 1980 and 2017.

In the coming decades, risks and accompanying losses are expected to increase significantly. In addition to the traditional issue of flooding, there are new risks that have emerged around heat stress and access to water that can also impact property. This year marked one of the hottest summers on record, with countries including Germany, the United Kingdom, and the Netherlands breaking all-time record high temperatures. Cities and countries across Europe are investing in risk mitigation measures, but the continued densification of major urban areas will add stress to existing infrastructure in dealing with these issues. And while property insurance can be a tool to mitigate direct losses, it is important to consider the indirect impacts to tenants and the potential long-term effects of continued exposure to climate stress.

In order to address these issues, investors are beginning to assess their exposure to physical climate risk and explore potential investments in resilience. However, there are challenges in addressing these issues.

First, it can be difficult to obtain accurate data on exposure to floods and other risks, although new private-sector data providers and tools have arisen to help better model these exposures. Second, there is understanding how to underwrite the cost of these risks and the value of resilience measures. Unlike energy efficiency measures, where energy costs can be calculated based on historical usage, it is not possible to predict when these events could occur and thereby predict potential losses. Finally, the benefit of resilience is based on potential loss avoidance as well as the reduced risk of downtime, both of which are difficult to value. While the impact on real estate pricing remains to be seen, the issue has become more prominent.

Social Value: While much of ESG programming to date has focused on key environmental issues, social topics such as affordability and health and wellness have grown in prominence.

The most important and easily measured factor regarding social criteria is certainly the rent level. While high rents seem favourable at first sight, investments into affordable residential schemes can be beneficial for long-term investors as well. Given steep rent increases in many markets, affordability constraints are becoming an issue across Europe. Mass market, affordable rental housing is well placed to benefit from increased tenant demand, thus further reducing void risk and adding additional stability to portfolios through stable income streams.

Moreover, affordable residential schemes are less prone to market regulation, which is likely to become more widespread in the years ahead. This in turn will limit competition from investors with a short investment horizon, as clear and enforceable rules make aggressive pricing based on optimistic business plans less likely. This is particularly true for residential investments in established PRS markets like Germany or the Netherlands, where tenancy agreements often have a longer duration compared to commercial leases. Prudent investments in order to avoid investment backlogs and proper

maintenance of existing assets not only relate to energy efficiency, but also limit reputational risks for investors and lead to a higher comfort factor with respect to the wellbeing of existing tenants.

Health and wellness has become an important social factor across all sectors in real estate. In essence, it encompasses the design standards, policies implemented and operational measures in place that can improve the quality and comfort of the built environment for tenants and communities. The topic has already become a growing feature for office markets, driven by open-space floor plans, co-working, and as part of a corporate tenant strategy to attract retain employees. These principles are also influencing the design of other property types as well, particularly within the residential sector, and have also given rise to certification programs, such as the WELL standard and Fitwel. While the overall number of certified properties are small, many investors are pursuing these certifications alongside traditional LEED and other designations during the construction or renovation phase of a project as a way to attract tenants. However, challenges still exist in understanding the value of these improvements.

First, it is difficult to benchmark the wellness of a building in a similar way to its energy efficiency as there are numerous metrics, which are often qualitative in nature. And while certifications can be used to demonstrate health and wellness credentials, some buildings will not be able to achieve certification status without significant capital investment. However, these programs do provide a potential set of standards against which to score buildings across a key set of metrics. In addition, evolving sensor-based technologies, which can track factors such as air quality and temperature, can allow for ongoing monitoring of a standardised set of quantitative metrics.

Second, it can be a challenge to value the benefit of these measures. Benefits typically accrue to the tenant and require substantial data back from the tenant on how the measures are improving outcomes such as employee health, absenteeism, and productivity. While calculating a precise return on investment may not be possible, strategies that better enhance tenant-landlord data sharing on health and wellness can help to align objectives and provide more incentives to undertake these measures.

5 / Office Market

Current Conditions: Despite global economic headwinds, most European markets are continuing to enjoy further gains in employment and a tight supply environment. Development activity has been muted, with net completions between 2013 and 2018 averaging only 0.7% of stock. As a result, we are seeing steady rent growth across most major markets.

Following an extended period of growth, rents are now higher on average than at the peak of the last economic cycle. Rents in some markets have reached unprecedented levels. In Stockholm and Berlin, real prime rents are now around 50% higher than the 2004-2008 average. However, real rents in Spain and regional markets in the United Kingdom and France still sit some way below levels achieved in the previous cycle.²⁴

Outlook and Investment Strategies: Supply conditions remain tight across much of Europe. Average vacancy in the third quarter of 2019 was 30% lower than the long-term average. As a result, development activity is starting to pick up, and we expect net completions in the next five years to average 1.3% of stock.²⁵ Central European markets including Warsaw, Budapest and Prague are forecast to see the greatest increase in supply. However, levels of development are still well below those seen before the GFC, when annual net completions averaged more than 2%.²⁶

In the context of slowing economic growth and a slight increase in completions, rent growth is likely to be more gradual. We recommend a strategic focus on markets that are slightly earlier in the rental cycle, with continued potential for rental outperformance, such as Lisbon and Madrid. Stronger rent growth is also expected in the German cities, particularly Berlin, where vacancy is among the lowest in Europe.

Given that the spread to 10-year bonds is still wide relative to the previous cycle, there is room for further compression in office yields, despite current low levels. The greatest yield declines are likely to be found in CE markets where yields are currently more than 100 basis points higher on average than Core European markets.²⁷ Investor interest is high: 2018 was one of the strongest years on record for office investment in the CE region and 2019 was another very good year.²⁸ The United Kingdom may also offer value, having missed out on the yield compression seen in other Core European markets over the past three or four years due to Brexit-related uncertainty.

In the context of low vacancy and limited future development, a focus on repositioning existing assets can unlock higher rents. Assets in markets such as Stockholm, where vacancy is less than half the 10-year average and prime rents are now almost 30% higher than the previous cycle²⁹, could be well positioned for this approach.

	Theme	Comment
Office Strategies	Active Management	Identify markets with low vacancy and potential for rental uplift to reposition existing assets.
	Emerging Locations	Target emerging office locations, often profiting from infrastructure improvements, to realise higher total returns.
	Tactical	Focus on high-quality assets in markets such as the U.K. where pricing may have over-corrected.

²⁴ PMA, DWS, December 2019.

²⁵ PMA, DWS, December 2019.

²⁶ PMA, DWS, December 2019.

²⁷ PMA, DWS, December 2019.

²⁸ RCA, December 2019.

²⁹ PMA, DWS, December 2019.

6 / Retail Market

Current Conditions: Last year marked a significant turning point for retail real estate. Having moderately underperformed for around two years, 2019 saw a sharp deterioration in total returns. On the surface, the consumer backdrop is good, but despite this, many traditional retailers are struggling for profitability, vacancy is rising and we see widespread rental decline across much of Core Europe.

Investor sentiment towards the sector has slumped. Transaction volumes fell by almost a quarter in 2019,³⁰ reaching the lowest level since the Eurozone crisis in 2012. And with little investor appetite, yields have increased across much of the continent. Secondary retail has been most affected, but even prime shopping centres are estimated to have seen a 40 basis point increase in yield so far.

The United Kingdom and Core Europe have suffered most, with Central and Southern Europe proving more resilient to date. The U.K. market in particular, buffeted by everything from Brexit to business rates, has seen a slump of up to 30% in prime shopping centres values since 2017.³¹

Outlook and Investment Strategies: For the second time in a row we have significantly downgraded our outlook for European shopping centres. Over the coming five years we expect average prime rents to fall by around 6.0% in total, and net initial yields to rise by 70 basis points to 5.70%.

Having already lost 10% of their value, this outlook suggests that on average, shopping centres will see a further value decline of 17% over the next five years. Of course, this hides a wide range of outcomes, although we don't see any markets recording positive value growth in this period.

France and Germany are forecast to be two of the worst-performing markets. In both, we anticipate an acceleration of rental decline coupled with a sharp rise in prime yields from what are still relatively low levels – a pattern we expect to see repeated to varying degrees across much of Core Europe.

In other parts of Europe the outlook is somewhat less bleak. We expect less value decline in Southern Europe, and for the Central European markets to sustain consistently positive rental growth. Nonetheless, even in these markets we suspect it is only a matter of time before structural changes lead to higher vacancies and lower rents.

We should take it as a positive though that the market is adjusting to the new retailing reality. In time the market will find a new equilibrium as formats that no longer work are closed or converted, weaker demand translates into lower rents, and as higher costs and shorter leases are reflected in higher yields. Indeed, it is the United Kingdom where we think this adjustment is most advanced. And while the immediate outlook looks exceptionally difficult, there is a good chance that parts of the U.K. market will become oversold, offering opportunities to re-enter at an attractive, sustainable price.

	Theme	Comment
Retail Strategies	Factory Outlets	Focus on large, well-established outlets sustaining high sales densities. Selection of operating partner important for driving brand engagement, tenant churn and consumer experience.
	Reduce Exposure	Liquidity is low and sales price will often be at a discount to book value, but reducing exposure to structurally weak assets in declining markets may still support long-term portfolio performance.
	Oversold	Monitor markets such as the United Kingdom where sharp falls in values are creating distressed conditions, increasing the likelihood that good quality asset become oversold.

³⁰ Real Capital Analytics, January 2020

³¹ Cushman & Wakefield, DWS, December 2019

7 / Logistics Market

Current Conditions: Tenant demand for European logistics remains buoyant. Vacancy sits at just 4.5% across Europe,³² despite development activity picking up in some places, while rent growth continues to broaden. The rapid rise of online retail, increased urbanisation and a consumer demand for ever faster deliveries continue to place pressure on the entire supply chain, driving an evolution in property requirements in terms of size, location, specification and function.

Indeed the hub and spoke model remains in favour. Ever larger distribution and e-fulfilment hubs – often demanded by omni-channel and pure play retailers, 3PLs and increasingly manufacturers – sit as the central nodes in growing national or international supply chain networks. These feed into spokes such as second stage sortation facilities, last mile customer delivery centres and cross-docked parcel hubs, often close to urban centres.

Outlook and Investment Strategies: Tenant demand for logistics space is set to grow rapidly, with structural drivers providing an offset to weaker economic conditions. Urban logistics in particular should be a key beneficiary from these structural drivers – supporting outperformance.

We still believe large first stage distribution facilities have an important role to play, but we prefer those close to consumer catchments or in major national distribution locations. However, we maintain caution on port-linked logistics without a strong consumer market, and corridor locations, particularly where rent levels are high. Indeed the latter often face competition from new speculative schemes given limited land constraints.

New supply in corridor locations looks to have become more of a threat. While demand is strong and vacancy remains low, development has risen sharply in some areas. The A-2 distribution corridor in Madrid and parts of the Midlands Golden Triangle in the United Kingdom are just two examples of markets where rising supply is leading to slower rent growth.

In addition to the continued growth of online sales, we see faster and more convenient delivery as a key trend influencing the sector. To facilitate this, the larger first stage distribution hubs are often now found closer to consumer markets, while we're witnessing strong demand for the later stage urban facilities.

These urban facilities can often serve multiple tenant types, while supply constraints and potential for alternative use often support low levels of vacancy. Coupled with strong demand, we see this leading to urban rent growth being almost double that of non-urban logistics across the markets we project. Furthermore, while today urban facilities offer a substantial yield premium across much of Europe, we expect that gap to narrow over time, particularly as more modern stock is delivered.

All this leads us to our call on urban logistics. Paris, Dublin, Helsinki and Amsterdam stand out as key markets. But as we outlined in our recent Last Hour Logistics paper, utilising data analysis can help unearth new locations, even in markets where prime logistics is expensive, such as the United Kingdom and Germany.

	Theme	Comment
Last Hour Strategies	Urban	Typically inner ring. Multiple end-user / land-use competition. Usually smaller (sub-10k sqm) and may include industrial such as Dagenham (London), Mariendorf (Berlin) and Gennevilliers (Paris).
	Metropolitan	Found on outer ring of large metropolitan centres. (Limited) land use competition. 3PL, retailer and parcel sortation usual profile with larger requirements such as Dartford (London) and Roissy (Paris).
	Multi-nodal	Hub locations with excellent accessibility between a number of towns or cities. Similar tenant / criteria to Metropolitan. Examples include Rhine-Ruhr, North West U.K. and Randstad.

³² JLL, November 2019

8 / Residential Market

Current Conditions: Residential markets across Europe appear to have lost none of their appeal to institutional investors in recent months. On the contrary, residential investments continue to form an integral part of the investment universe, the pan-European investment volume increasing to around €56 billion in the 12 months to September 2019. This figure represents a historical high tide mark for residential transactions and for the first time the sector accounts for more than 20% of the total European investment volume. The upward trend was most pronounced in Spain and the Netherlands, both overtaking the United Kingdom in terms of volumes – if only temporarily, as the U.K. market looks to have had a strong fourth quarter. With a transaction volume of almost €15 billion, Germany remained the largest European market.³³

While the investor base widens across Europe, residential performance remains strong. Annual fund-level returns, as measured by the INREV Quarterly Index, showed the second best sector return after logistics. At 12.5% the annual total return slipped slightly below its three and five-year averages, but outperformed most other sectors by a comfortable margin. Capital growth was one again the main driver of performance, while income returns remained lower.³⁴ However, given the defensive character of the asset class, residential investments will likely retain their appeal for long-term investors.

Outlook and Investment Strategies: New supply continues to increase moderately in most European markets, but often falls short of strong demand. Given persistent supply-demand imbalances, which are most pronounced in major agglomerations, we expect residential markets to perform well over the next five years. We see strong market dynamics in markets such as Dublin, Madrid and the Randstad region in the Netherlands, which in addition to further institutionalisation should drive down yields in the short term.

In line with population growth, household formation is likely to play an increasing role in major cities across Europe. With an above-average share of young inhabitants between the ages of 25 and 44, those cities will likely see stronger suburbanisation trends. More families in their “founding phase” will move into the first ring and well-connected commuter towns outside the inner city. Affordability constraints in downtown locations will add to this trend, making “mass market” housing solutions a desired alternative. This trend is already visible in Germany’s larger cities, which are losing inhabitants to the first ring, despite overall population gains.

Another trend, which could shape residential markets in 2020 and beyond is regulation. Berlin remains the focus of attention in this regard, but other cities could follow suit. While in the Netherlands more power was handed over to local authorities, rent regulation could resurface in the Spanish cities or in London.

	Theme	Comment
Residential Strategies	Outperformers	Focus on markets with strong demand fundamentals such as Madrid, Dublin, Paris and Copenhagen, but also key regional markets with sound economics, like in southern Germany.
	Co-living & Micro Apartments	Focus on major agglomerations, which generally appeal to millennials and benefit from supply shortages in addition to a sound economic base that attracts contingency workers.
	Commuter Belt	Focus on well-connected suburban locations with access to fast-growing but expensive cities like London, Munich or Barcelona, as their hinterland profits from suburbanisation and spill-over effects.

³³ RCA, December 2019

³⁴ INREV, November 2019

9 / Private Debt

Current Conditions: Private real estate debt continues to look attractive within a wider market context. Returns from direct real estate investments comfortably outperformed expectations in 2019, but we believe that private debt still offers an attractive risk-adjusted return profile looking ahead.

The borrowing landscape has remained largely unchanged over the past year in terms of both average LTVs and margins. Senior margins have been trending downwards in recent years, although the GDP-weighted average margin on a prime office loan stayed fairly flat last year at around 130 basis points. Senior margins currently range from as low as 85 basis points in the Netherlands to as high as 200 basis points or more in some markets. Meanwhile, typical senior LTVs are hovering around 60%, or up to 70% in parts of Central Europe. However, with swap rates having fallen, overall borrowing costs are almost universally down. Mezzanine loans, meanwhile, continue to offer margins of 600-800 basis points, typically at LTVs of up to 80%.

Underlying issues in the retail real estate market are beginning to push up margins on retail debt, which are now higher than offices in almost every European market, with a gap of 50 basis points or more between the two sectors in the case of the United Kingdom.³⁵ U.K. lenders are increasingly worried about the number of retail centres in trouble. As it is often problematic finding an alternative use for a large shopping centre, lenders are reluctant to appoint receivers for existing holdings if there is no clear exit strategy for a centre.³⁶ And for new lending, borrowers are increasingly required to demonstrate a clear asset management plan that assesses alternative uses beyond retail if the scheme should no longer be viable.³⁷

Last year, fundraising activity in the debt space was down on previous years. While fundraising for Europe-focused debt strategies averaged almost \$8 billion per annum in the five years previous years, 2019 looks likely to have seen a drop to below this level. Still, real estate debt remains one of the most important parts of the private equity market in Europe, being outpaced only by value-added and opportunistic direct property fundraising.³⁸

Outlook and Investment Strategies: Strong competition to lend against the most secure office and logistics properties has squeezed returns. We still feel that growth sectors such as hotels and student housing, as well as office properties with curable deficiencies in good locations, continue to offer value in this context. The return premium on senior debt in the United Kingdom has grown slightly over Core Europe, reflecting the increased risk around the political situation there. As such, we would remain cautious on U.K. mezzanine opportunities, where there is less downside protection against value decline in the underlying assets. Growing challenges in the retail sector are already somewhat reflected in an additional margin premium in the United Kingdom, but less so on the continent – and we would be cautious here as well, particularly for anything but the best schemes. In addition, despite continued low interest rates, there is still an expectation that rates will eventually begin to rise gradually, and floating rate loans should offer a degree of protection against this trend.

	Theme	Comment
Debt Strategies	Senior	Focus on core properties outside the prime segment in France, Italy, Spain and the United Kingdom. As well as offices, consider emerging segments like student housing, private residential and hotels.
	Mezzanine	Strong focus on asset selection rather than market allocation. Given market uncertainty, exercise caution in the United Kingdom, despite it being the largest market.

³⁵ CBRE, December 2019

³⁶ Cass, September 2019

³⁷ CBRE, May 2019

³⁸ Preqin, January 2020

10 / Listed Market

Current Conditions: European listed real estate returned +26% in 2019, slightly underperforming the Stoxx 600 by 150 basis points.³⁹ Logistics companies were once again the strongest performers, returning +50% with the self-storage sector following just behind. Office-centric listed companies across Europe also performed well, returning +43%. After a strongly negative performance in 2018, retail names continue to lag behind other sectors but still delivered a solid +16% growth in 2019. German residential, despite its historical attractiveness in the low bond yield environment and embedded supply-demand imbalance, suffered this year due to the proposed Berlin rental freeze.

The U.K. listed real estate market delivered a total return of +31%,⁴⁰ the highest level since 2006 and outperforming the wider market by 11 percentage points. This was not driven by underlying fundamentals, with NAV growth largely flat-to-negative. However, the listed market saw a strong run leading up to and following the general election. There was some opportunistic M&A activity, most notably London Metric acquiring fellow logistics company Mucklow.

Outlook and Investment Strategies: We believe U.K. companies operating in alternative, less cyclical areas such as student housing or PRS should continue to deliver the strongest NAV growth and relatively appealing earnings and dividend growth. London office names are likely to benefit from increased tenant optimism and higher investor demand. Retail-focused companies continue to struggle following significant asset valuation write-downs and tenant failures but are taking steps to shore up balance sheets through asset sales and fresh equity.

We expect stocks in Spain and Germany to perform best in 2020, given rent reversion potential and further portfolio vacancy reduction. Companies exposed to CBD locations benefitted most in 2019 due to the limited market supply and lack of new developments. French offices also saw positive growth in rents of around 3%; however, lettings in areas like La Défense are more challenging given supply coming to the market. Overall, office providers are well positioned to benefit further from strong market fundamentals, but we would expect secondary locations to outpace the prime areas. Despite the continued vacancy reduction and strong rent reversions, companies agree that rental growth has probably reached its peak.

Given the low property yields on German residential (Berlin assets in particular), owners are reliant on organic rental growth and modernisation-driven uplifts to generate total returns and to support current valuations. Last year's rental freeze proposal in Berlin has not yet been deemed constitutional but companies like Vonovia have already decided not to increase rents in Berlin. The proposed plan has resulted in the sector now trading at a 9% discount to NAV.⁴¹

The retail sector remains our least favoured. The best quality shopping centres continued to attract footfall and sustain underlying operating numbers. Earnings results from Klépierre clearly indicated solid development in rents, rent reversions and footfall, while URW struggled due to its U.K. and U.S. market exposure. Even here though, yields for prime shopping centres are at risk of increasing as tenant concerns persist. Many of the companies committed to ambitious disposal plans to repair balance sheets but did not manage to sell any assets.

	Theme	Comment
Listed Market Strategies	United Kingdom	Slowing returns for U.K large caps suggest discounts to NAV are unlikely to reverse over the short term. Logistics and London office-focused names offer development surpluses, supporting returns.
	Continental Europe	Growth at a reasonable price – European sectors are fairly priced and so identifying top performers, mainly through bottom-up analysis, will be vital in 2020.
	Non-cyclical Alternatives	We expect student accommodation, healthcare and residential companies to deliver above-average earnings growth, higher dividends and ultimately superior returns.

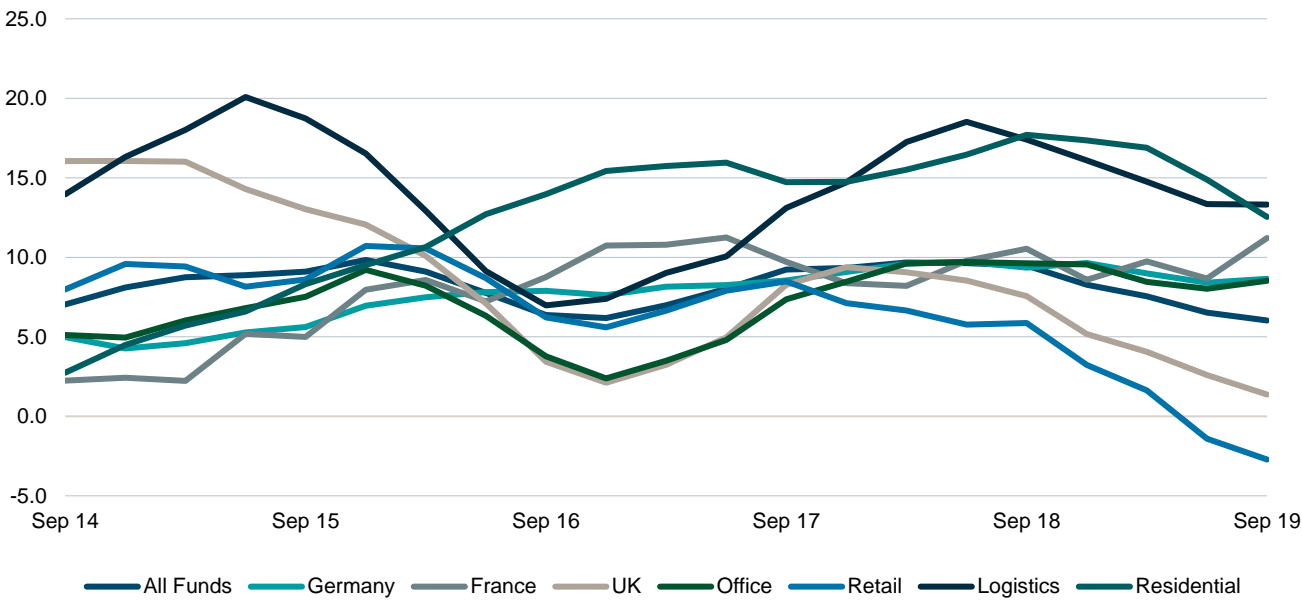
³⁹ EPRA, Bloomberg, Dec 2019

⁴⁰ EPRA, Bloomberg, Dec 2019

⁴¹ EPRA, Bloomberg, Dec 2019

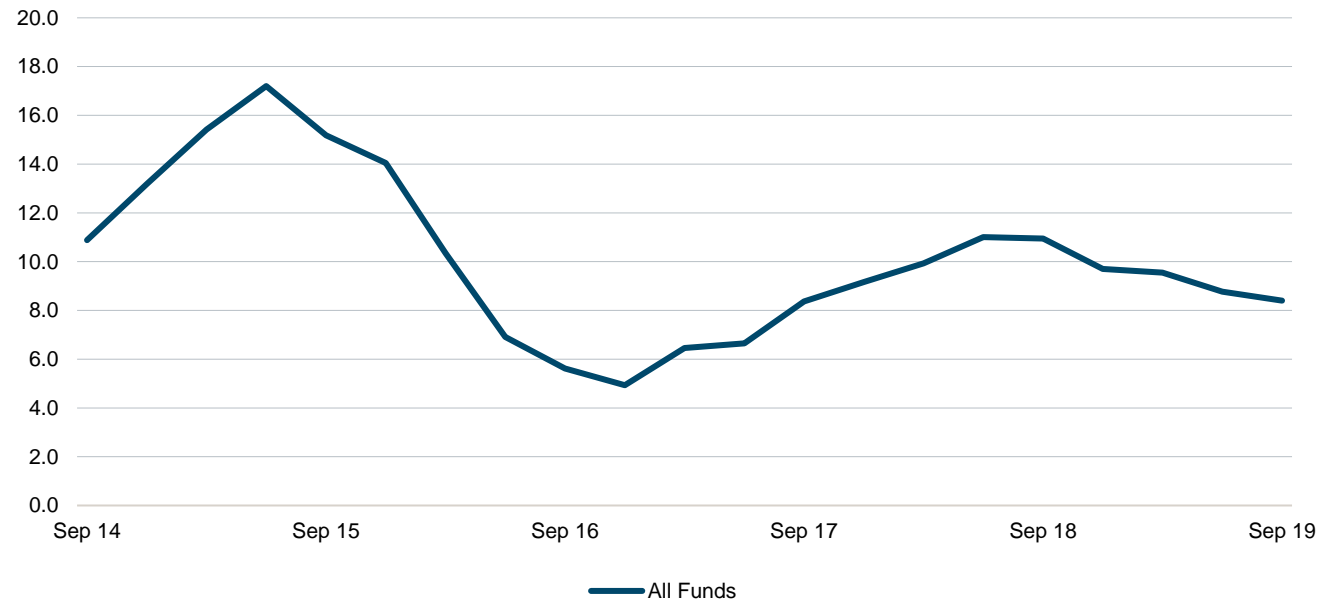
11 / Appendix

EXHIBIT 8: INREV HISTORICAL ANNUAL FUND-LEVEL RETURNS TO 2019 Q3 (%)



Source: INREV, December 2019
Note: Past performance is not indicative of future results.

EXHIBIT 9: MSCI HISTORICAL ANNUAL FUND-LEVEL RETURNS TO 2019 Q3 (%)



Source: MSCI, December 2019
Note: Past performance is not indicative of future results.

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