Marketing Material*

EUROPE REAL ESTATE STRATEGIC OUTLOOK

Mid-Year 2021

IN A NUTSHELL

- The European real estate market has entered a period of recovery. Initially led by yield compression, we expect the return of rental growth to sustain performance over the coming years.
- Residential and logistics continue to provide the highest risk-adjusted returns, although our long-term outlook is now less supportive of corridor logistics, given pricing and potential new supply.
- We believe investment strategy should be focused on residential (including co-living), next generation offices, selective hotels, urban logistics where available, and the sale of long-let commodity office.

Market Outlook

The past year and a half has been very challenging for European real estate. However, businesses and their employees have seen unprecedented support from governments and central banks across the continent. Subsidies, loan guarantees, tax relief, social security measures, and employment retention schemes are just some of the measures that have helped to prevent large-scale bankruptcies and unemployment in the face of a sharp drop in economic output.

Many of these support measures remain in place, yet the short-term outlook is one of re-opening and recovery. As restrictions are gradually being lifted and the economy begins to come back to life, we expect to see a further pick-up in both the investment and occupier markets in the second half of 2021 and into next year. The investment market in particular has taken a significant hit in terms of activity over the past year, although we expect the easing of travel restrictions to breathe new life into the market.

In 2020, private equity fundraising for European real estate was in line with both the previous year's total and the five-year average, while German open-ended real estate funds continued to see positive net inflows in the first quarter of this year.[1] However, a significant divide has grown between sectors. Sentiment towards retail remains exceptionally weak, while offices have seen limited activity. Yet there has still been strong demand for logistics and residential assets, and in these sectors yields in some cities are down by 50 basis points already this year.[2]

Many multi-asset investors continue to find real estate an attractive asset class. Relative to fixed income, there remains a premium that's significantly higher than in the past. At the end of last year, for offices, residential and certainly retail, that spread was just about as high as it's ever been – and still very healthy for logistics. But with yields heading lower, some investors may struggle in hitting existing cash return targets, and stronger rental growth will be required to meet overall return expectations.

[1] Preqin, July 2021
[2] PMA, broker sources, July 2021

One area to watch is inflation. If the recent run up in prices proves longer lasting, we believe that on balance this may be a positive for the real estate sector. This is particularly the case for European real estate, where many leases are indexed against inflation. With construction costs also on the rise, this may also lead to reduced supply, and in turn higher rents. Indeed, over the longer-term we see a number of reasons to suggest that construction costs could rise at a faster pace, thereby providing structural support to performance. Of course, higher inflation could also suggest higher bond yields, but as already mentioned, real estate spreads remain well above historical levels and with central bank support likely to continue, this should moderate any impact on real estate pricing.

FACTORS INFLUENCING CONSTRUCTION COSTS

TEMPORARY

ON-SITE COVID CONSTRAINTS
Staggered shifts. Safety checks

SUPPLY CHAIN DISRUPTION
Commodity and production costs

LABOUR MARKET DISRUPTION
Misallocation of labour

LONGER-TERM

NET ZERO CARBON
Development is carbon intensive

FISCAL STIMULUS
Large-scale infrastructure projects

LABOUR SHORTAGES
Shrinking working age population

Source: DWS, July 2021

Generally speaking, occupier markets are in a better position than perhaps we had expected a year ago. Governmental support across the continent has provided a significant cushion to the economic impacts of the pandemic. Today, vacancy rates – with the exception of retail, which has seen a much longer trend of falling occupancy – are comfortably below their long-term averages, and this puts the market in a good position as the economy recovers. Business and consumer confidence is well above the long-run average, PMI figures are indicating strong private sector growth, unemployment is down, and business failures are the lowest for some time.

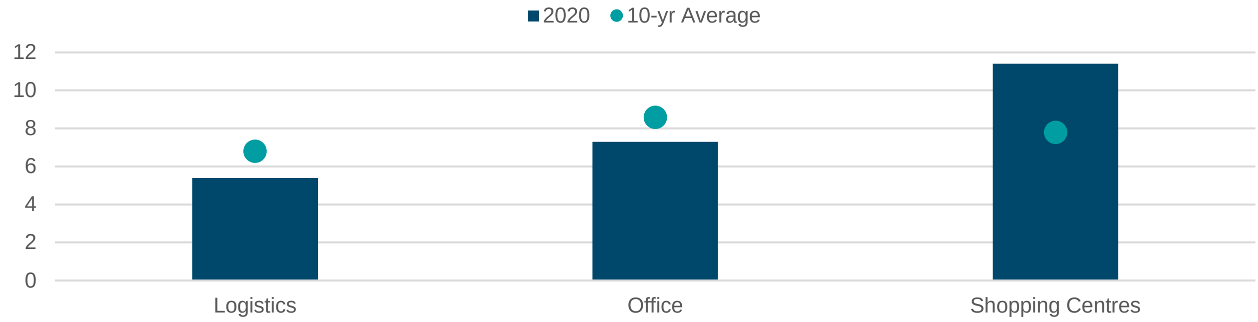
But we still need to be conscious that for the past year many tenants may have been in a weak position, having spent reserves, taken on debt, or seen rising costs. As support measures are withdrawn and moratoria on tenant evictions come to an end, we may see a spike in bankruptcies and an increase in vacancy. Tenant risk should be a key consideration during the recovery.

Office: The pandemic has clearly had a strong impact on certain sectors, but the short-term effects on the office market have been less severe than expected. While offices have not prospered, they haven't suffered nearly as much as the retail and hotel sectors.

With a number of social, work and travel restrictions in place, it is perhaps unsurprising that we've seen a sharp drop in office take-up and some increase in overall vacancy. Before the pandemic, pan-European office vacancy had trended downwards for 26 consecutive quarters, reaching 6.3% at the beginning of 2020, its lowest level since 2002. Since then, the rate has risen in all but a very small handful of markets, growing by 130 basis points on aggregate.[3]

[3] DWS, PMA, June 2021

VACANCY RATES (%)



Source: DWS, PMA, JLL, July 2021

However, businesses have remained operational and tenants have largely been able to continue paying the rent, despite physical occupancy remaining exceptionally low throughout much of the past year and a half. As such, average prime rents have dropped by only 1.2% so far – a much smaller decline than we and many others had expected.

From a short-term point of view, the sector looks relatively well positioned coming out of the downturn. Vacancy, although on the rise, remains low, and the supply pipeline is generally limited. We do expect a small fall in rents in some markets this year, but on the whole are anticipating a return to growth in 2022.

The longer-term outlook for the office sector is less clear. While some firms have expressed a desire to return to pre-pandemic working arrangements, a significant number have indicated that they expect some or all employees to work remotely for at least some of the week. The extent to which this could reduce demand for office space is still uncertain, but there has certainly been a general shift in attitudes, and there are already examples of prominent businesses relocating to smaller premises in order to accommodate partial remote working.

A decline in future construction activity should help to cushion weaker demand, and we may start to see obsolete stock being converted to other uses – in particular residential, where there are shortages of stock in major cities. But we still believe that rents are likely to increase less strongly over the medium-to-long term, with pan-European growth of 1.2% over the next five years. We still expect London to be an outperformer over this period, with Berlin also likely to see healthy growth of close to 2% per annum. Beyond this, it is in Central Europe where we would expect to see the strongest growth, driven by the positive long-term economic outlook.

This uncertainty over the future of the office is also likely to have contributed to a hesitance to invest in the sector. European office investment volumes for the second quarter of this year were up slightly on the previous three months, but remained lower than the period immediately before the pandemic took hold.[4]

Yields for offices have generally not increased over the past year, but have moved sideways while other sectors such as logistics and residential have seen continued compression. Looking ahead, we do expect yields to move in further, as offices

[4] Real Capital Analytics, June 2021

remains comfortably the largest sector by value, and the weight of capital waiting to be deployed will surely put further pressure on pricing. But we do expect the gap between office yields and other sectors such as residential and urban logistics to narrow over the next decade as the relative risk premium on offices edges higher.

Residential: The residential sector continues to gain in prominence among investors. In recent times, the sector has featured repeatedly near the top of the list when investors have been asked for their preferred investment targets. This comes despite income returns already being the lowest of any sector, as the perceived security of income and prospects for future rental growth sustain investor demand. Pan-European apartment investment volumes for the first half of 2021 were down slightly based on provisional data from early July, but the market is still on track for another year of very strong activity, well in excess of recent historical volumes.[5]

Despite the multifamily market being well established in Germany, the Netherlands and the Nordic region, there are a number of other major European countries, including the United Kingdom and France, where the institutional private rented sector (PRS) is still relatively immature. With capital chasing a limited number of European opportunities, yields have come under increasing pressure, dipping to around 2.75% on average across Europe, and as low as 2.00% or below in a handful of cities such as Munich.

With regard to the rental market, we had anticipated the residential sector to be a strong performer throughout the downturn. However, with disposable incomes growing and support given to the labour market, this has meant that average rental growth has even outperformed our expectations. Last year, the majority of markets avoided any sort of rental fall, with some – including many of the German cities – seeing continued strong growth.

Our outlook for rental growth is comfortably the highest of the four main sectors, driven by supply shortages, positive urban demographic trends and stronger disposable income growth. While overall residential completions have been increasing in recent years, the number of new permits had already dipped before the pandemic, and has fallen further since. Overall, we are forecasting pan-European rent growth to surpass 3% per annum from next year onwards, with the strongest growth foreseen in Berlin. Markets such as Amsterdam, London, and Madrid, where rents have paused or even declined during the pandemic, are also expected to see a strong recovery.

Rent regulation is becoming an increasingly prominent issue as rents have outpaced incomes in a number of markets. Much more so than in the commercial sector, rental affordability is a highly political issue, and so in certain cities we have seen moves to impose or strengthen rent caps. In Dublin, for example, where rents have grown considerably in recent years, a previous temporary annual rent cap of 4% is now likely to be replaced with cap in line with inflation.[6] However, in certain cases, there are exemptions on rent caps within regulated markets, such as on new build properties or existing assets that have undergone significant renovation, while some level of regulation can also lead to a greater rate of occupancy and increased income stability, so may not always be seen as a negative by investors.

Logistics: The logistics sector has thrived throughout the pandemic. Investors continue to be drawn to the sector's long-term prospects, with growth in e-commerce among the most important drivers of current and future occupier demand.

Overall logistics construction activity has undoubtedly increased over the past decade. Ten years ago, European construction starts were running at about 2% of stock each year. Recently, this has increased to as much as 6% per annum.[7] However, while before the GFC we were seeing a lot of speculative construction, more recent supply has tended to be constructed on a build-to-suit basis.[8] And although new supply has been catching up with high levels of demand, the occupier balance has tightened.

Consequently, rental levels have seen upward pressure. To an extent the pandemic has taken away some of this momentum, with supply chains being disrupted and overall retail sales and consumer confidence taking a significant hit initially. Rents in the first quarter of 2021 were just 1.4% higher than a year earlier – compared to average annual growth of

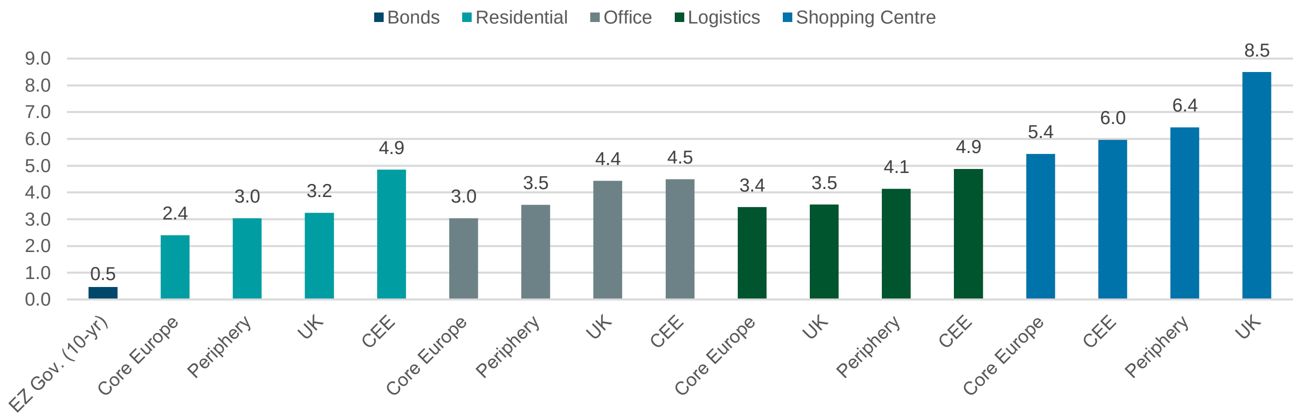
[5] Real Capital Analytics, July 2021
[6] DWS, Oxford Economics, June 2021
[7] JLL, May 2021
[8] Cushman & Wakefield, May 2021

more than 3% over the previous five years – but this still compares favourably to retail and offices, which both saw rents decline in the 12 months to March 2021.

This renewed rental growth and apparent resilience through the cycle, driven by powerful structural trends, has been well noted by investors. The limited pool of existing assets has seen a strong rise in competition, driving up pricing to record levels. Yields for well-located, modern assets are now just 50 basis points higher than those in the office sector, with the average gap being three times higher than this over the past 20 years.

But pricing has now moved a long way and achieving existing IRR and cash return targets is becoming harder. For certain assets and locations though, we continue to see very strong rent growth, particularly last hour or last mile logistics, which need to be close to or within large urban conurbations in order to be able to service large numbers of consumers. We would expect a scarcity of land to develop in this type of location, alongside the issue of competing land use from other sectors, to maintain pressure on rents looking ahead.

FIXED INCOME AND PRIME REAL ESTATE YIELDS, 2021F



Source: DWS, July 2021
Notes: f = forecast. 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.

On the other hand, we believe that big box distribution centres, which are often required to serve a much larger catchment and are typically located further away from major cities, are less likely to see the same pressure on rents. For this reason, while we expect further short-term yield compression across the board for logistics, we feel that lower yields should be more sustainable for urban logistics assets.

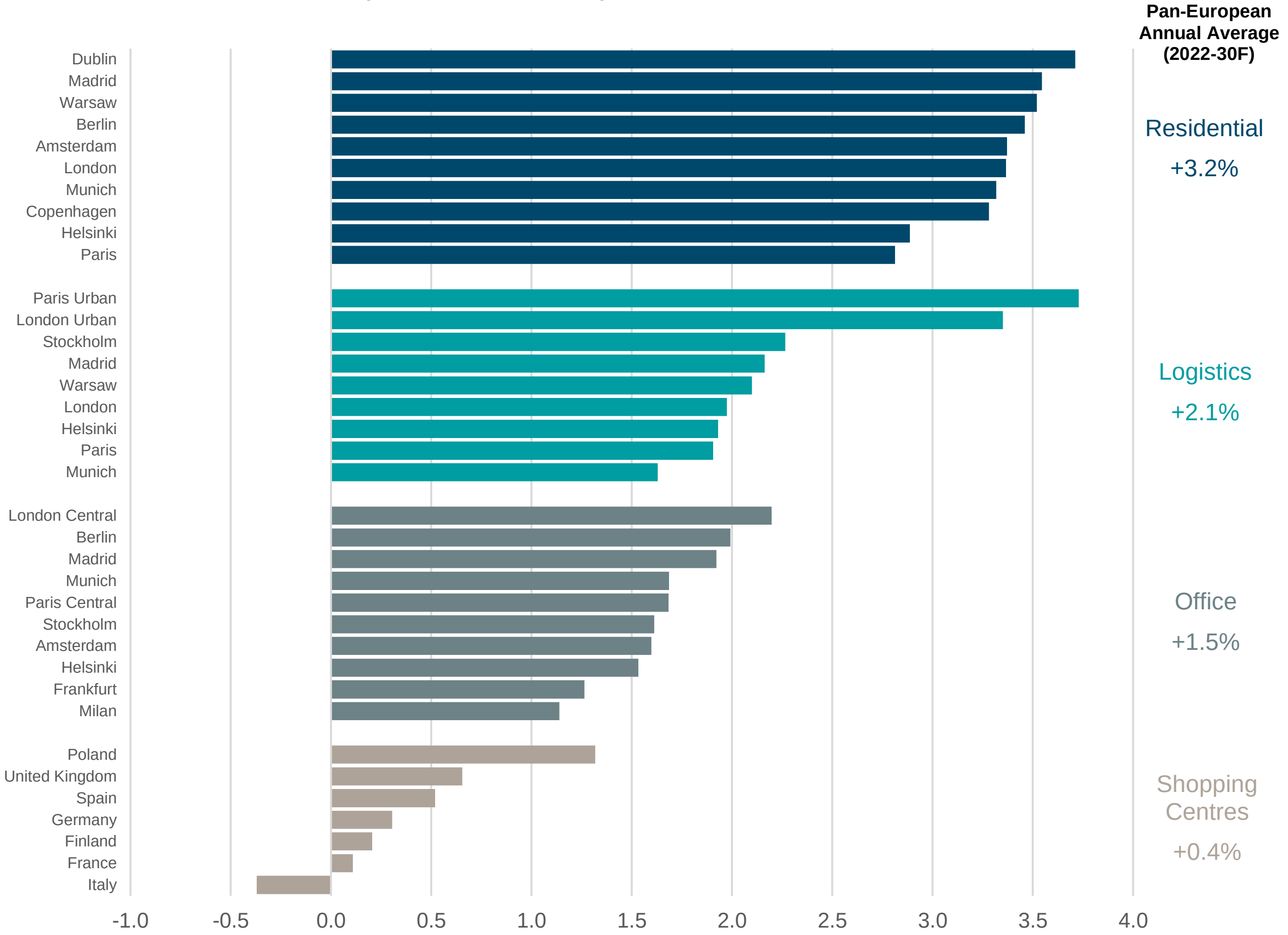
Retail: The last year and a half has been incredibly challenging for the retail market. Shops have been forced to close for lengthy periods, and during the times they have been allowed to open, have had to deal with a lack of international tourism – an important driver of spending on the prime high street. And furthermore, with consumers often having no choice but to switch spending online, the ratio of online sales as a proportion of total sales has increased dramatically in every country across the continent. This means that as physical stores have gradually been allowed to reopen, they are starting from an even more difficult position. We do expect that a small portion of this recent increase in online spending could move back in store in the short term, but a large proportion of it is likely to remain online.

The fundamentals of consumer demand look quite positive at the moment. Overall retail sales have performed better than expected; unemployment has been kept low thanks to government support; and disposable incomes have increased as people have had fewer opportunities to spend. This situation may change, however, once government support schemes are stopped. Still, the recent spike in savings rates could help to fuel spending, providing unemployment doesn't rise too far.

Nevertheless, with most of the positive trends being absorbed by online rather than in-store sales, retailers' margins have been squeezed and we have seen a notable increase in the number of retailer insolvencies. Even the more successful retailers are increasingly reassessing their store portfolios, closing less successful stores to focus on online.[9]

Additionally, rent collection rates for the retail sector have been well down, and shopping centre vacancy – which had already been trending upwards for a number of years – saw the biggest annual rise on record last year.[10] It is of no surprise that rents have come under significant downward pressure. Average European prime shopping centre rents were down by 8.5% year-on-year in the first quarter of 2021, and we expect to see further falls this year and next. In fact, over the first five years of the forecast period, only the Central European region is expected to see positive rental growth.

PRIME RENTAL GROWTH 2022-30F (%, ANNUAL AVERAGE)



Source: DWS, July 2021. Note: F= forecast. 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.

[9] BNP Paribas Real Estate, March 2021
[10] PMA, March 2021

That said, within the retail property sector, certain types of asset have been performing much better than others. Supermarkets are an obvious outlier here, as they have remained open throughout the pandemic, and online sales rates for grocery products remain relatively low compared to the likes of fashion and electricals. Retail warehousing has also done well, with the large edge-of-town store format better placed to fit within the new multi-channel retail environment. This trend can be seen in both investment activity and in recent performance data.

For prime shopping centres, we now expect yields to move out further and for longer compared to our outlook six months ago. Yields in the United Kingdom have already risen by a total of more than 400 basis points over the last five years, and while not all countries may see such a marked trend, we believe this may well be a sign of things to come elsewhere.[11]

Return Outlook

European real estate has entered a period of recovery. While challenges remain, performance over recent months has been better than we had been expecting at the start of the year. Led by yield compression, particularly in the logistics and residential sectors, we anticipate that returns will gain momentum over the coming years, as increasing liquidity and the return of rental growth support higher values.

Recent performance: While 2020 recorded the lowest level of return since the 2012 Eurozone crisis, by the end of the year, performance was trending higher. Despite the resumption of lockdown across much of Europe, this momentum only strengthened in the early part of this year. According to INREV's fund level index, quarterly capital value growth was above its 20-year average during the first three months of 2021.[12] A similar trend was recorded across Europe's open ended funds. Over the same period, the MSCI Pan-European Property Fund Index (PEPFI) saw quarterly returns in excess of 2%, led in part by a strong performance of non-balanced funds.

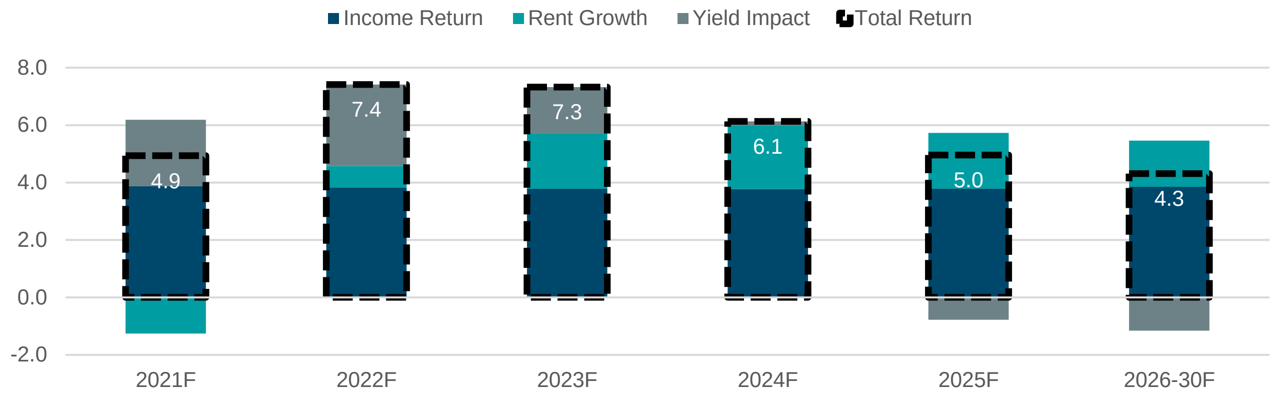
This outperformance of the non-balanced funds represents a clear divergence in performance between sectors, with Industrial remaining a clear outperformer, recording value growth in excess of 3% during the first quarter of this year. Residential and offices posted steady positive total returns as values edged higher, while hotels are also beginning to make up some of the ground lost during the early stages of the pandemic – although values remain almost 12% off their peak. Retail continues to struggle, recording a tenth consecutive quarter of value decline despite segments such as supermarkets starting to see positive quarterly returns.[13]

As we were expecting at the start of the year, after a relatively poor 2020, the United Kingdom has started the year well, recording the highest total return of any European market in the PEPFI during the first quarter. On an annual basis, Germany and the Netherlands remained among the strongest performing markets at the end of the first quarter, while Sweden topped the table by some margin, recording an annual return of close to 18%.[14]

Return outlook: We expect the recovery to gain momentum over the second half of this year and into 2022. Initially led by yield compression, as economic and occupier conditions improve we see rental growth becoming the main driver of performance from around 2023 onwards. From the middle of the decade we expect a slight increase in prime yields to weighing on performance, particularly if projections for higher long-term bond yields do materialise; however, here there is a high degree of uncertainty.

[11] Cushman & Wakefield, June 2021
[12] INREV, May 2021
[13] MSCI, May 2021
[14] MSCI, May 2021

EUROPEAN AVERAGE ALL PROPERTY PRIME GROSS TOTAL RETURN (2021-30F, %)



Source: DWS, July 2021.
Notes: f = forecast. 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.

As has been the case for a number of years, we're forecasting considerable differences in sector performance. This is most evident over the next two years where current momentum is projected to push logistics and residential returns into double-digit territory.

As time progresses, we expect this divergence in performance to lessen. We think it unrealistic that, despite structural changes, the logistics sector can sustain prime double digit returns, particularly when yields are now half the level they were in 2012. We believe that much of the upside for logistics will have been taken over the next eighteen months, particularly in corridor locations. This doesn't prevent us from expecting outperformance in places like Paris, Milan and Warsaw, while urban space is still set to be one of the highest returning parts of the European real estate market over the coming decade.

We expect less of a drop off in performance across residential, with this sector still providing the strongest risk-adjusted returns over the next ten years. In addition to 3% rental growth, the institutionalisation of markets outside of Core Europe are expected to help sustain performance over the longer term. At the prime level, we see the most attractive risk-adjusted returns in cities such as Amsterdam, Dublin, Warsaw and the Nordic capitals, and on the whole we tend to see most residential markets offering outperformance over the coming decade – although pricing in parts of the German market is becoming prohibitive.

Our projections show a relatively modest return outlook for the office sector. Having experienced less decline during the pandemic than originally expected, and with ongoing question marks over remote working, we see office as a relative underperformer. This is particularly the case for older, commodity stock, where the risk of obsolescence has intensified. London and Warsaw stand out as potential outperformers, but the window of opportunity in London may prove to be small as yields could compress sharply once overseas capital can invest more freely.

Retail is challenging. While the yield premium does suggest that with even a modicum of rental growth, retail could become a strong performer, a dark cloud of uncertainty hangs over the sector. Over a ten year horizon we maintain that most shopping centre markets will underperform, and with value decline expected to persist into next year, we see few places where there is strong case for returning to the market. The exception to this may be the United Kingdom where on some measures, prime yields have reached 8.5%, making the market look oversold, particularly as rents have already seen a considerable adjustment. Even here though, a return to the market comes with high risk.

PRIME MARKET PERFORMANCE OUTLOOK

Residential	Logistics	Office	Shopping Centres
1. Warsaw	1. Paris	1. Central London	1. United Kingdom
2. Amsterdam	2. Milan	2. Warsaw	2. Germany
3. Dublin	3. Warsaw	3. Regional UK	3. Finland
4. Copenhagen	4. Brussels	4. Central Paris	4. Spain
5. Stockholm	5. Helsinki	5. Brussels	5. France
6. Helsinki	6. Copenhagen	6. Dublin	6. Ireland
7. London	7. London	7. Regional France	7. Poland
8. Berlin	8. Amsterdam	8. Amsterdam	8. Czechia
9. Madrid	9. German Top 3	9. German Top 3	9. Belgium
10. Regional UK	10. Madrid / Barcelona	10. Other CEE	10. Netherlands
11. Frankfurt	11. Regional UK	11. Helsinki	11. Hungary
12. Regional France	12. Stockholm	12. Other Germany	12. Italy
13. Other Germany	13. Other Germany	13. Madrid / Barcelona	13. Portugal
14. Paris	14. Regional France	14. Milan	14. Sweden
15. Munich	15. Rotterdam	15. Stockholm (prime)	15. Denmark

Source: DWS, June 2021.
Notes: f = forecast. Based on our outlook for risk-adjusted returns over the next ten years, plus an adjustment for cash yield. Colouring denotes relative risk-adjusted performance – green outperforming, orange in line with market average, red underperforming. 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.

Investment Strategy

We firmly believe that the real estate market will be high on the agenda for many investors over the coming years. In addition to reopening, recovery and rent growth, today's real estate yield premium may well push multi-asset portfolios to consider allocating a larger share to this sector. With more capital, lower yields and higher returns, the expected outlook is good.

Yields are reaching new record lows and deploying capital into the sector will become more challenging. This will be particularly so for those investors that are looking to sustain a cash return in line with the past. Trying to maintain historical target returns at a time of exceptionally low interest rates opens up the risk of portfolio style drift. As such it's important that investment strategies maintain a strong focus on long-term occupier fundamentals.

Responsible residential in major markets and key regional hubs: The residential sector remains our most preferred part of the European market. However, with surging investor interest and a yield in some German cities below 2%, a targeted approach will be important. We strongly favour focusing on the themes of affordability and long-term demographic changes.

We believe affordable residential assets, located in and around major cities such as London, Berlin and Copenhagen, or within key regional hubs such as Krakow, Malmo and Leipzig, have the potential to benefit from trends such as remote working and suburbanisation, an under-supply of affordable accommodation and demand for well managed rental stock.

Gaining access to income-producing stock may be difficult; however, this does provide the opportunity to work with developers to deliver schemes that can positively impact factors such as carbon emissions and air quality, water usage, biodiversity and social inclusion. In particular, targeting an affordable rental level should help to supply accommodation to this underserved part of the market.

Changing lifestyles support operational residential: In addition to normal PRS stock, operational assets sit high on our list of key investment themes. Covering everything from student accommodation, co-living, senior housing and care homes, these assets are well set to benefit from rising tenant demand, improving operational efficiencies and increased investor interest.

The occupier story for later living is well told, but even for students and singles, there is a strong case for professionally managed co-living options. Whether it be the internationalisation of education, flexible employment, or a growing number of single-person households, this type of residential is expected to be in high demand. For most investors, access to an operating partner will be required in order to execute this strategy. This may be easier said than done, particularly in smaller and more fragmented segments such as senior living. While this should be recognised as a risk, a successful partnership could also provide the opportunity to achieve both scale and outperformance.

The pandemic has certainly been challenging for the co-living sector. While it's not unusual for this segment to experience a less stable income return than traditional PRS, lockdowns, university closures, and the shielding of the vulnerable have created substantial difficulties. Some challenges may linger during the early stages of recovery, but we believe these are unique circumstances, which will pass as the appeal of city living reasserts itself.

Finally, we shouldn't underestimate the potential social good of co-living. The past fifteen months have once again stressed the vital necessity of community. With more people living alone and reports of widespread loneliness across age groups, this segment could play a key part in tackling what is becoming a serious societal issue.

Pricing leading to a more selective approach towards logistics: While the short-term outlook remains one of higher rents and falling yields, we see a less compelling investment case for logistics. There is a risk that we're underestimating the impact of future demand on rents, but with supply also increasing and entry yields sinking into the mid-threes, we feel it likely that even core investors may struggle to meet their return requirements from prime stock.

This backdrop may push some investors to move up the risk curve, taking on older stock or engaging in development. Today's low vacancy rates support the approach, although in core markets there does seems to be a limited premium for this risk. In turn this may lead some to seek out alternative locations with higher yields. And while this may seem like style drift for core investors, there is certainly a case to be made that some of the higher yielding Central and Southern European cities with large catchment populations could in time emerge as key logistics hubs.

Urban logistics across Europe continues to be an attractive option for investing, although gaining access to product is a barrier. Development, including the conversion of redundant retail space, is an option, but on the whole many investors are likely to find it difficult to build scale in this part of the market.

ESG may not seem like an obvious consideration for the logistics sector, and recent survey evidence would suggest it is not yet a top priority for occupiers. Nevertheless, the sector clearly has a considerable environmental and social impact, whether through energy usage, traffic, biodiversity or employee wellness – which landlords should look to mitigate through tenant engagement and asset management initiatives, for example, green roofing to PV panels.

Next generation office: For the majority of office markets in Europe we continue to have an underweight call, and expect the sector to shrink as a share of the investable universe as capital shifts into residential and logistics. Despite this, offices will remain a highly relevant part of most real estate portfolios, and it is therefore important for investors to focus on locations and assets that are protected, or could even benefit from expected structural changes in office occupancy.

This means an increasing focus on next generation offices. Located within high-margin business clusters within the CBD or emerging districts of major cities, these offices should accommodate the growing list of corporate requirements, from flexible and collaborative space, through to wellness and sustainability. Today much of Europe's office stock is dated and increasingly at risk of obsolescence, particularly in the face of increasing regulatory requirements for energy efficiency. We therefore see next generation space offering a rental premium, lower voids and a lower risk premium.

Much of this space is still to be built, and therefore this strategy will likely require taking on some form of development risk – both ground-up development and the refurbishment of older stock. Where the asset allows, the second option is likely to be a more environmentally sound approach, while also offering an attractive return, with investors currently shunning the additional risk.

Gradual move up the risk curve: In this period of recovery we see opportunities in taking on additional risk. Growth is resuming, vacancy rates are generally low and supply has been held back by the pandemic. Given this backdrop, taking on development and leasing risk could prove accretive to returns, while providing greater access to high-quality stock.

In the early stages of recovery, market risk is likely to remain elevated, particularly in this post-pandemic environment. Disruption is ongoing, business practices have been upended, while exceptional government support suggests business failures could rise over the coming years. It will be even more important than normal for landlords to understand the strength of their tenants, while focusing on sectors and locations that are likely to sustain long-term occupier demand.

As such, we remain cautious on moving up the risk curve in the retail sector. While there are likely to be opportunities to transform increasingly redundant city centre space into community hubs, or to repurpose units towards last mile delivery, the approach here should be highly selective.

Selective return to discounted hotel sector: Having been severely disrupted by the pandemic, we now see a tactical opportunity to return to the hotel sector. Prime values have fallen by around 10% to 15% since the start of the pandemic, but we believe the gradual return of travel and tourism should start to put a floor on pricing.

We remain convinced that the appetite for travel remains strong. Witnessing the continued demand for domestic holidays and the rush for flights and accommodation in response to the loosening of travel restrictions has provided us with further reassurance. As was the case before the pandemic, we still favour tourist hotels over business-focussed assets, particularly in attractive and supply constrained cities such as Amsterdam, Barcelona and Prague.

A return to this sector should be highly selective though. We remain concerned that as current government support is unwound, there is a higher-than-average probability of business failure here, and believe all transactions should be accompanied by a thorough understanding of the hotel operator. In general we favour the larger, well-run and established budget and midscale operators, but would also consider smaller, innovative concepts, with limited Covid legacy.

The return of liquidity provides opportunities to sell: Investment strategy should not only be focused on acquisitions. With an expected pick-up in liquidity during the second half of the year, we believe investors should reduce exposure to assets and sectors at risk of long-term underperformance. This includes assets in the strongly-performing residential and logistics sectors. Given the volume of capital currently targeting both, we see this as a good time to reduce exposure to residential assets in demographically weak locations, and aging logistics facilities in markets where modern stock is being delivered at a growing pace.

We believe many portfolio managers will face pressure to reduce their exposure to office and retail. Even with greater market liquidity, finding a buyer in these sectors is still likely to be difficult – particularly for weak stock. With this in mind, we would target the sale of long-let commodity offices – offering an attractive income stream but depreciating value – and supermarkets, which performed well during the pandemic but which we still see as exposed to the rise of online grocery.

Country Summaries

Germany	• Lock-down effects are fading as the economy starts to rebound, while consumer and business sentiment improves. Long-term uncertainties around demographic trends prevail. • Office letting markets remain muted, but occupancy and rental levels showed resilience. Take-up is starting to gain traction again. Logistics and residential prove defensive.	• Investment activity is starting to pick up in sectors beyond logistics and residential. Large office deals are being tested in major cities. • Swifter recovery and expected outperformance in major cities. Ongoing yield compression and sharp pricing at the prime end of the market, especially logistics and residential.
France	• After a weak 2020, we expect the French economy to outperform the Eurozone over the next five years, with GDP returning to pre-crisis levels by the end of 2021. • While office rents in Paris CBD held up over 2020, our forecast suggests some correction is due in 2021 as a result of a rise in vacancy.	• The consumer recovery we expect in 2021 as a result of pent-up savings is likely to boost the retail sector, but sales are increasingly moving online. • The private rented sector in Paris is starting to emerge. Standing assets are few, but development activity is presenting some attractive forward-funding opportunities.
U.K. & Ireland	• After a challenging start to the year, the recovery in prime London offices finally seems underway, with a steady pick-up in both the occupier and investment markets. • Supported by comparatively attractive pricing, alongside positive longer-term fundamentals, Central London offices are expected to outperform the wider European market.	• The London residential market continues to look well positioned for growth. Supply shortages persist and despite short-term challenges, demand drivers remain solid. • Despite good market fundamentals, the introduction of stricter rent regulations, alongside higher stamp duty tax, could dampen Dublin's residential market.
Southern Europe	• The Southern European economies fared especially poorly over the pandemic. A recovery is expected in 2021, but weak demographics could constrain long-term growth. • Barcelona logistics is likely to outperform Madrid as supply is more constrained. Lisbon looks to be a stable market, with strong rental growth expected for urban assets.	• The residential sector is growing in importance. Madrid rental growth is forecast to be stronger than in Barcelona due to lower regulatory constraints. • The Greater Milan logistics market remains the main focus in Italy, with the residential sector also increasing in importance.
Benelux	• Having not experienced the same extent of economic decline as many other parts of Europe, the short-term recovery looks more subdued across the Benelux region. • The Dutch residential market looks well positioned to be a significant outperformer, Vacancy is exceptionally low across the Randstad region, particularly in the largest cities.	• While logistics development in the Netherlands is at record highs, demand is currently still outpacing supply. However, further speculative development could dampen rent growth. • Amsterdam's job market has so far benefitted from the ongoing Brexit shake up. However, any significant benefit to the office market has yet to be realised.
Nordics	• Strong demographic and economic growth projections, alongside relatively attractive entry yields, continue to spur investor interest in the major Nordic cities. • The Nordic residential sector is anticipated to record some of the highest risk-adjusted returns in Europe. Despite strict regulation, Stockholm is expected to be a top performer.	• The logistics sector continues to offer investment opportunities. A strong e-commerce market will likely drive further demand, while vacancy remains largely in check. • Nordic prime offices will be supported by the fast growing tech and life sciences sectors. Strong ESG credentials will be increasingly prioritised by investors and occupiers alike.
Central Europe	• The CE region is expected to remain an economic outperformer, positively impacting disposable household income. • Despite strong economic fundamentals, letting markets have softened, especially for retail and offices, with the later experiencing rental adjustments and increasing vacancy.	• Thanks to a strong supply side, current rent growth is limited, but yield convergence should propel the CE markets among the top performers in Europe in the mid-to-long run. • There has been strong divergence in local office submarkets, with the occupier side in prime Budapest and Prague remaining robust. Residential is gaining in importance.

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