EUROPE REAL ESTATE STRATEGIC OUTLOOK

January 2022

IN A NUTSHELL

_ European real estate saw a marked improvement in returns during 2021 and is expected to continue to perform well over the coming years as the return of rental growth further supports performance.

_ Residential is expected to remain the strongest sector, but we've become more cautious about logistics. There is a clear divergence expected within the office sector, with Next Generation space doing well.

_ Recovery, structural change and ESG requirements are supporting an increased focus on refurbishment, while increasing liquidity is providing options to reduce exposure to potential underperformers.

Market Outlook

The second half of 2021 proved to be a strong period for European real estate. Across the continent, a gradual lifting of restrictions on working, shopping, socialising, and travelling from the second quarter onwards led to a sharp rise in economic activity. This was reflected in many parts of the real estate market, with the logistics market remaining on a firm footing, stronger demand for residential space, and prime office rents returning to growth.

The emergence of a new Covid-19 variant in the final weeks of the year highlights the risks that are still present, despite huge progress with vaccinating the European population. Omicron has created significant uncertainty, led to some restrictions being reimposed, and is likely to have dampened growth at the end of 2021 and into the first quarter of 2022. However, with the world now far more adept at responding to the pandemic, we expect the impact to be modest and temporary, and as such we still expect another strong year for the European economy this year.

Another important development for European real estate has been the emergence of significantly higher inflation over the course of 2021. The combination of robust economic growth, Covid-related supply chain issues and supply-demand imbalances in the oil and energy markets have led inflation to jump to the highest level for ten years.[1]

The consensus view remains that stronger inflation will be relatively short lived, returning to normal levels by the second half of 2022. However, were higher inflation to persist for a sustained period, this could prove positive for some parts of the real estate market. This is particularly the case in Europe, as leases on the continent are largely index-linked. As such, many landlords will see operating incomes rise in line with inflation, while rising construction costs could also have a dampening effect on future development, leading to less choice for occupiers and pushing rents higher. Historically, residential has performed well against inflation, while logistics rents should also see growth as demand continues to outstrip supply.

[1] Oxford Economics, December 2021

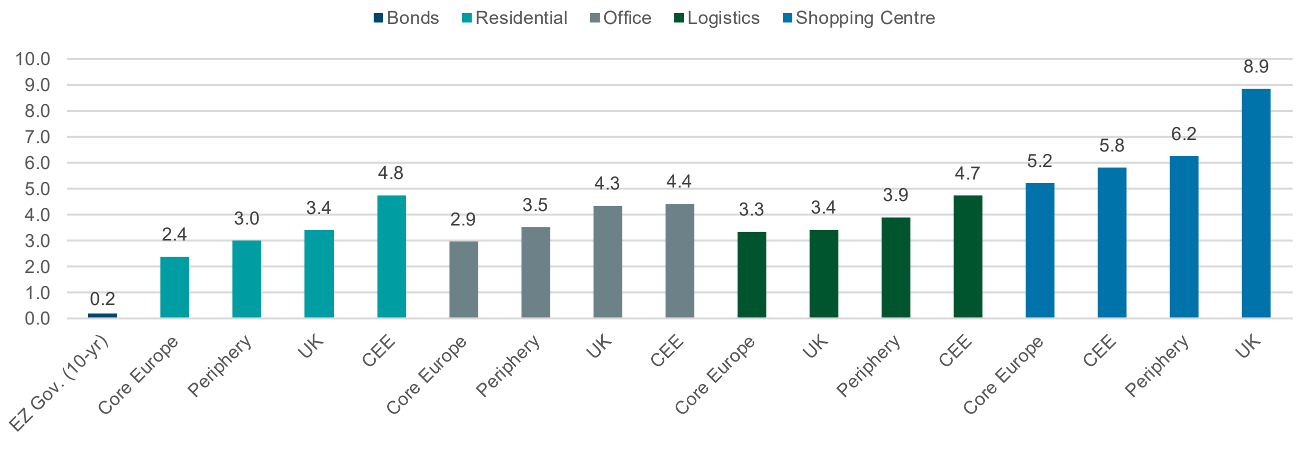
Of course, there are also risks around inflation. Higher operating costs for occupiers could lead to some level of cost cutting, while persistently stronger inflation could also raise the prospects of rising interest rates, higher bond yields and potentially weaker economic growth. This is far from our central case scenario though and given that real estate yield spreads over bonds remain close to all-time highs, the sector looks well positioned in this event.

Despite the significant uncertainty that spilled into the first part of 2021, the European investment market had an active year as business and travel reopened during the summer and autumn months. Preliminary estimates show that all property transaction volumes in 2021 surpassed €300bn, an increase of more than 20% year-on-year and only slightly below the level recorded in 2019.[2]

Investment sentiment also improved in all the main sectors, although by far the largest rise was recorded in the logistics sector, where sentiment reached an all-time high.[3] This was also visible in industrial investment volumes, which were up by almost 50% in 2021, surpassing the previous record annual total by some considerable distance.[4] Residential investment also hit new highs, with a strong fourth quarter. However, while opinions towards retail improved slightly, this should be kept in context as investment activity remains subdued, and sentiment is still lower than at any point in the last 20 years except during the worst of the pandemic in 2020. Opinions on offices are still divided, and the expected divergence in performance within the sector means that on average, sentiment and investment volumes are beginning to recover only slowly, although we still see strong interest at the prime end of the market.

These sector trends are also reflected in recent yield movements. Prime logistics yields have continued to fall sharply, down by an estimated 50 basis points in the year to sit just 25 basis points above offices. Residential yields are expected to end the year at an average of 2.70%, down 20 basis points from the previous year, while prime office yields edged down by around ten basis points. Hotel yields are also trending downwards, although largely remain above pre-pandemic levels. However, while retail park yields have fallen sharply, prime European shopping centre yields were up by as much as 35 basis points in the 12 months to September.[5]

FIXED INCOME AND PRIME REAL ESTATE YIELDS, 2021F (%)



Source: DWS, Macrobond, December 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.

These falls in yield were a major driver of performance in 2021. With a large yield spread over other fixed income assets and plenty of dry powder, we see few reasons for this not to continue further. However, for some investors these lower yields are making it increasingly hard to meet cash return targets by investing in prime property within gateway cities or key hubs

[2] RCA, January 2022
[3] PMA, September 2021
[4] RCA, January 2022
[5] PMA, DWS & broker sources, December 2021

in these sectors. This is unlikely to curb transaction activity over the coming years, but may have a bearing on strategy, with a greater focus on more active asset management, particularly given the improving market backdrop.

Overall, occupier markets remain in a healthy position across many markets and sectors. While certain parts of the market have seen a deterioration in occupier fundamentals over the past 18 months, there are still relatively few instances where the overall picture looks worrying in a historical context.

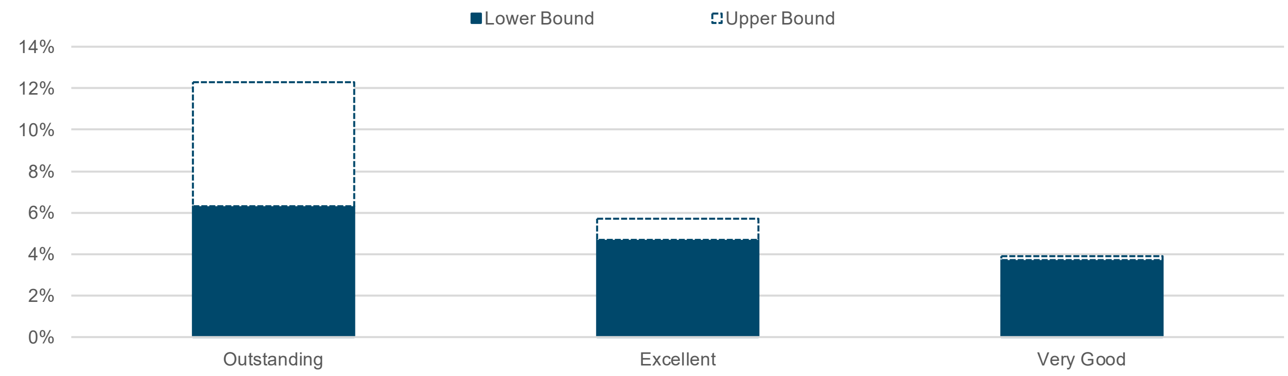
Office: Future uncertainty stemming from the pandemic has perhaps been greater for the office sector than for any other. While other sectors often have clear long-term performance drivers – both positive and negative – the likely equilibrium point for office-based versus remote working is still yet to be fully understood. For much of the last 18 months or more, a large proportion of office-based workers have been fully or partially working from home. However, what is not yet clear is how much time people will want or be asked to spend in the office once all these restrictions have been lifted.

Offices have comfortably outperformed both hotels and retail in terms of both rental growth and total return since the pandemic began, and performance has also been some way ahead of what was expected for the sector during the early part of the pandemic. However, it has also lagged far behind logistics and some way behind residential, as some occupiers have started to signal and implement plans to reduce their office footprint, and investors have expressed concerns over the exact nature of the future workplace.

Occupier take-up in the 12 months to September 2021 was equivalent to 3.4% of the current office stock, compared to an annual average of 5% in the five years before the pandemic. And a similar pattern was seen in the investment market, with transaction volumes down by 22% against the five-year pre-pandemic average.

That said, it has perhaps become more difficult to talk about the sector under one single trend. Average European office vacancy rates have increased by around 150 basis points since before the pandemic, and this has by no means been limited to lower grade stock.[6] But looking ahead, as some tenants are likely to cut back on space, we expect to see a substitution of quantity for quality, with an even greater focus on assets with strong green credentials in well-connected, central locations.

GREEN OFFICES: % RENTAL PREMIUM ABOVE EQUIVALENT NON-BREAM CERTIFIED BUILDINGS



Source: Chegut et al., 2014; Addae-Dapaah et al., 2021

More generally, rental growth had already stabilised or turned positive in most markets as of the third quarter of 2021. We expect moderate growth to resume in 2022, and while vacancy remains low in a historical context, it is unlikely to come down significantly in subsequent years due to headwinds for the demand outlook. A restrained construction pipeline should help the occupier balance, and indeed we expect to see a lot more obsolete and low-quality office space being converted to other uses, although higher vacancy is likely to hold back average rental growth.

[6] PMA, CBRE, December 2021

However, we strongly believe there are certain markets that will still be able to sustain higher rental growth at the prime end, as more of the existing stock is upgraded to the highest standards. These upgrades will of course come at the cost of higher capital expenditure, but given the strong occupier focus on quality and ESG, locations with highly productive tenants should be able to pass these costs in the form of higher rents. Gateway cities, particularly those with a strong tech presence, are expected to benefit the most in this respect. As such, we are forecasting the strongest rental growth in cities such as London, Paris, Berlin, Amsterdam, Barcelona, Madrid, and Stockholm.

At the same time, despite the longer-term uncertainty in the sector, investors are still somewhat positive on the sector, and the sheer volume of capital currently looking to invest in Europe continues to weigh on prime yields as demand is funnelled more to the top end of the office market. Office yields haven't fallen at the same rate as other sectors, but they have edged lower. And we expect that over the next two years, as future hybrid working models and occupancy levels continue to move towards their new equilibrium, yield compression will continue. That said, over the longer term we still see the yield gap between offices and sectors such as urban logistics and residential widening.

Residential: The multifamily sector remains high on many investors' wish lists. Excluding entity-level deals, residential investment reached €67 billion in 2021 – 13% more than 2020 and 5% more than the previous record high in 2019.[7] Until only a few years ago, residential was considered an alternative real estate sector by many. But with investors increasingly looking for stable income and strong long-term drivers, residential investment has accounted for a quarter of the European real estate market over the past two years, compared to an average of less than 15% in the previous ten years.

In markets such as Germany, the Netherlands and Sweden, where the multifamily sector is already large and well-established, residential investment accounted for around a third of all activity in 2021. However, less-well established markets including those in the Central European and Southern European regions are now seeing a flurry of transactions as investor demand widens. In many instances, the only viable route into these less-well established markets is through forward funding, and so we would expect to see strong multifamily development activity in the coming years.

That said, we don't see stronger construction activity in the multifamily sector as a threat to rental growth. There remains a significant supply-demand imbalance across Europe, and overall residential development including rental stock and owner-occupied housing remains in check. The number of building permits for new dwellings had been gradually increasing before the pandemic, and although activity is recovering again following a sharp dip last year, it is still less than half the level recorded prior to the GFC.[8]

The pandemic has caused a dip in residential rental growth to some extent, but rents have fallen in only a handful of cities. Among the strongest corrections have been Madrid and Barcelona, although the decline now seems to have plateaued, and we expect strong growth for both cities in 2022.

Rent regulation remains an important consideration for residential investment. Some governments already have national or city-specific regulation in place, such as a cap on annual rental uplift, which means that in practice it may not always be possible for in-place income to grow fully in line with market rates. And with the potential for further rules to be implemented in the future, a keen understanding of this area is crucial.

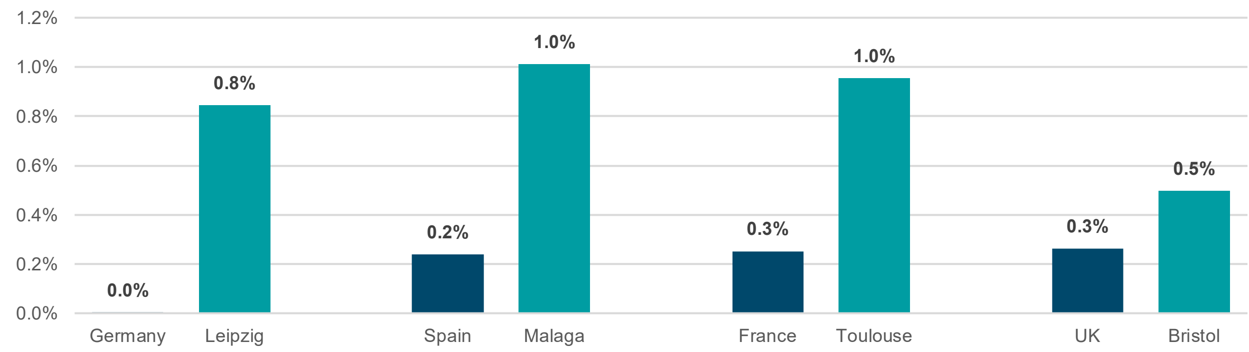
At the market level, our outlook for pan-European rental growth is by far the strongest of any sector, supported by good employment prospects, strong disposable income growth, and positive urban demographic trends. We expect average European prime rent growth of 3.2% per annum over the next ten years, with the strongest growth forecast in large, dynamic cities such as Berlin, Madrid, Amsterdam, and Copenhagen. On a risk-adjusted gross total return basis, these are some of the best performers over a ten-year horizon among the markets we cover.

However, unprecedented competition has driven prime yields in many of these gateway cities down well below 3.00% – and in the case of the major German cities, closer to 2.00%. This means that it is often difficult for investors to meet cash return targets here, even if strong rental growth and expectations of further yield decline led to a healthy total return outlook. Yet

[7] RCA, January 2022
[8] Eurostat, December 2021

moving outside of Europe's major metropolitan areas there are many economically and demographically attractive regional cities, where market fundamentals are equally as attractive as in the major agglomerations, but with less investor competition and more attractive pricing.

POPULATION GROWTH IN SELECTED REGIONAL MARKETS, 2022-31F (% P.A.)



Source: Oxford Economics, January 2022
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Logistics: The pandemic has given a huge push to logistics – a sector which already has a strong long-term outlook. Recent survey evidence on prospects for 2022 suggests that together with niche sectors such as data centres and life sciences, investors placed logistics right at the top of the pile.[9]

Performance through the pandemic has been nothing short of stellar. With shops forced to close across the continent during periods of lockdown, and consumers frequenting city centres and shopping centres much less, shopping has been pushed online at a much-accelerated rate. At the same time, with businesses returning to more normal operations throughout 2021, they have looked to take on more space to avoid further supply shortages. This has led to a significant increase in demand for logistics space.

Take-up during the first three quarters of 2021 was the highest ever recorded, with strong activity from e-commerce occupiers, and on a rolling 12-month year-on-year basis demand was up by around 40%. Construction activity has also been reaching historical highs, and speculative construction is on the rise, but development has still not been able to keep up with recent demand. As such, the pan-European logistics vacancy rate has just dropped below 4% for the first time.[10]

This ongoing demand imbalance has driven rents higher. We estimate prime big box logistics rents to have grown by close to 3% in 2021, with urban stock growing at more than 4%. We expect similar average rates of growth over the next five years, but with strong developer margins we think it unlikely this level of growth can be sustained over the longer term, particularly in locations where there are limited barriers to new supply.

On the investment side, huge demand pulled European prime yields down by more than 50 basis points in 2021, with some markets seeing compression of up to 100 basis points. On average, logistics yields are now only 25 basis points above offices, although for corridor logistics assets we don't expect this spread to narrow much further. We see current yield levels already stretched, and often only justified by underwriting significant rental growth to meet return targets. In fact, some investors, particularly those with cash return targets or liabilities to meet, are turning towards development in order to remain active in the sector.

[9] PwC, December 2021
[10] JLL, PMA, DWS, December 2021

The exception here is perhaps urban logistics, where occupiers tend to have relatively narrow location targets and supply constraints are generally much higher. Here, yields have now dropped below offices for the first time. The structural drivers and additional rental growth in this segment mean lower yields could be more justifiable, and we expect outperformance in the coming years. We are forecasting gross total returns of 6.1% for urban logistics, around 150 basis points higher than for out-of-town big box logistics.

Retail: The retail sector continues to perform poorly. On the face of it, consumer fundamentals are in relatively good shape. Total retail spending bounced back strongly in 2021, unemployment remains low, and disposable incomes continue to rise.[11] Footfall has recovered to an extent, although remains some way below pre-pandemic levels, particularly for shopping centres.

Likewise, in-store sales saw something of a recovery last year; however, further restrictions implemented over the Christmas and New Year period are likely to have pushed more spending online again. Additionally, inflation could pose a further risk to overall retail spending. Given that many retailers are already facing a significant squeeze on margins, increased material and freight costs are likely to at least partly be passed on to consumers, particularly if inflation proves to be more persistent.

E-commerce penetration spiked during the pandemic, increasing from an average of around 10% across Europe in 2019 to an estimated 15% in 2021.[12] And while there may be a small pause in growth once restrictions are fully lifted, we don't expect this pandemic-induced increase to be reversed, with growth in the online sales ratio likely to continue close to its pre-pandemic growth trajectory but from a higher base.

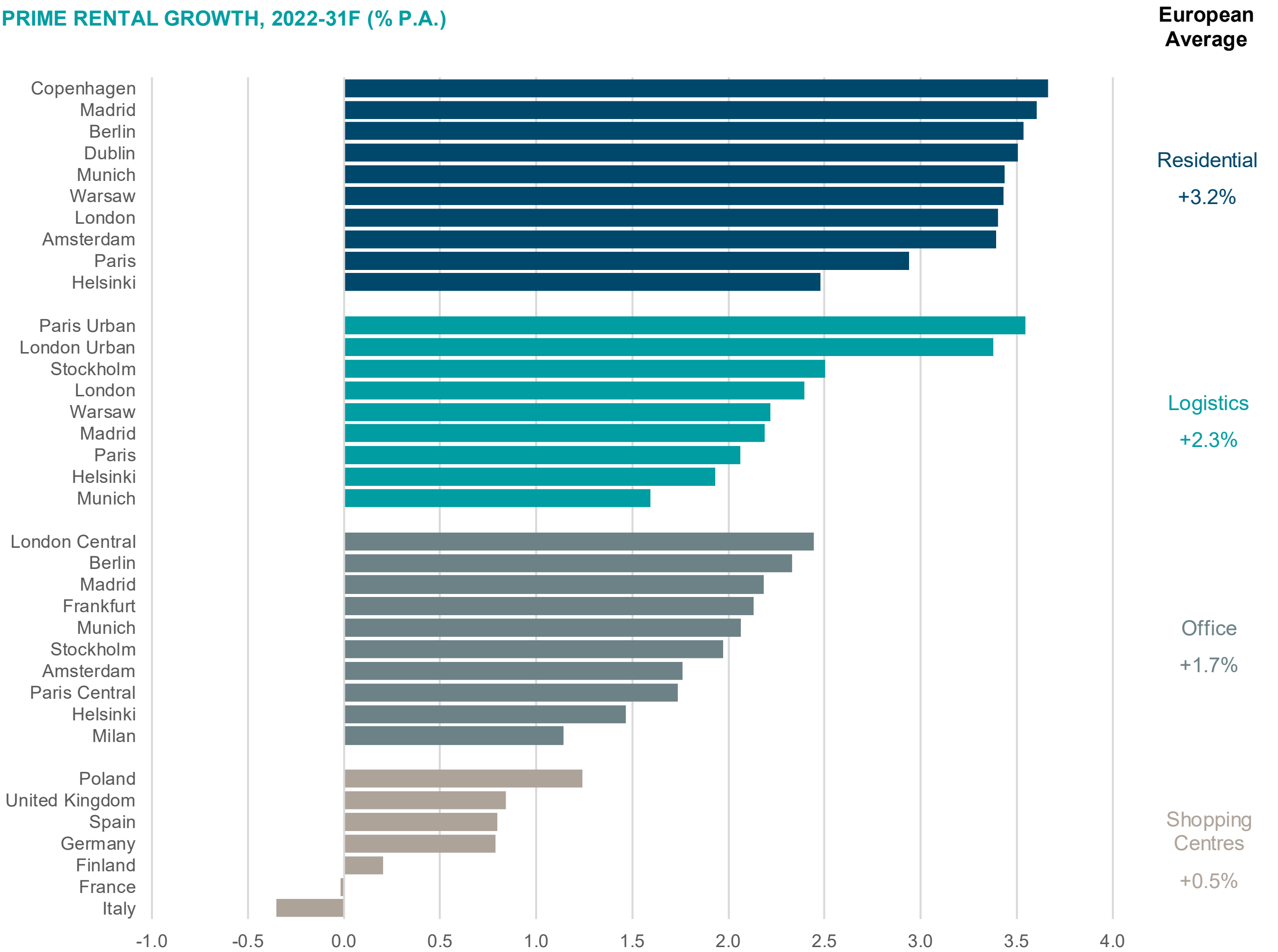
The sector remains a difficult and largely unattractive proposition for most investors. With much uncertainty over income and capex requirements, many have essentially discounted new retail acquisitions for the time being.[13] Overall, retail transaction volumes remained weak in the second half of 2021,[14] although the grocery and retail park segments – which have benefited through the pandemic from access by car and easier social distancing – did see interest.

Some brands continue to open new stores, but record numbers of store closures mean that the net change in store numbers has turned strongly negative. As such, vacancy rates, which had already been increasing for some time before the pandemic, have risen strongly for both shopping centres and high streets over the past 18 months.[15] In fact it is becoming increasingly clear that some stores and centres will need repurposing, although devising a strategy here that works financially can be challenging.

Prime shopping centre rents fell in just about every market last year,[16] with further falls expected in 2022. We forecast markets with stronger consumer outlooks such as the CEE region, Sweden, Ireland, and the United Kingdom to be the best performers over a ten-year horizon, but even here we expect growth to be weak in a wider context. As such, except for the United Kingdom, where yields have almost doubled, we expect European shopping centre yields to move out further in 2022, leading to continued underperformance over the short term.

[11] Oxford Economic, January 2022
[12] DWS, PMA, Oxford Economics, December 2021
[13] PwC, December 2021
[14] RCA, January 2022
[15] PMA, October 2021
[16] Cushman & Wakefield, November 2021

PRIME RENTAL GROWTH, 2022-31F (% P.A.)



Source: DWS, December 2021.
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Return Outlook

The recovery in European real estate performance continued with vigour during the second half of 2021. Having taken a pause during the early part of the pandemic, total returns have steadily increased since, driven in large part by significant yield compression and strong rental growth in the logistics sector, and to some extent in the residential sector. We anticipate a further improvement in all-property performance this year as the recovery widens.

Recent performance: After the initial effects of the pandemic put a sizeable dent in performance early in 2020, the market is well and truly in recovery mode now. While not everything has yet returned to pre-pandemic levels, certain parts of the market are having a strong positive impact on overall total returns. According to the MSCI Pan-European Quarterly Property Fund Index (PEPFI), quarterly fund-level total returns for the third quarter of 2021 were 3.3%, only marginally lower than the previous quarter, meaning that on an annual basis total returns were running at a six-year high of 11.8%.

This noteworthy uptick in performance was in no small part driven by the logistics sector, where yearly total returns grew to an astonishing 22.9%, but even excluding sector-specific funds, balanced pan-European funds returned a respectable 6.6% year-on-year.[17]

There remains a clear divide in performance between sectors, but most parts of the market are now beginning to move in the right direction. The retail sector, on the back of five consecutive quarters of negative asset-level total returns, has now recorded two positive quarters in a row, meaning annual returns edged back into the black. Residential was among the most resilient sectors during the early part of the pandemic, and has continued to record modest returns throughout, while annual returns in the office sector improved to 7.3% in the third quarter.

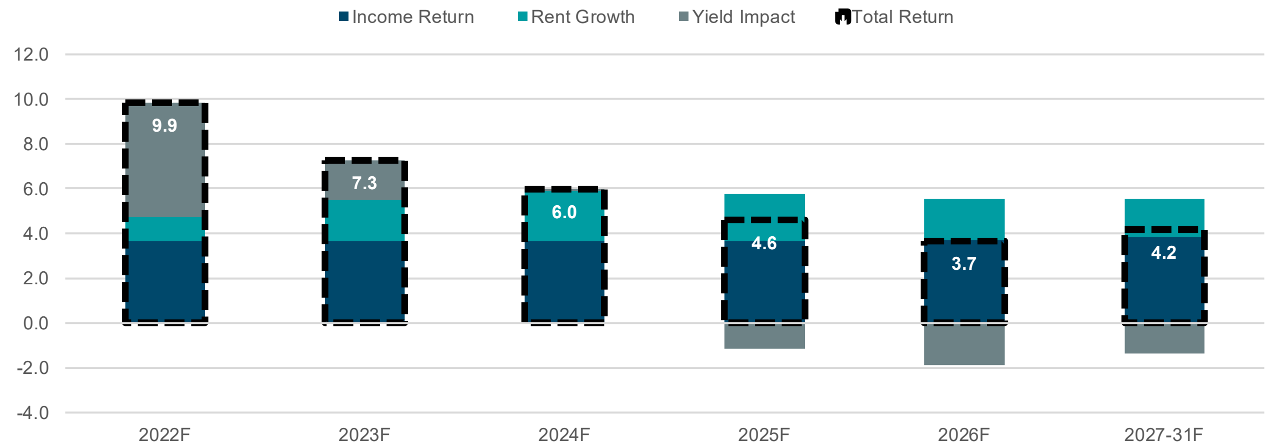
The breadth of the recovery can also be seen geographically within the PEPFI index, with eight countries recording double digit annual total returns in the third quarter. This group includes most of the continent's largest economies, with the United Kingdom and the Netherlands seeing returns above 15% in the year to September, and Sweden surpassing the 20% mark. Germany was also a strong performer, with Italy and France not far behind.[18]

Outlook: While at present returns are largely being driven by yield compression, we do expect rental growth to become more of a driving force from next year onwards. With the occupier market recovery still finding its feet this year, all property rental growth is likely to remain modest – albeit with significant variation between the best and worst performing markets and sectors. But at around 2% per annum from 2023 onwards, rental growth should soon begin to provide more of a counterbalance to the fading, and eventually negative, yield impact component.

At the all property level, our ten-year average total return forecasts have not seen any great change from six months ago, although performance is now more front-loaded. Last year was a much better year than most people had predicted, and we expect some of that momentum to carry through into this year, with a prime gross total return of 9.9%.

We should indeed see some good rent growth across much of the real estate market from next year onwards, but all property total returns are likely to be gradually eroded by a lower income return and lessening yield impact as rising interest rates begin to make the property yield spread – which has already come down in those parts of the market that have moved quickly – look less attractive. As such, we expect prime returns to tail off gradually, but still to average more than 5.0% over ten years.

EUROPEAN AVERAGE ALL PROPERTY PRIME GROSS TOTAL RETURN, 2022-31F (%)



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[17] MSCI, December 2021
[18] MSCI, December 2021

At the sector level, we expect continued strong performance from the logistics sector in the short term, particularly within the urban logistics segment. But for corridor logistics, yields have been driven down so far that at current pricing investors are often having to assume very strong rental growth in order to meet return targets, and on the whole things are looking increasingly overpriced. As such, we see the sector as something of an underperformer on a risk-adjusted return basis, although there are undoubtedly still opportunities in development and in niche segments such as cold storage.

The residential sector has been held back a little over the past two years, as city living fell out of favour during the early stages of the pandemic. However, with the economy opening up again and people returning to cities, we expect performance to step up a gear this year as stronger rental growth begins to feed through once again. The sector remains our top performer on a risk-adjusted return basis, with markets such as Copenhagen, Dublin, Amsterdam and London still looking attractive. However, we also see value in selective regional cities such as Leipzig in Germany and Seville in Spain, where the economic and demographic outlook is strong, but where a notable yield premium over the major cities still exists.

Offices has been an underperformer since the pandemic took hold, although improving investor interest in the sector should see slightly stronger returns in 2022, albeit still lagging behind logistics and residential. Looking ahead, the rental growth premium achieved by creating Next Generation stock in high-productivity cities should provide a boost to return prospects at the top end of the market. But we feel that there is an increasing polarisation between the best and worst assets within the sector, and lesser-quality stock in unfavourable locations may struggle, and in some cases become unviable.

The outlier here is retail, where after an initial continuation of recent repricing, yield compression in the second half of the forecast period is expected to counteract weak rental growth. This, combined with a much higher income return relative to the other sectors, leads us to an expectation of stronger total returns for shopping centres over this period. However, given the significant level of risk inherent within the sector, this is far from a suggestion to rush out and acquire retail property.

Investment Strategy

The European real estate market is in a period of recovery and growth. Macro risks may remain elevated, but 2022 is still expected to see improved performance, with falling yields and the return of prime rental growth. Given this backdrop we see no shortage of attractive investment opportunities. But this doesn't mean all investments will perform equally, far from it. The divergence in performance between sectors and investment strategies that we've seen over the past decade is likely to remain a key feature for some time to come.

Active management: We see increasingly attractive opportunities in taking on active asset management. Market fundamentals are in relatively good shape, new supply remains modest and structural economic changes are altering occupier demand. Furthermore, with many investors shying away from risk over the past few years, pricing in this space looks more attractive.

Active management covers a broad spectrum. In this instance we suggest a focus on the creation of modern, high-quality stock. Outside of the retail sector, we see considerable shortages of space that can meet the needs of today's occupier. Whether it be Next Generation office space, high quality suburban residential, or urban logistics facilities, vacancy rates in many cities are at record lows.

ESG obligations are having a major impact on corporate occupier decisions and meeting these needs will require active management. The industry will almost certainly fail to meet its carbon reduction commitments without a major push to transform the current stock. As such, we prefer refurbishment over new construction, providing high quality, operationally efficient space, while retaining much of the embodied carbon.

Taking on active management involves additional elements of risk and requires an even more selective and diligent approach to investment. This is particularly true with today's backdrop of divergence and macroeconomic uncertainty. Investors should focus on select key investment strategies (as detailed below), while interrogating asset-specific risks.

Responsible residential in commuter towns and regional hubs: Residential remains our number one sector pick. This is unchanged from six months ago, offering an attractive combination of below-average risk and an above-average return outlook. However, our suggested approach is evolving. We remain committed to a focus on affordable accommodation, particularly assets located in commuter locations surrounding the major cities, but we're also now increasingly interested in investment opportunities in key regional cities.

At first glance this may look like a search for yield, and indeed residential yields in these key regional cities do tend to be higher than major markets. However, this is a secondary consideration. The attraction of cities like Bristol, Malaga, Malmo, and Leipzig is based on solid fundamentals, including strong population and disposable income growth, access to renters, and a history of rental outperformance.

Gaining access to institutional quality stock in these regional markets is likely to prove more challenging than the more established parts of the market. For many investors this will often mean taking on some form of development risk. Nonetheless, through careful market selection and with the support of experienced professionals and local partners, investors should be able to mitigate much of this risk.

Life-long living: We're also attracted to the more operationally intensive parts of the residential sector. Senior housing, student accommodation and co-living should provide an additional return, benefitting from both increasing demand and a growing pool of institutional capital.

Senior housing is set to benefit from rising tenant demand and increased investor interest given the ageing population in Europe, with the emerging and undersupplied assisted living subsector expected to expand over the next ten years. In general, the operational risk is shifted to the operator via a long-term lease, so tenant credit underwriting will be important.

Student housing is also benefitting from growing educational attainment levels, increasing numbers of international students and limited supply of purposed-built student accommodation (PBSA) relative to student numbers. PBSA investments require a specialised operator to attract students and manage short leasing windows.

Operational residential assets are typically valued on a yield premium compared to traditional residential, reflecting operational and alternative use risk. Importantly, with expectations of growing occupier demand, we expect the market to continue to mature with operator consolidation, improved access to stock and increasing liquidity. And with reducing risks and compressing yields, this suggest that early movers into these sub-sectors could benefit from outsized performance over the coming decade.

Highest quality office refurbishment: We strongly favour the refurbishment of well-located office stock into exceptionally high-quality space. Targeting strong corporate tenants, and fast-growing, high-margin businesses, we see this strategy best placed in high productivity cities and growing technology hubs such as London, Paris, Berlin, and Stockholm.

Employee wellbeing, environmental certification, the need for flexibility and a desire for quality over quantity are all expected to favour best in class office space over the rest of the market. In most major European cities, there is a scarcity of this type of space, and while we're starting to see developers respond, we believe this will persist for some time, supporting higher rents.

We see great advantages in undertaking office refurbishment, with the potential for far greater risk-adjusted returns over today's low yielding new build stock. The environmental case is also strong, improving day-to-day operational efficiencies while retaining a vast amount of embodied carbon. This won't be a viable option for all offices, however. Where this is the case in a portfolio, we would strongly support considering a sale, as the risk of obsolescence is only likely to grow.

Logistics niche and value add: We're more cautious about the logistics sector in Europe. There remains plenty of momentum which should sustain outperformance over the coming few years, but for long-term holders we do not believe current pricing reflects the risks for ageing stock and in those locations where supply is less constrained.

Investors looking to increase exposure to this sector should take an increasingly selective approach. We continue to see value in urban logistics locations. Despite a lower-than-average yield, which may deter cash focused investors, the potential for substantially higher rental growth and limited voids is attractive. Gaining access to this type of stock is difficult, although the conversion of redundant retail space is becoming more common, but in general a lack of access may prevent many investors from a strategic push into this part of the market.

Similarly, we favour more niche logistics opportunities such as cold storage. Fewer in number and technically more challenging than dry storage, supply constraints and growing demand from sectors such as pharmaceuticals and food offer the potential for rental outperformance. And while the yield premium over dry storage has lessened in recent years, we think yield convergence will continue as institutional capital recognises the long-term potential of this part of the market.

Although tactical rather than strategic, we also see strong merits in the development of modern stock in both urban and strong corridor locations. This may seem counterintuitive given our general concerns about the sector, but we continue to see a window of opportunity with high developer margins, low vacancy rates and a lack of modern stock in some locations.

Liquidity providing opportunities to sell: Finally, investment strategies should not only focus on acquisitions. Market liquidity has risen over the past twelve months, and we see no shortage of investor demand over the coming year. While there may remain some caution about taking on risk, as the recovery gains momentum in 2022 we think it likely we'll see more liquidity for non-core locations and assets.

Portfolio managers should take this opportunity to reduce their exposure to assets that are environmentally stranded and sectors facing negative structural trends, being at risk of underperforming over the long term. While it may be difficult to dispose of poorly located commodity office stock or secondary shopping centres where there is little alternative use, our expectations for long-term value decline would suggest it may be optimal for owners of such properties to accept a sales price below book value, particularly in a portfolio overexposed to these assets.

Perhaps more controversially, we think this will be a good time to start to sell some ageing logistics assets. Despite the recent strength of performance, with many assets in this sector now fully priced, we see fewer upsides, particularly in weak corridor locations where there is a clear threat from future development.

Country Summaries

Germany	• An economic recovery is underway. Supply bottlenecks and a fourth wave of Covid-19 are limiting economic activity, but without derailing the positive trajectory. • Demand is picking up, but remains below previous peaks, while investor sentiment is also broadening beyond the prime segment again.	• Prime residential and logistics asset remain sought after but continued downward pressure on yields is making the case for investment more difficult. • Strong fundamentals and expected outperformance are supportive of residential investments in regional markets and smaller segments such as senior living.
France	• 2021 Q3 data confirms that the re-opening of the economy triggered a strong, consumer-led recovery. Moderate outperformance is expected over the next five years. • Office take-up has returned after a weak period, particularly in the Paris CBD, where we see opportunity to refurbish dated office stock to the latest standards.	• Strong growth in the 70–84-year-old age cohort and affluent elderly population bodes well for assisted living investments in France. • The residential investment market is growing from a small base. We see most opportunity for yield compression in suburban Paris and fast-growing regional markets.
U.K. & Ireland	• U.K. and Irish real estate is still supported by comparatively attractive pricing. In particular, the office and residential sectors continue to benefit. • There has been a notable rebound in the Central London office market. As international investors return to the market the downward pressure on yields is increasingly evident.	• The weight of capital targeting U.K. logistics has driven down yields further. Pricing is increasingly expensive, but we see better opportunities in urban and value-add refurbishment. • London's residential sector continues to mature, and we see the best opportunities in affordable schemes outside Zone 1. Growth prospects in regional U.K. markets are also strong.
Southern Europe	• After a strong recovery in 2021 H2, economic growth is likely to slow due to rising Covid cases. Structural demographic issues are set to weigh on medium-term growth. • A weak outlook for rental growth and high pricing in the office market restrict acquisition opportunities, but a lack of modern stock may allow for refurbishment strategies.	• Logistics yield compression has exceeded expectations, narrowing opportunities for acquisition as rental growth, particularly in Madrid, is unlikely to justify current pricing. • We see opportunities in affordable residential in select Spanish regional markets, which remain undersupplied and where yield compression is likely to outperform.
Benelux	• The Benelux economic recovery is expected to lag the European average. Trade and exports have made a full recovery, but consumption is still well below 2019 levels. • The Dutch residential market (Randstad) looks well positioned to be a significant outperformer, with low vacancy, high house prices and lack of quality stock.	• Urban logistics looks attractive given relatively high online sales penetration, low vacancy, and quick absorption of new supply. Markets also benefit from port access. • A rapidly ageing population and growing presence of international students bodes well for future demand within operational residential, such as senior and student housing.
Nordics	• Short-term headwinds exist around supply chains and inflation, but urbanisation continues to boost performance of major cities and longer-term growth prospects look solid. • Most Nordic capitals and key regional cities look well placed for residential sector growth and outperformance. However, with concerns over supply, we are cautious on Helsinki.	• Stockholm's prime office market will be supported by the fast-growing tech and life sciences sectors. We anticipate outperformance in emerging, more affordable submarkets. • Increasing opposition to development of logistics assets on greenfield land could see more demand for brownfield plots and urban logistics schemes.
Central Europe	• Supply bottlenecks are limiting manufacturing activity, while private consumption is fading. Still, long-term economic outperformance over European peers is expected. • There is a clear discrepancy between prime and secondary stock, with prime assets moving back into positive territory. We expect renewed yield compression in the office market.	• A strong investor push into Polish logistics has weighed on yields, while rents are generally moving sideways. We still see investment opportunities, despite strong supply. • Residential markets are still in their infancy but are gaining in importance. Despite yield compression, pricing is favourable, although hedging remains an issue.

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