Marketing Material *

July 2020 / Research Report

U.S. REAL ESTATE STRATEGIC OUTLOOK

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1 / Overview

- In our view the outlook for U.S. real estate has tentatively improved as business reopening and fiscal and monetary stimulus have buoyed the economy and financial markets.

- We continue to expect that the COVID-19 recession will weigh on real estate fundamentals. However, we do not believe that cap rates will rise materially, unlike in past downturns.

- Transactions, largely frozen since March, will likely begin to thaw in the second half of this year, starting with higher-quality assets. While we do not anticipate widespread distress, pockets of stress may bring more troubled assets to market in 2021.

- We favor investments that are cyclically defensive and supported by structural drivers. These include the industrial and apartment sectors as well as technology- and population-driven markets. Additionally, we believe that secure cash-flowing assets will benefit from low interest rates while providing protection against downside risks.

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2 / House View Summary

- Industrial (Strong Overweight): E-commerce has been a boon to the industrial sector, as retailers have stored more inventory and consumed more space to facilitate rapid fulfillment. The COVID crisis has reinforced this trend: E-commerce sales increased nearly 30% (year-over-year) in April, even as total retail sales plunged 20% (year-over-year).[1] Stores are reopening, but we believe that consumers have acclimatized to purchasing more products online. Furthermore, businesses might store more inventory as a precaution against supply-chain disruptions.

- Apartment (Overweight): Demand for apartments is relatively inelastic during recessions, as jobless renters resort to savings and government or family support to remain in their homes. People also typically avoid taking on substantial financial obligations, including mortgages, in periods of economic uncertainty. Even as the recession runs its course, we believe that housing shortages and affordability challenges will continue to support the sector.

- Retail (Underweight): The retail sector has traditionally been a refuge for real estate investors in recessions. However, the relentless growth of e-commerce had already wreaked havoc among traditional retailers, and this pressure will only intensify, in our view. Even as stores reopen, malls might continue to struggle following a series of retailer bankruptcies. Grocery-anchored centers, on the other hand, might fare better, as necessities and services are typically resilient in recessions and largely insulated from e-commerce.

- Office (Strong underweight): There is an active debate about whether homeworking will dampen demand for office space. We believe this view is speculative: although recent experience might show that remote working is possible, morale and productivity might suffer from isolation and household distractions. Moreover, social distancing measures could induce employers to de-densify their office layouts. Regardless, due to its heavy capex burden, the office sector typically only outperforms in the late stages of a cycle when tight markets generate robust rental growth, a condition that we do not expect for several more years.

- Markets: We believe that geographies with greater exposure to technology (e.g., San Francisco, Seattle, Boston, and Austin), a secular growth industry on which the public is relying more than ever, will outperform over the next several years. Additionally, Sunbelt markets with low living and business costs (e.g., Texas and Florida) will in our view continue to attract in-migration and corporate relocations, supporting demand for real estate.

[1] Census Bureau. As of April 2020.

3 / Real Estate Fundamentals

The impact of COVID-19 is generally not yet visible in industry statistics: In the first quarter of 2020, vacancy rates (6.2%) were near all-time lows and net operating income grew by more than 4% (year-over-year).[2] Within the Real Estate Investment Trust (REIT) universe, rent collections in June were within 5% of normal levels for apartment, office, and industrial properties, although they were off by 40% at shopping centers.[3] Nevertheless, we believe that the recession that took hold in March will manifest in rising vacancies and falling rents in the second half of 2020. Key questions include the depth and duration of the recession, the speed of the recovery, and the sensitivity of real estate to this unique cycle, both with respect to the industry as a whole and across sectors and markets.

In one sense, this recession has followed a standard script: as in each of the past seven cycles, it was foreshadowed by an inverted yield curve, in this case in June 2019.[4] But the historical parallels stop there. Unlike past recessions, this one was not caused by imbalances such as inflation or asset bubbles, resulting interest-rate hikes and financial stress, which ultimately depressed demand. Instead, lockdowns took large swathes of the supply side of the economy offline. This triggered a sudden surge of unemployment unseen since at least the 1940s: the economy lost more than twice as many jobs in March and April (22 million) than it did over two years during the Great Financial Crisis (nine million).[5]

In a typical recession, an initial shock triggers a vicious circle of job losses, weaker profits, bankruptcies, and falling asset prices that are mutually reinforcing, sometimes exacerbated by shrinking state budgets and international trade (see Exhibit 1). The vicious circle peters out when one or several of these forces reverse course, whether due to pent-up demand, bargain hunting, policy stimulus, or exports to stronger foreign economies. Yet this process usually takes time: since the 1940s, the average recession has lasted about one year, while the Global Financial Crisis (GFC) lasted 18 months.[6]

[2] NCREIF. As of March 2020.
[3] NAREIT. As of June 2020.
[4] Federal Reserve. As of July 2020.
[5] Bureau of Labor Statistics. As of June 2020.
[6] NBER. A of June 2020.

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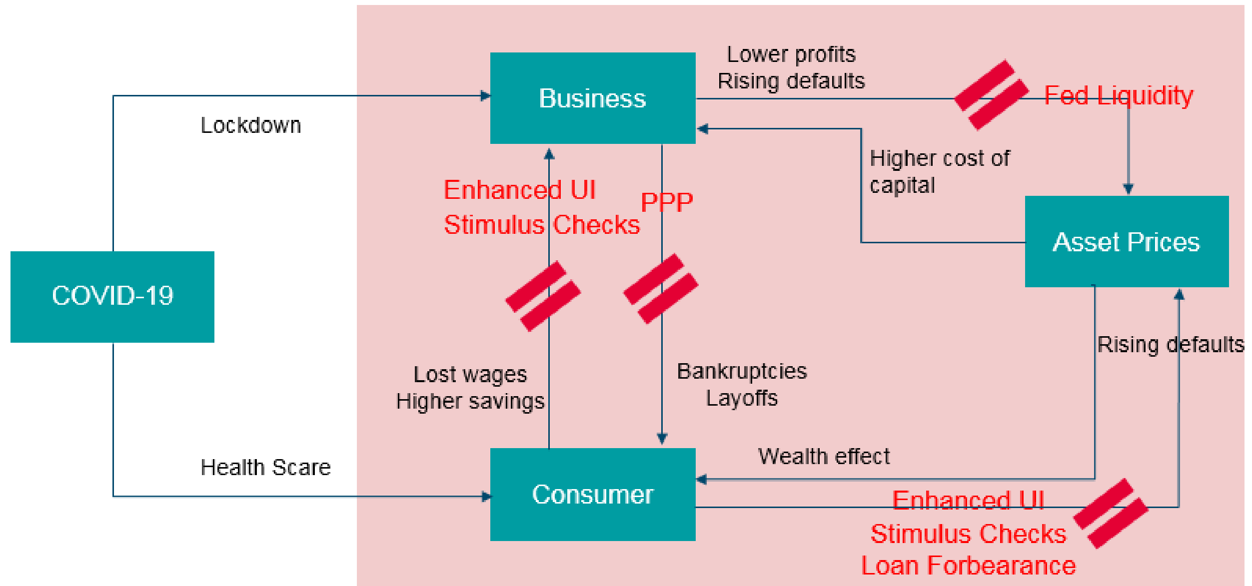
EXHIBIT 1: "VICIOUS CIRCLE" OF RECESSION



For illustrative purposes only. Past performance is not indicative of future results.
Source: DWS. As of July 2020.

This recession may prove much shorter. Mirroring the initial shock, the rebound and its drivers have been unprecedented. Business re-opening delivered a supply-side boost to the economy in May, restoring 2.5 million jobs.[7] More astonishing, in our view, has been the scale of the policy response. The Federal Reserve (Fed) expanded its balance sheet by more than $3 trillion over three months, equivalent to the liquidity it provided over five years around the GFC.[8] And fiscal injections (indirectly financed, in part, through Fed Treasury purchases) have pushed about $3 trillion into the real economy through automatic stabilizers (e.g., lower tax collections and more food stamps) and emergency measures (e.g., the Paycheck Protection Program (PPP), stimulus checks, and enhanced unemployment benefits).[9] The result: Financial markets have staged a remarkable rebound, and personal income, which usually falls amid job losses, increased in April at its fastest pace in 35 years, or 60 years after adjusting for inflation (see Exhibit 2).[10] Income growth cooled in May after the stimulus checks were distributed, but it remained elevated considering the depth of the recession.

[7] Bureau of Labor Statistics. As of June 2020.
[8] Federal Reserve. As of June 2020.
[9] Congressional Budget Office. As of June 2020.
[10] Census Bureau. As of May 2020.

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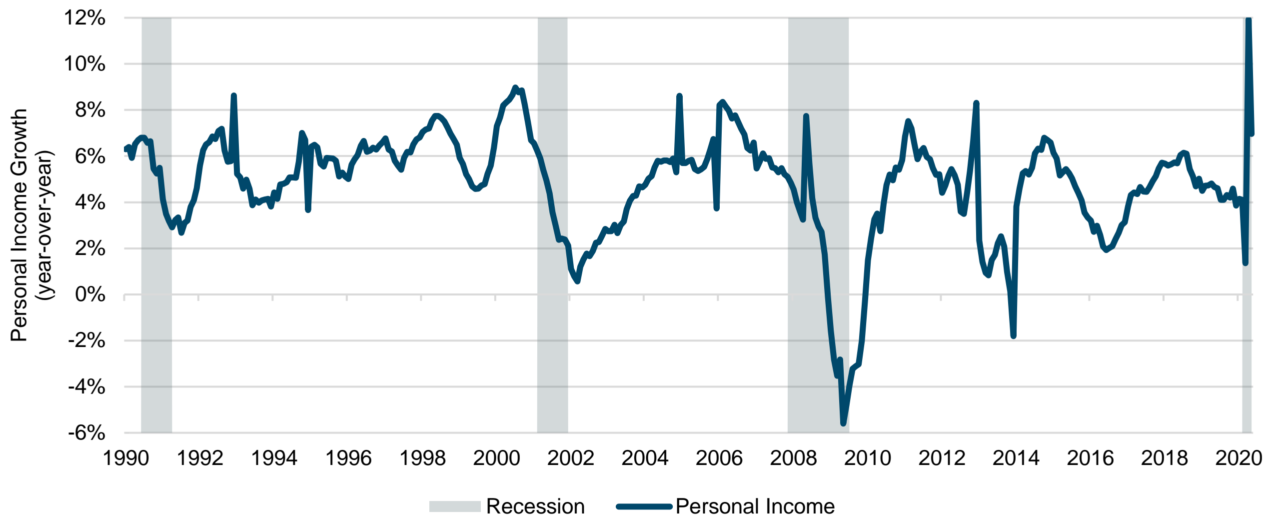
EXHIBIT 2: PERSONAL INCOME GROWTH (1990 - 2020)



Source: Bureau of Economic Analysis (BEA): National Income and Product Accounts (NIPA). As of May 2020.

The recovery is fragile, in our view. The virus has not disappeared and sporadic lockdowns could stall the re-opening. Fiscal stimulus could be exhausted before the economy gains sufficient momentum. Financial markets could relapse due to virus flare-ups or any withdrawal of Fed support. Even if the recovery remains intact, the economy may not recover all of its lost ground — leaving unemployment above pre-COVID levels — as certain industries (e.g., leisure and hospitality) may be semi-permanently impaired. On balance, we believe that the economy is on course for a meaningful bounce in the second half of 2020, followed by a slower recovery in 2021.

While the recession may prove transitory, its severity will, in our view, exact a significant toll on real estate fundamentals. While stimulus together with loan and rent forbearance have staved off personal and business bankruptcies, we believe that these will materialize in the second half of the year as emergency measures unwind, causing some tenants to default on their leases. Reduced (albeit improving) profitability and employment may also depress leasing activity. And a pipeline of buildings already under construction will compete for a limited pool of tenants. Overall, we expect that rents will slide by 7% through 2021, with significant variation by sector and market (see Exhibit 3).

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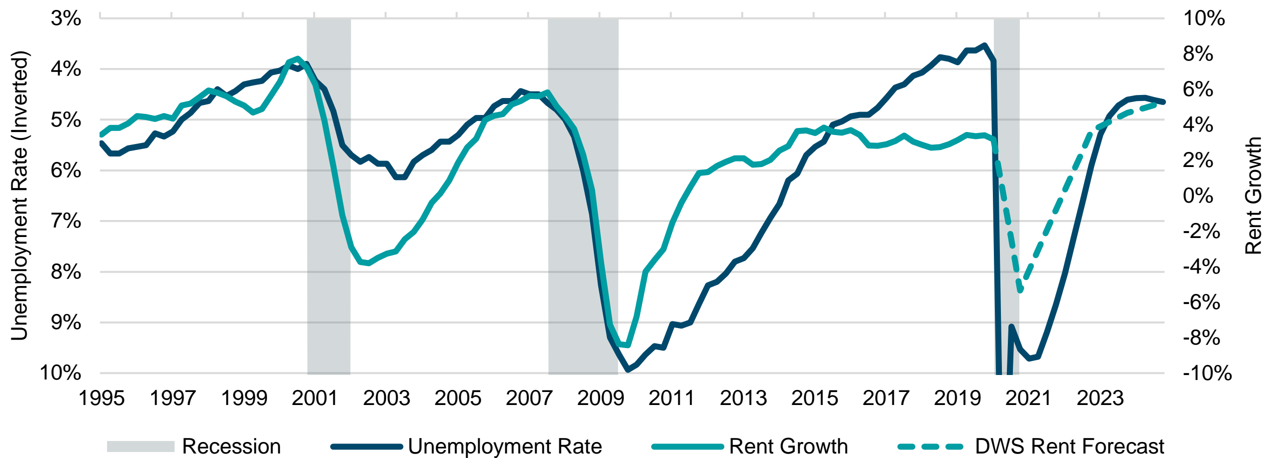
EXHIBIT 3: UNEMPLOYMENT AND REAL ESTATE RENT GROWTH (1995 – 2024)



Source: U.S. Bureau of Labor Statistics (BLS), Moody's Analytics, CBRE-EA, DWS. As of June 2020.

Still, this would represent a victory of sorts: rents declined 18% during the GFC.[11] The differences this time are threefold. First, while this recession is deeper, the recovery may also be swifter. Second, vacancy rates were lower coming into this recession, so even a significant increase would leave them below peak GFC levels.[12] Third, new construction is generally more constrained (about 25% lower relative to GDP).[13]

We are optimistic about prospects for rent growth once the COVID-19 crisis passes. We believe that construction starts will plunge this year, due to logistical constraints, restrictive financing, and uncertainty around future demand (a June Federal Reserve survey indicated that a net 52% of banks were tightening lending standards on construction loans, the highest level since the GFC).[14] Coupled with an improving economy, this should drive vacancies lower, and rents higher, beginning in late 2021. Yet the recovery will not be uniform: We believe that industrial and apartment buildings will be the first to revive, likely next summer, followed by office and retail properties in 2022.

[11] CBRE-EA. As of June 2020.
[12] CBRE-EA. As of June 2020.
[13] Bureau of Economic Analysis. As of March 2020.
[14] Federal Reserve. As of June 2020.

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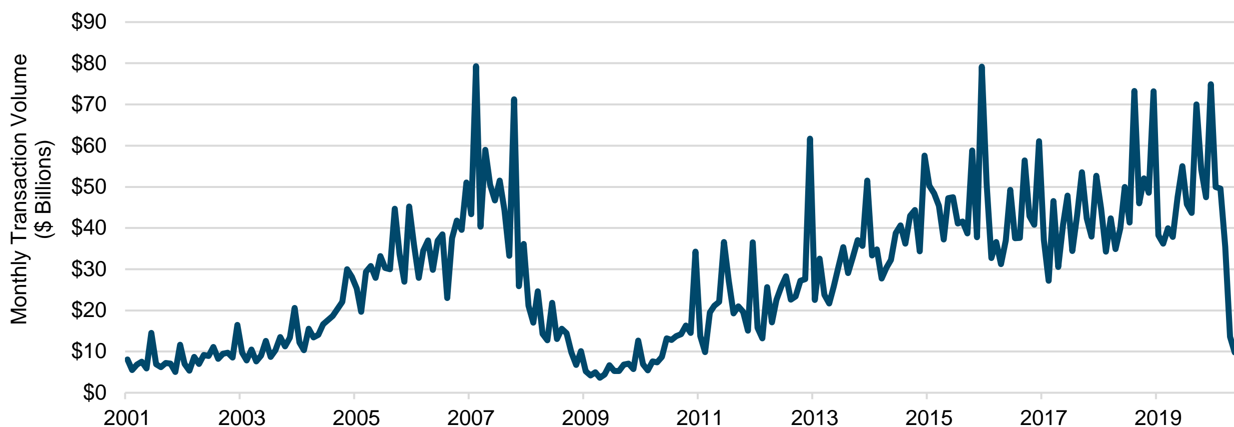
4 / Real Estate Capital Markets

Massive liquidity injections from the Federal Reserve have helped to deliver a sharp rebound in financial markets. While publicly traded real estate has lagged behind, it has nevertheless benefitted: Having slumped more than 40% in the first weeks of the COVID panic, listed REITs recouped more than half their losses, ending the second quarter down 17% year-to-date (compared with 7% for the S&P 500).[15] CMBS spreads, aided by Fed intervention (i.e., Agency MBS purchases and the Term Asset-Backed Securities Loan Facility (TALF)) also retraced roughly half of their initial expansion; together with lower risk-free rates, this brought yields back to pre-COVID levels.[16]

Private real estate markets, on the other hand, have been largely moribund. Transaction volume plunged 79% year-over-year in May 2020 to nearly GFC levels amid logistical hurdles, market uncertainty, and a dearth of financing (see Exhibit 4).[17] A net 50% of banks tightened standards on commercial and multifamily lending in May 2020.[18]

EXHIBIT 4: MONTHLY TRANSACTON VOLUME (2001 - 2020)



Source: Real Capital Analytics (RCA). As of May 2020.

Nevertheless, we believe that trading will pick up in the second half of 2020 and into 2021, for several reasons. First, an easing of restrictions on mobility should facilitate the process of underwriting and executing transactions. Second, a market may form for high-quality assets with clear cash-flow visibility as sellers (e.g., owner-occupiers and investors rebalancing portfolios) seek liquidity and buyers seek alternatives to low-yielding fixed income instruments. Third, while we do not expect a deluge of distress, pockets of stress may push more troubled assets to market, particularly once forbearance measures run their course. While delinquency rates are generally low, CMBS loans in special servicing have begun to escalate, a trend that we would expect to continue through next year, particularly in harder-hit areas like lodging and retail property (see Exhibit 5).[19]

[15] Bloomberg. As of June 2020.
[16] Bloomberg. As of June 2020.
[17] Real Capital Analytics. As of May 2020.
[18] Federal Reserve. As of June 2020.
[19] Moody's Analytics. As of June 2020.

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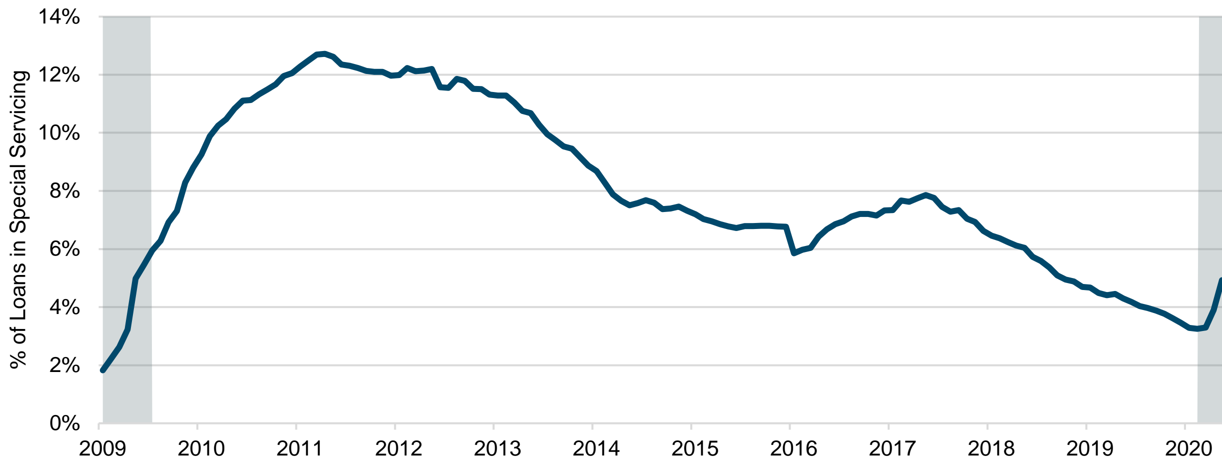
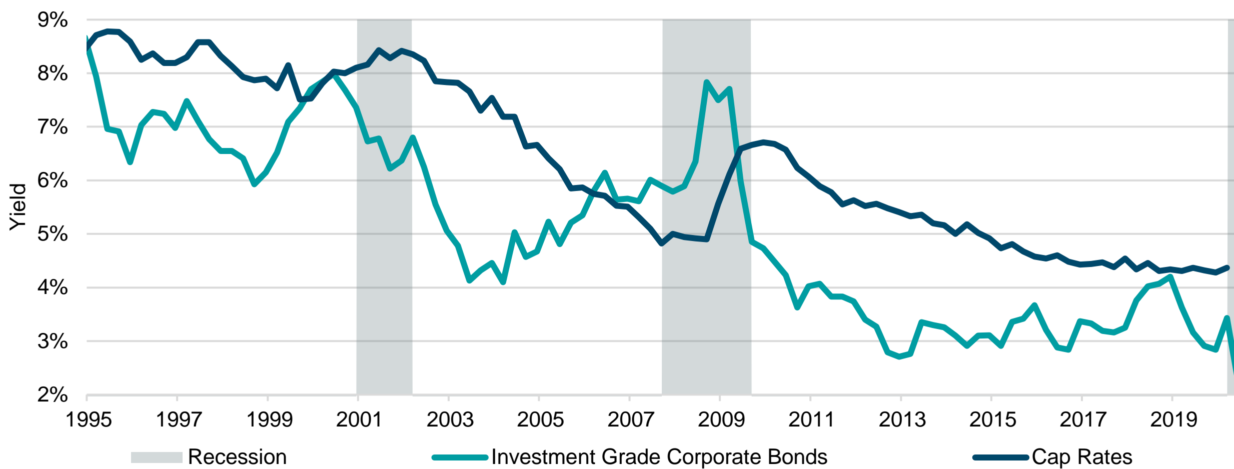
EXHIBIT 5: SHARE OF CMBS LOANS IN SPECIAL SERVICING (2009 – 2020)



Source: Moody's Investors Service: Moody's Delinquency Tracker and NBER. As of May 2020.

We calculate that cap rates have historically increased roughly half as much as investment-grade (IG) bond yields in recessions, lagging behind by about one year (see Exhibit 6). With IG yields back to pre-COVID levels, this would imply no increase in cap rates overall. Stronger equity markets, cheaper credit, and lower dollar hedging costs (as U.S. and global interest rates have converged) could help to support valuations. Yet we expect significant dispersion: With yields of A-rated corporate debt hovering in the 1%-1.5% range, it would not be surprising to see cap rates decline for warehouses occupied by strong tenants on long-term leases.[20] But where cash flows are highly uncertain — e.g., a lower-quality mall occupied by struggling department and apparel stores — cap rates could certainly increase.

EXHIBIT 6: INVESTMENT GRADE BOND YIELDS AND REAL ESTATE CAP RATES (1995 – 2020)



Source: NCREIF (appraisal cap rates), Bloomberg/Barclays (bond yields). As of June 2020.

[20] Bloomberg. As of June 2020.

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5 / Real Estate Performance

With transactions markets largely frozen, determining the impact of COVID-19 and attendant recession on real estate valuations is inherently problematic. NCREIF Property Index (NPI) total returns slipped to 5.3% (trailing four quarters) in the first quarter of 2020 from 6.4% in the fourth quarter of 2019, but this pullback largely reflected pre-COVID stresses specific to the retail sector.[21]

In our view, once the dust settles and transactions markets clear, core real estate prices will have declined by approximately 0%-10%. The final tally will depend on two principal factors: the duration of and recovery from the recession (itself contingent on policy measures and health-care developments) and the sustainability of financial-market gains. Cash-flow disruptions will weigh on valuations, while generally favorable capital markets will cushion the blow. We believe that total returns (including income) will remain positive over the 2020-2021 period, more akin to the mild downturn of 2001 than the severe retrenchment of the early 1990s or the GFC.

Taking a longer view, we believe that real estate is positioned to perform well on a relative basis. Well after the crisis has passed and the economy is on the mend, interest rates will likely remain low, a pattern that is reflected in long-term (e.g., 30-year) bond yields. Cap rates provide an attractive spread that could power robust returns for several years. Furthermore, a constellation of factors, from massive fiscal and monetary stimulus to trade wars to supply-side constraints, arguably raise the specter of inflation over the medium term. Financial markets currently place low odds on an inflationary spiral (implicit expectations are below 2% for the foreseeable future), but real estate and other tangible assets may gain currency as a partial hedge over time.[22]

[21] NCREIF. As of March 2020.
[22] Federal Reserve and DWS calculations. As of June 2020.

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6 / Industrial Outlook and Strategy

6.1 Current Conditions

The COVID-19 pandemic has dramatically changed the economic and property market landscapes. Fortunately for industrial property investors, the sector's fundamentals were in very good health as the U.S. economy entered recession in 2020. The national availability rate, at just 7.3% in the first quarter of 2020, was just 30 basis points above cycle lows and well below the long-term historical average (10%). New development overtook demand in 2019, as U.S. – China trade tensions and slower economic growth dampened industrial space demand. New construction deliveries totaled about 247 million square feet in 2019, outpacing net absorption of 195 million square feet. Nevertheless, overall supply and demand levels achieved a healthy balance across most markets, supporting continued market rent growth and very strong total returns (13.6% over the trailing four quarters in the first quarter of 2020).[23]

Despite a favorable starting point to begin 2020, and what we believe are durable and beneficial long-term secular trends, there are risks in the industrial sector today and we do not expect it will escape this recession unscathed. First quarter 2020 data showed some of the negative impact of economic contraction. Net absorption was muted at 34 million square feet, and 15 markets experiencing negative demand (albeit modestly).[24] Construction deliveries totaled 59 million square feet and were on track to reach similar levels to 2019.[25] However, work stoppages and economic contraction may delay the current pipeline, depending on the pace of economic restart and confidence that a resolution of the health crisis is in sight.

While some downdraft can be expected during a recession, the unique nature of this one (with a sudden stop of the economy, massive government support, and shelter at home orders), may produce less negative trends for the industrial sector. Preliminary data through late June reflect somewhat stronger activity than was measured in the first quarter, but with a notable caveat: Through late June 2020, more than 100% of net absorption has taken place in the new construction pipeline (2018 through 2020Q2 deliveries), as larger traditional and internet retailers, as well as third-party logistics (3PL) firms continued to ramp up their direct-to-consumer, and in particular, last mile delivery capacity. The existing base of functional industrial properties (built from 1970 to 2017) experienced moderately negative demand, perhaps reflecting more traditional downsizing and business destruction with the advent of recession. Even so, the vacancy rate remained low at 4.8%. This could be considered near its structural limit.

The data for Exhibit 7 is comprised a diverse group of 33 U.S. metro industrial markets with stock totaling 11.1 billion square feet or about 77% of our U.S. baseline total.[26] The data indicate that there has been about 94 million square feet of absorption in development pipeline in the first half of 2020, while space givebacks have totaled about 25 million square feet in the stabilized post-1970 stock. Vacancy in construction deliveries, which has totaled about 215 million square feet in the four quarters ending June, was about 30%, which is healthy and bodes well for future market stability.

[23] NCREIF. As of March 2020.
[24] CBRE-EA. As of March 2020.
[25] CBRE-EA. As of March 2020.
[26] CoStar Property and CBRE-EA. As of June 30, 2020 and March 2020.

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EXHIBIT 7A: VACANCY TRENDS FOR INDUSTRIAL PROPERTIES BUILT FROM 2018 TO 2020

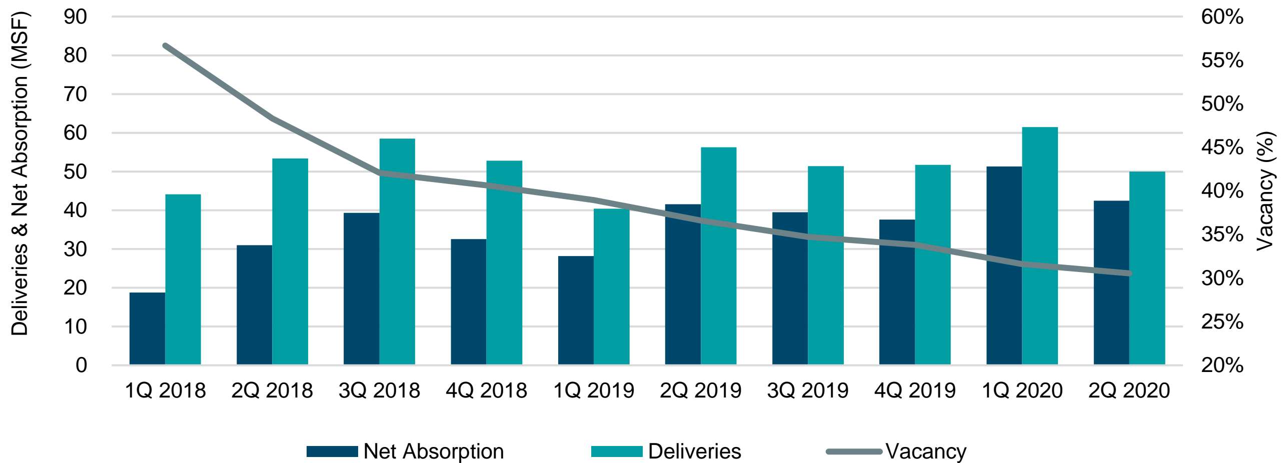
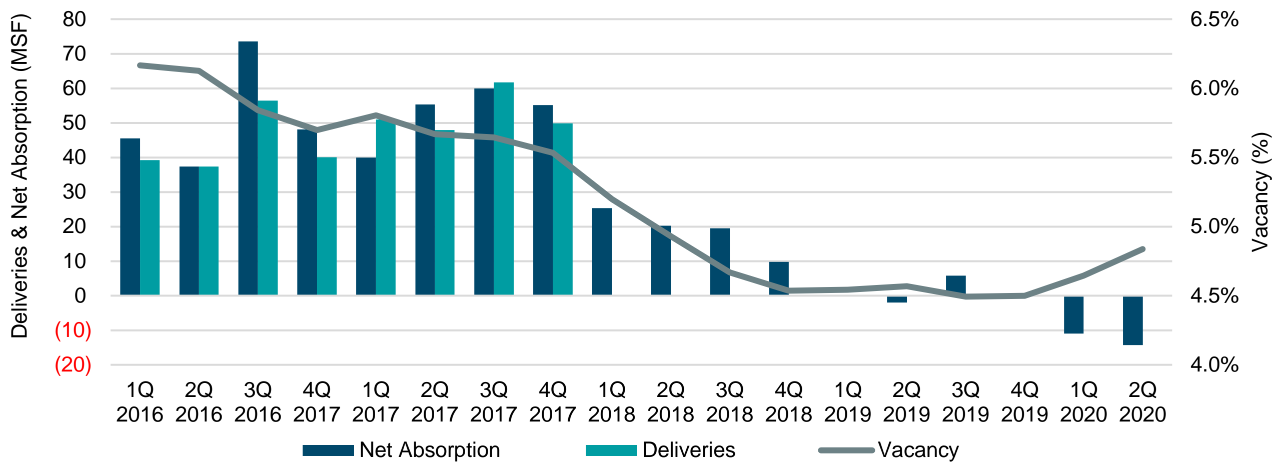


EXHIBIT 7B: SUPPLY, DEMAND, AND VACANCY TRENDS FOR INDUSTRIAL PROPERTIES BUILT FROM 1970 TO 2017



Source: CoStar and DWS. As of June 2020. No assurance can be given that any forecast or target will be achieved.

As evidenced so far in the preliminary data, we expect that the industrial property sector will hold up relatively well compared to the other sectors (office and retail) and also perform better compared to past recessionary periods. There may be negative trends yet to come for some industrial users, but the unique dynamics of this recession could accelerate the adoption of online shopping and rapid fulfillment. We believe that businesses (by necessity) are using the current circumstance to implement and refine new and more efficient concepts to serve a somewhat captive consumer base. The current environment, with impaired transportation and production processes, has also highlighted the need for a more flexible and resilient supply chain, and this could support greater demand in the future.

6.2 Outlook and Strategy

While it is too early to measure the depth of this recession's impact on property fundamentals, the early indicators appear good. Assuming a gradual re-opening of the broader economy in coming quarters (which is not certain), we expect that recession and disrupted consumption patterns in the economy, as well as disrupted industrial production, will lead to impaired space demand, rising availability and softening market rent levels in the near term, albeit modest by historical standards. Like

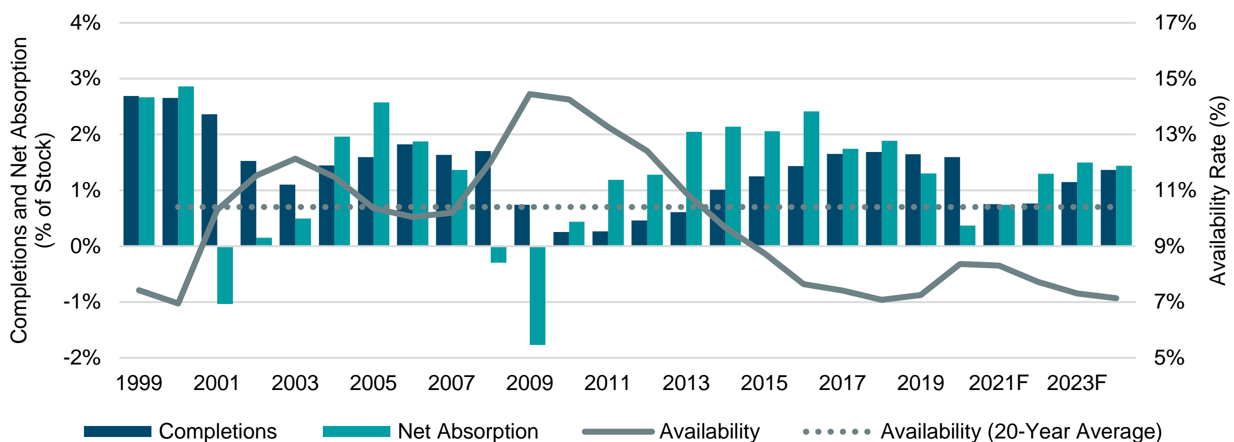
in previous cycles, a mature development pipeline will add to existing vacant supply during recession, making leasing conditions very competitive in some markets, while others may fare relatively well. Harder hit local economies (ones more heavily reliant on tourism, hospitality and energy) are expected to have sharper downturns and lag in recovery timing.

Our mid-year outlook calls for net absorption to remain moderately positive in 2020, totaling about 56 million square feet. We forecast that demand will recover to about 114 million square feet in 2021, and then bounce back more strongly in 2022, to about 200 million square feet. Despite job losses, various industry impairments and sharp GDP contraction this year, demand for warehouse space should see resilient demand from non-discretionary consumption, support from essential services, and importantly, a boost from very strong online retail sales. Sharply lower store sales and food consumed outside the home could negatively impact demand in and around major job centers in particular, and could remain a drag on demand through 2022.

The development pipeline has approximately 320 million square feet of industrial properties underway that are slated for delivery in 2020 and 2021. Our view is that a portion of completions will be delayed, with about two-thirds, or 200 million square feet finishing in 2020 and the remaining one-third rolling into 2021. Slower economic growth and below average demand in 2021 should serve to temper new development activity in 2022, but a rebounding economy should support healthy rises in supply in the following years.

The short-term mismatch between new construction deliveries and demand is not expected to have a sharp impact on national availability. We forecast the national availability rate will increase 110 basis points, to about 8.4% in 2020, and then remain stable in 2021 as demand begins to recover and development activity moderates in an uncertain environment. This outlook is favorable compared to past recessions and is premised on a gradual but steady re-opening of the economy in 2020 and significant progress in resolving the health implications from COVID-19 in the coming year. Uncertainty around the timing of these eventualities are uncertain and represent significant near-term downside risk. However, our longer term view on the prospects for the sector remains very good.

EXHIBIT 8: INDUSTRIAL NET ABSORPTION AND COMPLETIONS AS A PERCENT OF INVENTORY AND AVAILABILITY RATE (1999 – 2024)*



* Total for U.S. Sum of Industrial Markets (CBRE-EA)
Source: CBRE-EA (History) and DWS (Forecast). Data as of June 2020.
Note: F = forecast. Past performance is not indicative of future results. No assurance can be given that any forecast or target will be achieved.

We believe that market rent fundamentals will vary by individual market and property segment, with modern bulk and multi-tenant warehouses in our target universe faring relatively well and smaller business park and flex properties facing greater challenges. On average we forecast that effective rents will fall by about 4% in 2020 and rise less than 2% in 2021. There is potential for stronger rent growth in the years following. If realized, this pattern will be modest by historical standards, due to

the nature of this downturn and resulting immediate demand support from some industries (e-commerce and other business suppliers). Massive government spending could also help support the restart of businesses, shortening the impairment of industrial space demand. The opaque nature of progress and resolution of the pandemic allows for rationalization of a ‘V’ shape recovery for a significant base of businesses tied to consumption, so the prospects for industrial users may not be as challenged during recovery, compared to prior recessions.

The central themes that are shaping our industrial investment strategy:

Although there is heightened uncertainty at present, we believe the industrial sector will still provide a compelling opportunity for real estate investors in coming quarters. Given our current rent projections for 2020, five-year leases rolling in 2020 will on average be 13% below market. Several metros have greater lease roll-up potential, with current rents more than 20% higher than rent levels from 2015. This NOI potential is the strongest among the primary sectors, so that should fuel continued strong relative returns.

The prospects of a sharp recession in 2020 have altered our market selection themes for investment in a few notable ways. We still maintain strong convictions for the prospects of large coastal metropolitan areas on the west coast as well as those that serve the large northeast region, as linkages to knowledge-based industries should fare relatively well. However, Florida markets, with their tourism and hospitality exposure, may be subject to sharper economic contraction and longer recovery times. That said, we still like the long-term prospects for Miami, despite near-term risks. This holds true for Orlando as well.

Other target markets where prospects have diminished include Houston, with its outsized exposure to the energy sector, and also Phoenix, which was not fully recovered from the last recession and also has a large development pipeline. Lastly, Las Vegas, with a high concentration of entertainment and hospitality, will likely contract sharply, resulting in a difficult environment for related services and local space occupiers.

We are monitoring markets where distress may arise but also opportunities. Although we think Miami will get hit hard in the near term, over the longer term we like the demand prospects in its industrial market. Additionally, markets with the largest bulk warehouse supply pipelines (Atlanta, Chicago, Dallas and Riverside) may be volatile to the downside in coming quarters, but resolve those imbalances on the front end of recovery, especially if the local construction pipelines abate.

In the near term, we believe that markets with favorable exposures to knowledge based industries as well as metros with large stable economies and resilient growth prospects will fare best. Some of these are also underserved by modern warehouse facilities. Notably we continue to favor the San Francisco Bay Area, Southern California, Seattle, Portland, Washington D.C., Philadelphia and New York/New Jersey. Central Pennsylvania may exhibit mixed trends, with Allentown outperforming due to its linkage to New York, and Harrisburg underperforming due to supply competition in substitutable areas in the region. Notably the prospects for Washington D.C. and Dallas/Fort Worth have improved due to favorable structure and growth prospects and strong demand fundamentals.

Primary considerations for 2020 and ahead:

- Asset Fit & Location: It important to target appropriate physical features of industrial real estate for the market in which it sits. In this cycle, several physical features seem to have increased in importance, such as lower site coverage (with parking and loading implications), efficient circulation, and trailer storage for bulk warehouses. Specific locations can be particularly important in larger population centers with significant traffic barriers, so proximate access to appropriate labor pools, consumers, businesses and infrastructure (airports/ports) are vital. We believe that judicious asset targeting will garner better rent and occupancy prospects in a full cycle.

- Big Box Warehouse: Amazon, large retailers and 3PL’s continue to drive demand for new bulk warehouses. The need for more flexible and resilient supply chains should support sustained demand, but persistent supply and competition in secondary and tertiary markets will serve to moderate rent growth prospects.

- Multi-Tenant Warehouse/Urban Last Mile: We expect resilient performance across many markets with fulfillment providers and essential businesses driving demand, but a longer recession or weaker recovery could hurt smaller local businesses and correspondingly, occupancy and rent fundamentals in the harder hit metro economies. Short-term downside potential in this segment could afford good investment opportunities in higher-barrier markets.

- Food-Related/Cold Storage: Trends are strong in this cycle, but there is a potential for bifurcated near-term performance, with struggling restaurant businesses taking longer to recover. The freezer segment has had rapid growth, but part of this was driven by trends that may change (i.e., growth of food consumed outside the home). Demand for refrigerated food facilities should continue to be bolstered as direct-to-consumer food delivery rises. This segment should provide a safe near-term harbor, as demand has been strong in this cycle and longer term trends have exhibited stable growth.

- R&D/Flex/Light Industrial: We have few recommended targets for higher finish industrial properties, limited to about six major markets with large technology and life science industries. Functional and well-located light industrial facilities could perform well in highly constrained markets and serve as covered land plays in high value locations.

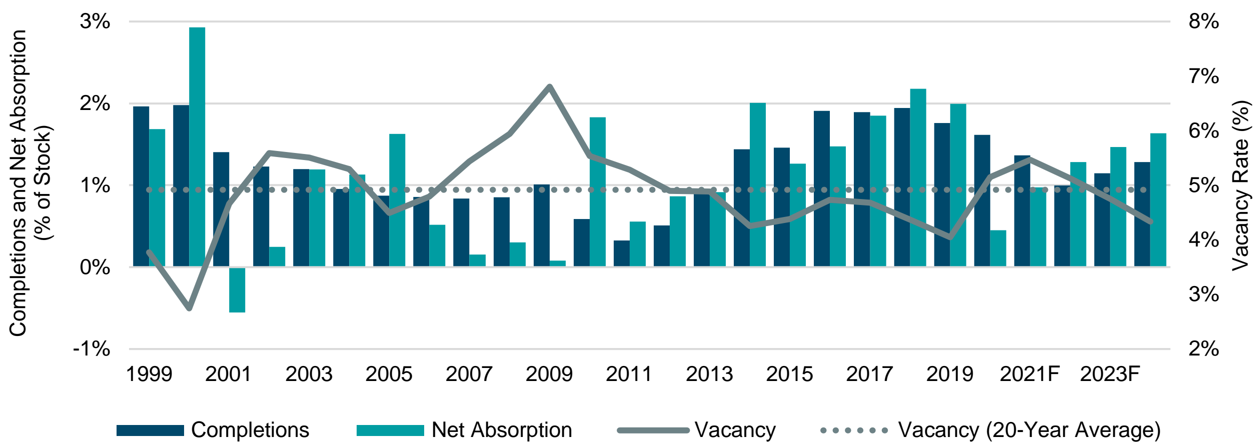
Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

7 / Apartment Outlook and Strategy

7.1 Current Conditions

Apartment fundamentals were healthy going into the current recession, however the sector is expected to be negatively impacted by the shutdown of the US economy due to the COVID-19 pandemic. The shutdown has triggered an unprecedented surge in unemployment in the span of only a few months, and this is expected to have a significant impact on near-term apartment demand (see Exhibit 9) across DWS's 29 Investable Markets ("Investable Markets", "Investable Universe").[27] When combined with new supply still scheduled for delivery, this is expected to push the vacancy rate higher in the near-term before cresting in mid-2021 as the broader economy recovers.

EXHIBIT 9: APARTMENT NET ABSORPTION AND COMPLETIONS AS A PERCENT OF INVENTORY AND VACANCY RATE (1999 – 2024)*



*DWS's 29 Apartment Investable Markets
Source: CBRE-EA (history) and DWS (forecast). As of June 2020.
Note: F = forecast. Past performance is not indicative of future results. No assurance can be given that any forecast or target will be achieved.

Temporary eviction moratoriums and enhanced unemployment insurance have provided some protection these past few months, helping to stabilize rent collection and occupancy; San Francisco, in particular, went a step further, passing a permanent eviction moratorium for COVID-impacted residents. However, the enhanced unemployment benefits are set to end at the end of July and many state eviction moratoriums are scheduled to expire soon except in markets like California, New York, Washington, and Florida. Evictions are therefore expected to increase over the next few months across the rest of the U.S. and push vacancy rates higher.

While units under construction are still elevated, multifamily starts have dropped to their lowest level in almost eight years, totaling 234,000 on a seasonally-adjusted basis as of April 2020[28]; that translates to a year-over-decline of 40.3%. This is likely being driven by several factors: COVID-forced shutdowns of non-essential construction, less financing available and tighter lending standards due to the pandemic, uncertainty around price discovery, and perhaps a normalization of supply from levels that were not sustainable. Multifamily permitting also dipped to 373,000 units on a seasonally-adjusted annual basis as of April 2020[29], the lowest rate since April 2016; that number was down 12.4% month-over-month and 22.6% year-

[27] DWS: Apartment Investable Markets include 29 major metros in the US
[28] US Census Bureau and the US Department of Housing and Urban Development. As of April 2020.
[29] Axiometrics. As of April 2020.

over-year. Given that discipline, as well as new construction delivery times likely averaging at least the 18 to 24 months they did pre-COVID, a pullback in new supply is expected by 2022.

While the expected overall increase in vacancy rates is proportional to that of the global financial crisis (around 100 basis points), strong rental demand over the last several years (five-year average absorption: 195,000 units)[30] has provided the sector with a much lower starting point at 4.2% as of the first quarter of 2020; therefore at its cyclical peak, vacancy only rises about 50 basis point above its long-term average. This persistent rental demand had been driven by strong job and favorable demographic trends, as well as significant barriers to homeownership. While the structural drivers remain strong, rental demand is expected to decline in the near-term due to the current recession and then recover in line with the overall economy.

The apartment sector has averaged 3.5% annual effective rent growth since 2015, peaking at 6.5% in the third quarter of 2015. While rent growth has moderated since then, the apartment sector continued to show resilience in the first quarter of 2020. Solid fundamentals resulted in effective rent growth of 3.3% year-over-year across the Investable Universe. This rent growth was not, however, consistent across product subtypes. Strong rent growth was concentrated in garden-style apartments that have seen limited new supply in suburban markets. Most downtown submarkets continued to underperform due to the oversupply of luxury high-rise product resulting in landlord concessions capping effective rent growth at levels well below inflation.

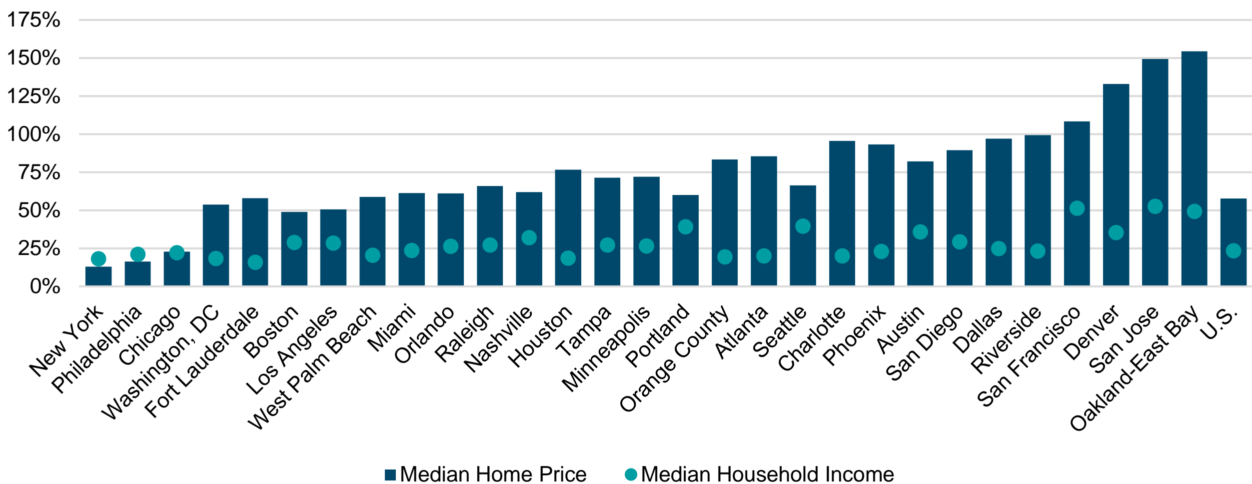
With a recessionary environment now in place, lower rent growth is expected in the near-term, not only due to unemployment and new deliveries, but also due to ongoing affordability concerns. Rents were already at high levels going into the economic shutdown and these job losses will weigh heavily on incomes and savings levels. We also expect the current supply pipeline to put downward pressure on rent growth in the near-term. Properties in lease-up currently, or scheduled to deliver over the next 12 to 18 months, will likely offer heavy concessions in order to reach stabilization, and those concessions could remain until all of those units get absorbed. While construction delays could help to set a steadier pace of deliveries, this trend will vary widely by market based on which cities considered construction as essential during the past three months. As deliveries slow by the middle of the forecast and the economy recovers, rent levels are expected to rebound by the end of 2022. Therefore, overall effective rent growth is expected to average 2% annually through 2024, 110 basis points shy of the sector's historical average; this is primarily driven by our market calls on large, underperforming markets like New York and Chicago.

As of the first quarter of 2020, the cost of renting versus owning still favored homeownership, despite home prices continuing to appreciate at a faster rate than rents. Through the end of March 2020, U.S. home prices have grown 57.8% cumulatively since 2008, primarily driven by a lack of new housing, especially entry-level homes.[31] The significant year-over-year decline in interest rates continues to ensure that the monthly cost of owning a median-priced home in the U.S. is more affordable than renting an apartment. Additionally, while developers have been mostly building more expensive homes due to high costs of construction, there have been recent signs of those costs possibly waning, which will likely provide a favorable boost to starter-home supply. This already seems to be taking place as demonstrated by single-family starts continuing to climb above their historical average over the past two quarters, the first time they have crossed that threshold since the third quarter of 2007.[32]

[30] CBRE-EA. As of March 2020.
[31] Moody's Analytics. As of June 2020.
[32] Moody's Analytics. As of June 2020.

Despite these positive developments for entry-level buyers, current economic volatility, as well as social distancing requirements on work sites, have disrupted construction timelines and will likely keep the single-family supply pipeline fairly restrained. Furthermore, even as household income growth had improved to make the cost of owning more affordable, its failure to keep pace with home prices (see Exhibit 10) as they surged above pre-financial crisis peaks has not removed the most significant barrier to homeownership: insufficient savings. Despite lower interest rates making homeownership more affordable than it was a year ago, first-time homebuyers still do not have sufficient savings for a down payment while in many cases also paying down student debt; in 2019, 30% of this group used down payment assistance from family and friends, and the median down payment was only 6%.[33] Combined with stricter lending standards due to the recession, these buyers will continue to find it very challenging to qualify for a mortgage. This lack of affordability, combined with limited new construction, should continue to help support apartment demand.

EXHIBIT 10: CUMULATIVE GROWTH OF HOUSEHOLD INCOME AND HOME PRICES BY INVESTABLE MARKET (2008 – Q1 2020)



Source: Moody's Analytics and DWS. Data as of March 2020. Past performance is not indicative of future results.

As we move towards the outer years of the forecast, the sector is well-positioned to bounce back strongly as the sustainable drivers of rental demand remain in place. The demand for rental housing is not only driven by relative affordability, but a more desirable lifestyle choice with convenience and flexibility. Demographic trends were already supportive of rental demand, particular for suburban product (see Exhibit 11); so while homeownership may still be the goal for ageing Millennials, the more affordable option right now is renting garden-style apartments. Headwinds facing first-time homebuyers, as well as demographic trends, continue to especially promote suburban apartment demand in the near- and long-term. Ageing Millennials continue to move out of cities in search of more space to raise young families, while paying down student debt and saving for down payments on homes. This cohort typically wants high-quality housing that maximizes space, offers outdoor living, is located near highly-ranked schools, and provides access to employment centers. Proximity to walkable neighborhoods and a highly-amenitized, mixed-use town center is also important.

[33] National Association of Realtors. As of November 2019.

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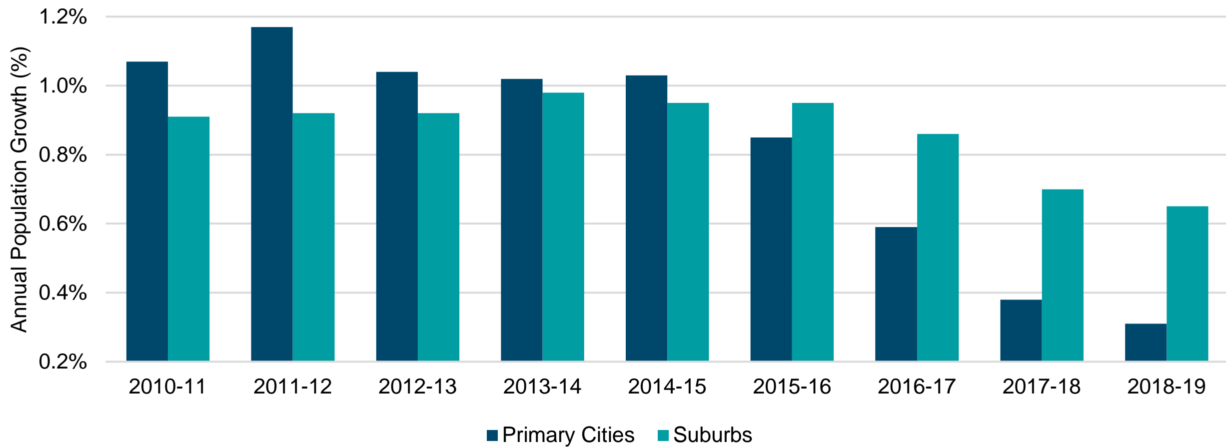
EXHIBIT 11: ANNUAL POPULATION GROWTH FOR PRIMARY CITIES AND SUBURBS OF MAJOR METROPOLITAN AREAS



Source: U.S. Census and Brookings Institute. Data as of June 2020. Past performance is not indicative of future results.

While fundamentals remain weak in many downtown submarkets, investors had not been deterred from seeking trophy properties in prime urban markets until the health pandemic froze activity. Leading up to the recession, the average going-in cap rate for Class-A urban core product remained in the low-4% range, with many prime stabilized assets trading in the high-3% range. Bolstered by positive demographic trends and limited new construction, garden-style product had seen stable rent growth and persistent cap rate compression, with its spread over mid/high-rise cap rates narrowing to just under 45 basis points as of the first quarter of 2020; that is its lowest spread since 2009. Transactions markets remain relatively quiet due to COVID-19 concerns, however debt and equity capital remain abundant, albeit sidelined for now. Post-COVID, investor appetite for the sector's defensive nature is expected to continue unabated, which should result in a very competitive investment landscape. Lower borrowing costs and stronger NOI growth expected coming out of the recession relative to other sectors should make investors willing and able to accept lower total returns for prime assets. Given average apartment cap rates across the quality spectrum have remained relatively stable over the past five years, despite the surge in new supply, it is not difficult to see cap rates holding firm through this difficult time, or even compressing further, especially with apartment cap rate spreads over the 10-Year Treasury rate remaining attractive. Low cap rates, coupled with weak NOI growth in the near-term, will likely keep total returns hovering around 5.5% for Class-A properties in prime urban locations.

Annual NCREIF Property Index (NPI) total returns for the apartment sector equaled 5.4% (trailing four quarters) in the first quarter of 2020 – a decline of 82 basis points from a year earlier.[34] Sector performance continues to be weighed down primarily by large, gateway markets that have seen an abundance of new supply (mainly luxury high-rise product). Western and southeastern metros have been the primary outperformers, fueled by strong economic and demographic drivers: Riverside, Phoenix, Tampa, Orlando, Austin, Denver, and Charlotte all produced total returns of 7% or more over the past year. In contrast, several slower-growth mid-west and northeast markets, such as Chicago, New York, and Philadelphia exhibited total returns of less than 2%. Among apartment property subtypes, garden-style apartments were once again the top performers, returning 7.5% as of the first quarter of 2020. Despite their popularity with investors, high-rise properties continued to lag behind, returning 3.9% over the same time period; this is almost half of the rolling four-quarter performance of garden-style product. High-rise properties are expected to continue to underperform in the near-term as significant supply is delivered to the urban core and de-densification trends continue to emerge.

[34] NCREIF. As of March 2020.

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7.2 Outlook and Strategy

Construction already underway, combined with significant economic volatility, is expected to push vacancy rates higher. New deliveries to the Investable Markets are projected to average around 175,000 units per year in 2020 and 2021, above their long-term average of 122, 000 units per year. Upward pressure on vacancies is expected to cause effective rent growth to weaken in the near-term. However, new supply is expected to recede in the outer years of the forecast, placing fundamentals more in balance. Favorable demographic trends and barriers to homeownership should continue to sustain healthy renter demand over the long term and lead to outperformance relative to other property types.

As the economy recovers, one of those demographic trends that could provide another tailwind for rental demand is young adults still living with their parents coming off the sidelines and forming new rental households. More than 14 million young adults nationwide — or 21.9% of people ages 23 to 37 — live with their parents, up from 12.7% in 2000.[35] This represents a large source of untapped rental demand for current and future housing supply. With two-thirds of this age group living in rentals, they are a dominant force supporting apartment demand, and a job market recovery will likely empower more of them to move out on their own; evidence of this trend can be found with the number of single-person households at a record high, while the number of married households are at a record low.[36]

Given our expectations for volatile rent growth in the near-term, investment strategy should focus on stabilizing cash flow within apartment portfolios; buying modern product with limited CAPEX exposure, and optimally targeting developers with strong track records in a given market. Pre-COVID, large coastal markets were exhibiting decelerating effective rent growth, and the pandemic is only expected to exacerbate that pain. These metros are also some of the largest, and have therefore had an outsized effect on national performance. In the first quarter of 2020, markets like Chicago, New York, and Los Angeles all trailed the U.S. average. If where renters live is not tied to where they work to the degree seen historically, the most expensive areas of the country could lose some of their appeal, especially where density is the highest. Further development could be deterred if eviction moratoriums are extended and rent control legislation gains momentum. Although we believe the prime markets should be viewed as stable long-term performers, elevated pricing and declining rent growth in these locations may continue to constrain total returns in the near-term.

While not immune to near-term volatility, the high-growth Sunbelt and west coast markets, particularly in the suburbs, should continue to outperform over the next several years. Regional metros such as Austin, Raleigh, Nashville, and Phoenix are expected to outperform based on strong economic and demographic drivers. Denver is expected to outperform driven by a robust job market and continued in-migration. Also, given the resilience of its tech-driven economy, especially now, San Francisco and Silicon Valley should both continue their upward growth trajectory. The factors that are driving long-term economic growth – favorable demographics, better workforce quality, lower cost of living, and pro-business climate – are expected to remain in place. These economies are well-diversified, knowledge-based economies with technology drivers in place.

Slowing rent growth and rising vacancy, combined with low yields, could limit the apartment sector's ability to produce outsized total returns in the near-term. However, relative to the other major property types, the apartment sector should recover more quickly given the sustainable demand drivers that remain in place. While certain metros are not considered favorable currently, we should bifurcate expected performance within the Investable Markets between downtown and suburban. Investors will likely continue to outperform the index in inner-ring suburban markets with limited new supply, particularly with assets that are near highly-rated school districts, employment centers, and a well-amenitized town center. Conversely, assets in downtown urban core submarkets will likely continue to underperform the index due to oversupply, low cap rates, and limited NOI growth in the near-term.

[35] Zillow. As of May 2019.
[36] US Census. As of November 2019.

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The central themes that are shaping our apartment strategy include:

- Fundamentals and Demographics Continue to Support a Suburban Strategy: Limited new construction in suburban markets, in-migration of ageing Millennials in search of more space and highly-rated schools, and now due to COVID concerns, a stronger preference for low density product, are all expected to sustain garden-style apartment performance. Over the long-term, barriers to homeownership, the development of more urbanized suburbs, and satellite office access should sustain strong suburban demand and lead to outperformance. While homeownership is still the goal, the relatively more affordable option in the near-term is likely to rent apartments, as student debt and limited savings make it difficult to qualify for a mortgage. To capitalize on these trends, suburban properties should meet very specific investment criteria, foremost being that they should be located in highly-rated school systems, as well as have proximity to employment centers and urban lifestyle amenities.

- Resilient Performance and Density Concerns Keep Target on Student Housing: At Tier 1/Power 5 universities, we expect demand to remain strong for modern, purpose-built properties that are walkable to campus and have bed-bath parity. Barring a second wave of COVID, we expect the majority of universities to resume in-person classes this fall, and that many of the beds that were accommodated on campus last year will be pushed off campus this year (and possibly into the future) due to the de-densification of on-campus residence halls. Pre-COVID, properties located less than one mile from campus demonstrated the strongest pre-leasing, most stable rent growth, and highest occupancy. Now those assets should be best positioned to capture this increased demand and outperform.

- Expect Underperformance in Urban Core to Continue: While construction delays should help many urban markets continue to manage the flow of new Class-A luxury, high-rise product, this product type was already underperforming due to oversupply and 1-2 months of concessions, on average, present as units were being absorbed. Additionally, high-rise product is most often concentrated in densely populated areas that rely on public transit, an amenity that will likely have a lower premium attached to it due to social distancing concerns. Given the trend towards de-densification as a result of COVID-19, demand for high-rise will likely weaken further and therefore continue to underperform. Long-term, high-rise supply is expected to come more into balance with demand. Also, Gen Z is anticipated to backfill Millennials as the dominant renter cohort and we expect them to continue to seek out the live-work-play lifestyle that urban apartments provide them, leading to stronger future performance.

- Flight to Safety Could Lead to Attractive Pricing on Value Add Properties: With a grim economic backdrop in place, the near-term ability to execute a successful renovation strategy to achieve higher yields is challenged. Due to sustained investor demand for Class-B product leading up to the recession, cap rates on these properties greatly compressed. However, given falling NOI expectations, these deals might be attractively priced post-COVID, with the yield premium over Class-A product potentially widening. Investors might look for stabilized assets built coming out of the financial crisis that do not need renovations now, but will provide both stable cash flow in the near-term and upside opportunity long-term; that upside potential is optionality - complete the appropriate renovation as the economy recovers for an acceptable return on cost or sell once capital markets shift back to value-add strategies.

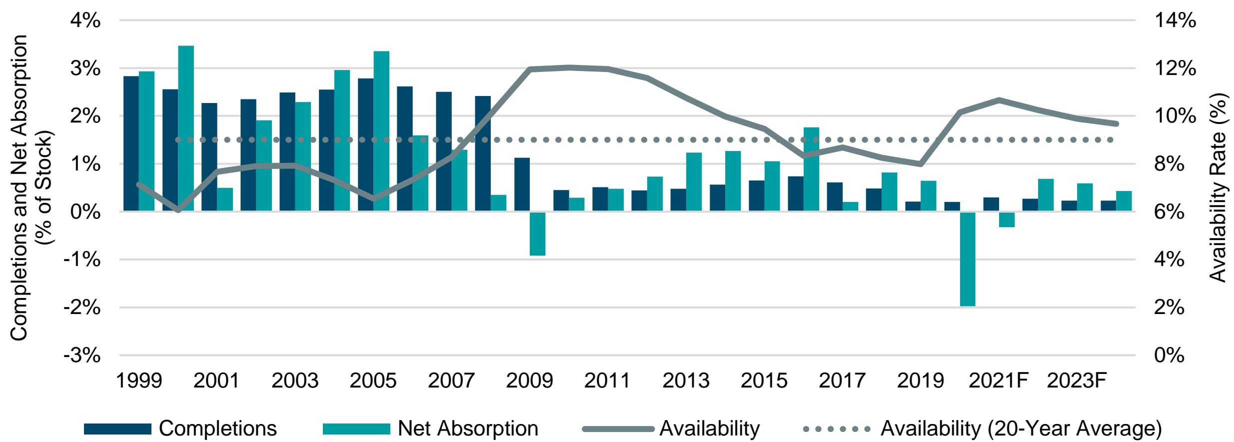
- Take Advantage of Ground-Up Development Opportunities: Apartment projects that break ground in the next 12 to 18 months should deliver into the broader economic recovery and a much more balanced supply-demand environment. With yields remaining low for Class-A apartments, the untrended return on cost for new development should continue to be very attractive relative to stabilized product, with spreads likely between 100-150 basis points on average.

8 / Retail Outlook and Strategy

8.1 Current Conditions

The retail real estate industry was already undergoing a period of transition prior to the COVID-19 pandemic. Despite the headwinds and negative headlines, fundamentals pre-COVID were still relatively healthy. Availability rates for neighborhood and community centers were near cycle lows at 8.1% in the first quarter of 2020. Historically low levels of new supply helped, but net absorption was also positive, with demand driven by grocery, daily-needs, services, health and wellness, fitness and entertainment. Retail rents were still growing at a slow, but steady pace, registering a 1.7% year-over-year increase in the first quarter of 2020.[37]

EXHIBIT 12: RETAIL NET ABSORPTION AND COMPLETIONS AS A PERCENT OF INVENTORY AND AVAILABILITY RATE (1999 – 2024)*



*DWS's Investable Markets
Source: CBRE-EA (history) and DWS (forecast). As of June 2020.
Note: F = forecast. Past performance is not indicative of future results. No assurance can be given that any forecast or target will be achieved.

Beneath the surface, structural forces were reshaping retail well before COVID-19. Changing consumer preferences and an increasing share of in-store retail sales shifting to online platforms were already resulting in bankruptcies and store closures. Releasing larger spaces has been challenging for some time, but concerns have recently materialized in the junior anchor space, even as store prototypes have trended down. As a result, rents during the cycle remained under pressure, and did not reach levels to justify new construction in most markets. Due to the changing landscape, rents likely need a reset as retailers negotiate the size of store fleets, the trajectory of online sales, and the role of their real estate.

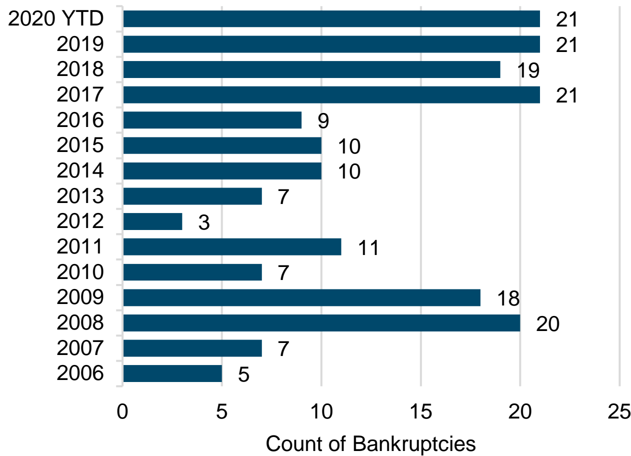
Overall, the implications of stay at home orders, the closure of non-essential retail, and the disruption in spending transcend all retail segments. However, the trends we saw playing out prior to the pandemic are exacerbating the imbalances in the retail space. On-the-cusp retailers struggling with profitability, shrinking market share, and relevance are being tipped over the edge. Unsustainable capital structures and falling profits are now coming home to roost as retailers are confronted with a substantial loss of sales. It is unclear how much liquidity retailers will need to ride out this disruption.

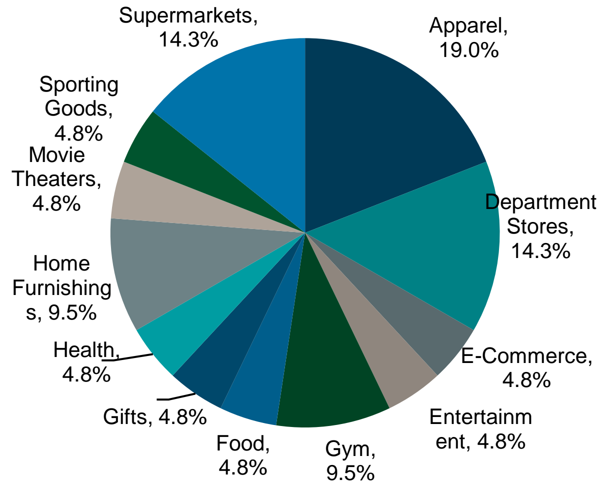
We expect 2020 will be the record year for retail bankruptcies and store closures. By mid-year 2020, 21 major retailers had filed for bankruptcy, matching the total for all of 2019 (see Exhibit 13).[38] This number is dwarfed by the number of regional,

[37] CBRE-EA, Data as of 3/30/20
[38] DWS, Company Filings, Bloomberg data. As of June 2020.

local and family-run small businesses across the U.S. that are on the brink or struggling to re-open while finding a balance between safety, capacity and profitability.

EXHIBIT 13: 2020 MAJOR RETAIL BANKRUPTCIES





Source: DWS, Bloomberg, Company filings and press releases. Data as of June 2020.

According to Coresight Research, U.S. retailers could announce between 20,000 and 25,000 closures in 2020, with 55% to 60% of those situated in malls. This comes off a record year in 2019 when retailers shuttered approximately 9,300 stores.[39] The experiential retail categories – restaurants, fitness, entertainment, and movie theaters – that were driving invigoration of shopping centers have a fundamentally cloudy outlook in re-opening phase(s). It is uncertain how much consumer behavior has changed or when they can return to 'normal operations'. It is clear, however, that prolonged social distancing measures will be a challenge for these categories to operate in the near term. Accordingly, we see distress in this particular subset of retail climbing in 2020 as a result of the pandemic.

[39] Coresight Research. Data as of June

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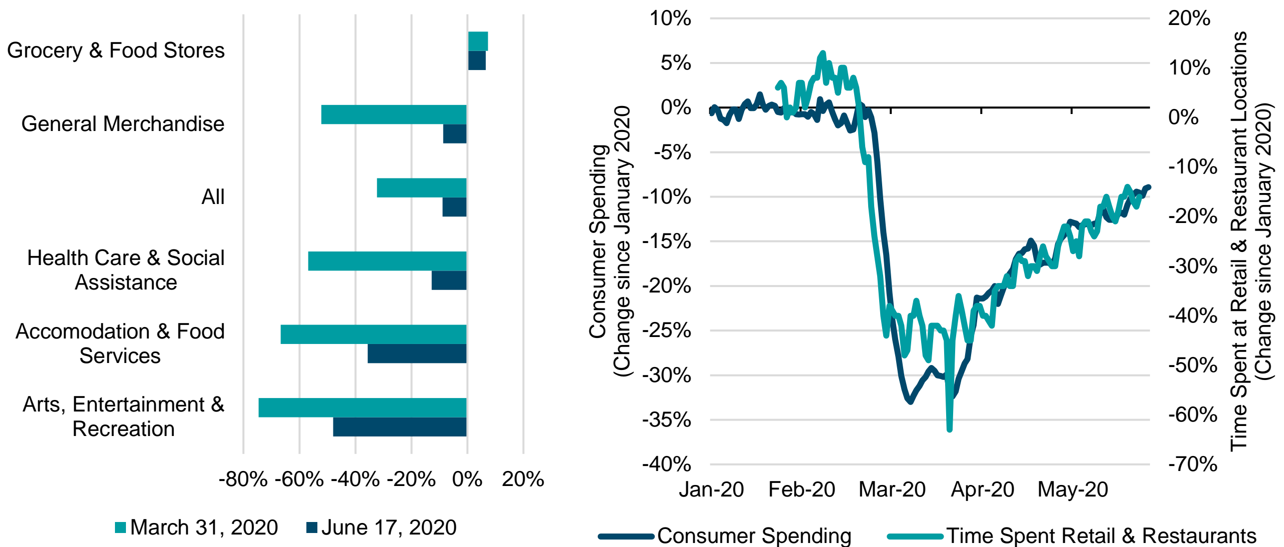
EXHIBIT 14: REOPENING RETAIL, TRACKING THE RECOVERY:

CONSUMER SPENDING BY CATEGORY & RETAIL'S RECOVERY POST LOCKDOWN, % CHANGE SINCE JANUARY 2020



Source: Google, Tracktherecovery.org, Affinity Solutions. As of June 17, 2020.
Note: Past performance is not indicative of future results. No assurance can be given that any forecast or target will be achieved.

8.2 Outlook and Strategy

Navigating the retail landscape has become much more complex and challenging for investors. With limited price discovery, the few trades for high-quality assets have pointed to limited liquidity and potentially lower valuations. In the near term, there may be a risk of further value write-downs by appraisers due to cap rate expansion coupled with lower NOI, which could be more severe for out-of-favor property subtypes such as malls than for dominant grocery-anchored neighborhood centers. That said, the performance of individual centers is expected to be uneven and depend on the quality of the real estate, the asset's position in the market, its tenancy, and its ability to adapt to what's next in retail.

The major structural shifts that were occurring in retail are expected to accelerate going forward, and we recognize that the pandemic poses tremendous challenges across the retail sector. Additionally, prolonged shut-downs and re-starts are a threat as a potential second wave looms. Acquisition criteria remains highly selective and therefore the field of investable assets will narrow. Resilient shopping centers have been able to maintain some traffic due to the presence of necessity-based tenants such as grocery, superstores, pharmacies, liquor stores, and home improvement supplies, and have been able to sustain rent collections in the 50%-70% range.[40] The pandemic is certainly a game changer for retail. While it feels as if the world and consumer behavior have changed dramatically, several aspects of our retail strategy remain valid.

DWS Research's target metro recommendations remain relatively unchanged from previous reports. We continue to have a bias for high-growth regional markets in the southeast and west coast due to favorable economic growth drivers for retail and real estate in general. We continue to believe in the growth of regional markets over the long term: particularly in the southeast and west coast, job, population and economic growth should drive these markets to outperform over the medium term. However, near term employment exposure to areas influenced by travel and tourism could increase near term risks, including

[40] Source: DWS. Data as of June 2020.

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

in the coastal markets in the west and Florida. We remain favorable to technology-driven west coast markets in the Bay Area, Seattle, and Portland and forecast them to outperform their mature east coast counterparts in the Acela Corridor stretching from D.C., Philadelphia, and New York.

We continue to seek positions in top tier submarkets, typically anchored by the best performing and most dominant mall pr shopping center in the region. Our retail strategy follows our office and apartment strategy to the well-amenitized and transit centric suburbs gaining residents and jobs. We continue to target these areas for retail investment, as we seek the balance of strong demographics, population density, and disposable income growth. The impact of social distancing and shoppers avoiding density informs an underweight to urban retail. While we do not predict an outright flight from urban centers to the suburbs, this transition to suburban areas has been underway for years.

The central themes that are shaping our retail strategy include:

Target Dominant Grocery-Anchored Product: We continue to prefer grocery-anchored and necessity based retail for investment. There is no doubt, in our view, that e-grocery and click-and-collect will re-shape the industry. However, there are caveats to how this will play out across geographies and the ability of the dominant grocer in the market to execute online. The most important aspect to this dynamic aside from the rate of customer adoption, truly hinges on a grocer's ability to meet customer expectations and fulfil last-mile profitably on razor thin margins. We believe this property type can survive alongside the growth of e-grocery. In the near term, store disintermediation in this space will be slow, and it will be difficult for most traditional grocers to fully automate orders from a warehouse at a reasonable costs. The grocery store will likely continue to be the most important and last touch point for grocers to connect to customers.

While we expect grocery, pharmacy, and daily needs to remain strong drivers, risks are elevated for small businesses, restaurants, and fitness that fill the remainder of grocery-anchored centers, due to their lack of credit, liquidity, and ability to resume normal operations quickly. Well capitalized retailers will be able to ride out the storm, but the distinctive small businesses that are the lifeblood of these centers are in jeopardy.

Follow the Evolution of Power Centers: For power centers, the term "essential' versus "non-essential" retail will disproportionately impact performance and their ability to adapt going forward. Additionally, the strength of retailer credit, longevity, and ability to compete online will continue to separate the winners and losers in this category. A grocer or daily-needs tenant strengthens the line-up and bolsters traffic. We continue to watch yields for grocery-anchored retail and select power centers, as there may be future opportunities to buy well located, strong assets with credit tenants, and right-sized boxes as investors avoid the sector and sell down allocations to retail carte blanche. We believe there is potential for these types of centers to adapt to omnichannel retail use such as showrooms, micro-distribution or online fulfilment centers, and customer service hubs.

Malls and Fashion Centric Assets Face Significant Repricing: The fall out in the department store apparel sector is going to pose major challenges for malls, lifestyle centers, and high street retail assets. While we believe there is a future for malls and expect the most productive, high-quality assets to survive, they will struggle in the near-term. Repricing will be most severe for lower-quality assets, off main/main locations, and potentially those disproportionately dependent on tourism for sales.

EXHIBIT 15: DWS RETAIL STRATEGY BY SUB-TYPE

STRATEGY	SHORT TERM	LONG TERM	DWS COMMENTARY
Malls	↓	↓	AVOID: Apparel and entertainment-oriented assets most at risk for near-term disruption. Repricing within the asset class is most severe for lower-quality assets.
Grocery-Anchored	↓	↔	Target well-located, dominant centers anchored by strong grocers and in-demand retailers and services. Will remain viable alongside the evolution of e-grocery with the leading grocer and in the right location.
Power	↓	↔	Selective: Opportunities with strong credit tenants, right-sized boxes, and potential for adapted omni-retail uses such as showroom, last-mile distribution, and service hubs.
High Street	↓	↔	AVOID: Rent resets coming. Retailers re-thinking Flagship concepts versus four-wall profitability.

Source: DWS. As of June 2020. Past performance is not indicative of future results.

9 / Office Outlook and Strategy

9.1 Current Conditions

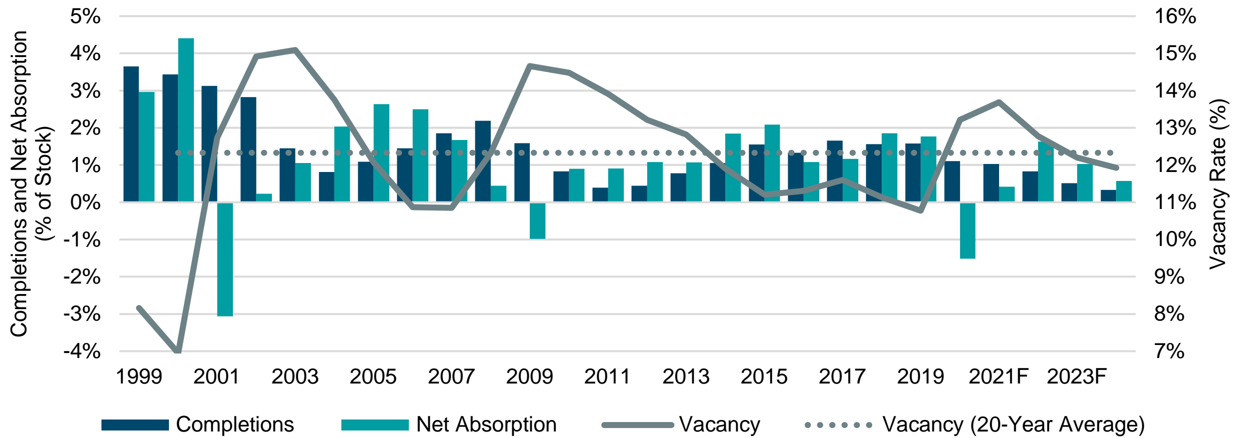
The U.S. office market has remained relatively resilient during the COVID pandemic, though not immune to the economic recession. The U.S. economy lost about four million office-using jobs between the first and second quarters of 2020[41], a large number, yet a fraction of the 41 million jobless claims filed since mid-March 2020[42]. Office-using employment losses are expected to continue in 2020[43] and limit office demand. With a COVID vaccine still many months away, public engagement and the work environment are expected to be drastically different than just a few months ago. Metros with high concentrations of tech and life science (e.g., San Francisco, San Jose, Austin, Seattle, and Boston) will likely perform better than the nation and lead the office-using job recovery over the next five years. Office-using job growth in the large core markets such as New York, Chicago and Washington D.C. is expected to lag behind.

Broadly, the U.S. office sector entered the COVID-19 crisis from a position of strength with low vacancies and balanced new supply. Vacancy rates across DWS's 21 Investable Markets ("Investable Markets")[44] stayed virtually flat compared to their 2019 levels in the first quarter of 2020, averaging more than 150 basis points below their 20-year historical average (see Exhibit 16). Moreover, compared to previous cycles, new construction and net absorption have been in sync since the GFC which contributed to healthy fundamentals and strong late-cycle performance. The total square footage of construction starts across the nation was about 30% lower in 2019 than in the 2006-2007 construction cycle heading into the GFC recession[45]. Markets with high exposure to tech and substantial construction pipelines (e.g., San Francisco, San Jose, Seattle, and Austin) continued to hold some of the lowest office vacancy rates across the nation.

To a large degree, the office sector has been relatively resilient so far. Office rent collections have been healthy – in excess of 90% for April and May[46] – as job losses were the largest in non-office-using occupations. In addition, technology has enabled companies to implement successfully work from home ("WFH") protocols which allowed office tenants to remain productive during the COVID-related lockdown, retain their office footprint and continue to pay rent. However, uncertainty around the duration and severity of both the pandemic and recession are leading to an inability to make short- and long-term space planning decisions. Some tenants are seeking rent relief or deferment due to liquidity issues. As a result, the first quarter of 2020 ended in a much different place than it started for the office market, with most leasing activity on hold and in flux. Leasing activity dropped below 50 million square feet for the first time this cycle (a decrease of more than 30% compared to the first quarter of 2019)[47], with even more acute declines in the core primary markets (e.g., New York, Chicago and Washington D.C.).

[41] Oxford Economics, As of June 2020.
[42] Oxford Economics, As of June 2020.
[43] Moody's Analytics. As of June, 2020.
[44] DWS: Office Investable Markets include 21 major metros in the U.S.
[45] Costar. As of June 2020.
[46] DWS. As of June 2020.
[47] JLL, As of June 2020.

EXHIBIT 16: OFFICE NET ABSORPTION AND COMPLETIONS AS A PERCENT OF INVENTORY AND VACANCY RATE (1999 – 2024)*



Source: CBRE-EA (history) and DWS (forecast). As of June 2020.
Note: F = forecast. Past performance is not indicative of future results. No assurance can be given that any forecast or target will be achieved.

With a weak economic environment expected to persist in the near-term, office demand will likely slow considerably. Net absorption is expected to decrease by almost 40 million square feet (1.4% of stock) across DWS's Investable Markets pushing office vacancy rates higher by the end of 2020. The increase in total vacancy will likely not be as dramatic as during previous recessions thanks to lower vacancies pre-pandemic and construction delays caused by shelter in place orders.

The densification of office space – placing more workers into less space – is expected to pause or reverse course over the near-term as companies strive to comply with CDC distancing guidelines. It is estimated that companies will likely need 20% more space per employee[48] to successfully implement the recommended 6-feet physical distancing between workstations. But, as firms continue to allow employees to work from home to reduce office density and protect employees' health, the de-densification trend will likely not contribute to a meaningful increase in net absorption.

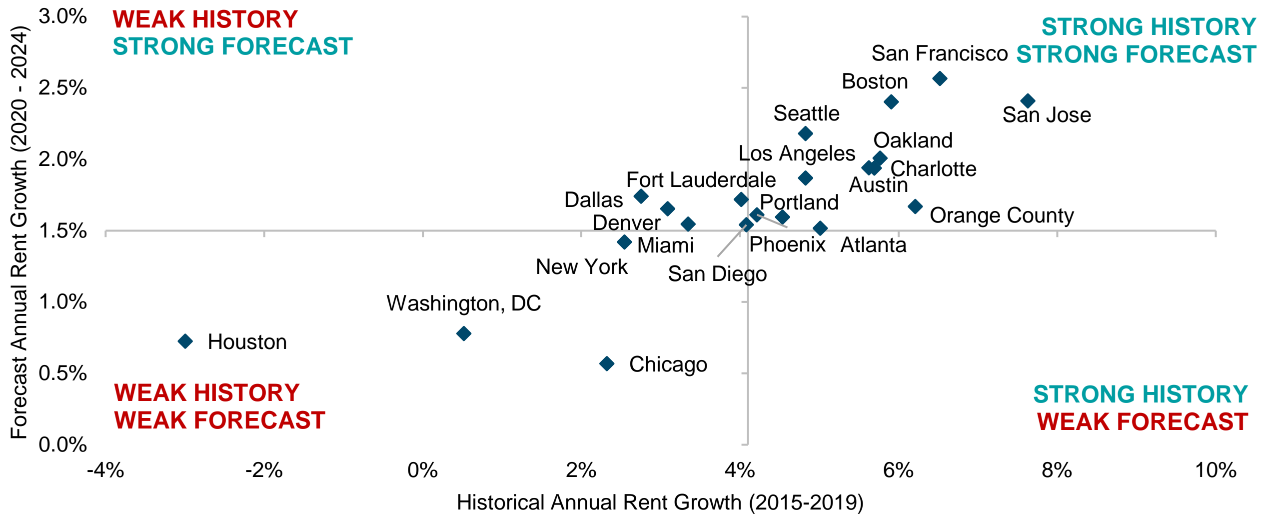
There was an ongoing a debate before the crisis about how well co-working would withstand an economic recession. What was not considered was how co-working would perform in not only a recession, but one that required physical distancing, which is counter to the approach of co-working. Instantly, co-working firms found themselves severely challenged during the COVID outbreak. A combination of stay-at-home orders, concerns surrounding seating density and financial strain led many operators to close locations and furlough staff.[49] Major operators reportedly are asking for discounts of up to 30% on all of their lease agreements, while offering co-working subscribers discounts on long-term agreements.[50] We expect a sharp decrease in co-working demand in 2020 resulting in more consolidations within the industry.

Construction delays are likely in the near-term as several cities have enacted construction bans during the COVID lockdown. Supply is not evenly distributed across metros. Construction is highly concentrated in a few high-growth and tech-oriented markets, notably San Jose, San Francisco, Seattle, Austin, and Charlotte, as well as in large, core markets such as Chicago, Washington D.C. and New York. As we head deeper into an economic downturn, speculative construction is expected to slow further, limiting widespread supply concerns and likely helping vacancy rates gradually recover by the end of the forecast.

[48] SunTrust, As of June 2020.
[49] JLL, As of June 2020.
[50] Costar, As of June 2020

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

EXHIBIT 17: OFFICE RENT GROWTH (ANNUAL, % YEAR-OVER-YEAR)



Source: CBRE-EA (history) and DWS (forecast). As of June 2020. No assurance can be given that any forecast or target will be achieved

The office sector posted robust rent gains relative to other property types over the past year. Going forward, an increase in landlord concessions and rent deferments will likely put pressure on effective rents. We are forecasting negative rent growth through the end of 2021, though far from the much steeper losses seen in both the 2001 and 2008 recessions. Historically, the U.S. office market has seen a roughly 13% drop in asking rents over the course of a 12-quarter correction.

Metros with an expanding tech and life science presence and strong population growth are expected to outperform over the next five years (see Exhibit 17). Those include mature markets in the San Francisco, San Jose, Seattle, and Boston as well as emerging markets such as Austin, Charlotte and Atlanta. New York, Washington D.C. and Chicago are expected to produce weaker rent growth due to higher vacancy levels, active construction pipelines, and a weak demand outlook.

9.2 Outlook and Strategy

The beginning of 2020 put an end to one of the longest expansions in recent history for the office sector. Although office fundamentals were healthy prior to COVID, the recession will weaken office demand. Tenants and their employees will likely remain reluctant to return to the traditional office space format. Companies may delay real estate decisions and wait to see how the economy emerges from the COVID crisis.

Many corporations have successfully adopted the work from home model and are planning to allow workers to work remotely for an extended period of time. Yet not much consensus exists on what office conditions will look like in a post-COVID world[51]. Most experts agree that working from home will increase and office attendance will fall. How much is still in flux. Workers may adopt flexible schedules, while maintaining in-person collaboration with teams for at least part of the week, keeping productivity as high as possible and giving time and space for thorough cleanings and social distancing.[52] Yet the long trend towards open floor plans and creative office space has led to crowding in the workplace. Over the past decade, we have seen office density rise substantially with the average space used per employee declining by almost 10% from 2009 to 2019.[53] As a result, most

[51] Gartner CFO Survey Costar. As of June 2020.
[52] Costar. As of June 2020.
[53] CBRE-EA, BLS, DWS. As of June 2020.

office space is not configured to facilitate social and physical distancing imposed by CDC. We expect the office densification trends to pause or even reverse.

Co-working demand will likely be limited for the foreseeable future. More contractions among co-working operators are probable as well as some consolidation in the sector. Long term, however, there is a role for shared work space in the real estate industry. There are small companies that like the flexibility and the speed to market of the product and some enterprise customers will continue to want to lease a small percentage of their office space on a short-term basis.[54] Speed, flexibility and low initial capital outlay will remain major drivers of co-working office demand.[55]

Near-term new supply is expected to remain elevated in select tech-oriented markets (Austin, San Jose and San Francisco) and large core markets (New York, Chicago and Washington D.C.). The impact of active development and the recession is expected to cause overall vacancies to rise. The increase in cap-ex due to COVID and relatively low yields across U.S. core markets and major CBDs are likely to restrict return performance for the sector.

Going forward, investors will likely remain cautious and selective as it relates to new investment opportunities. Stable rent roll and limited tenant risk are recommended, as well as higher quality assets with long-term leases and low near-term capital requirements. There is no question, in our view, thst the sector will likely go through near-term disruption. Over the long term, the utilization of office space will adapt to tenant preferences as it has done historically. Workers are social beings that thrive in a curated environment that offers collaboration, enhances productivity, fosters creativity and promotes company culture. Personal homes will not replicate that.

The central themes that are shaping our office strategy include:

- High-Quality/Flexible Office Product: Given the public health nature of the current crisis, we expect the trend toward a preference for high-quality office space to accelerate. Tenants will be required to implement changes to their office space to create a safer, healthier work environments in the post-COVID era. As companies conceive plans to return to the office, they are already recalibrating their office space given new design and infrastructure concerns. Some of these changes include the reconfiguration of common areas to avoid crowding, design upgrades including touchless entry for doors and elevators, installation of thermal scanners to take employee temperatures, and addition of modern heating and air conditioning systems that avoid recirculation of air, as well as air purifiers. In PwC's recent COVID CFO Pulse Survey, 73% of respondents indicated that they would reconfigure work areas to promote health and safety.[56] Older, lower-quality space is more at risk in the current environment, given the higher cost of upgrading for health and safety standards.[57]

- Prime Suburban Office Nodes: Locations in established suburban districts with urban type amenities will likely gain in popularity due to lower density and access to private transportation options (ride sharing operators & personal cars). There is continuous evidence that Millennials are making lifestyle changes and migrating out of dense CBDs to more family friendly suburbs. This trend was happening before COVID and the pandemic further reinforced it. These select suburbs include locations with ample transit connections, vibrant neighborhoods offering a wide range of amenities, major employment centers, and proximity to concentrations of highly skilled workers. Examples include: West Side of Los Angeles, Bellevue in Seattle, Northwest in Austin, Watertown & Waltham in Boston, Northern Virginia in Washington D.C., and select suburbs of San Jose.

- Knowledge-Based and Innovation Metros: Life sciences, technology, and other innovative industries are long-term growth drivers for the U.S. economy, even more so during the COVID crisis. They are also a major force in the office sector. Strong educational institutions are vital to fostering innovative ecosystems that will attract talent, jobs and office demand. We believe that markets that boast global connectivity, a well-educated workforce, and an appeal to knowledge workers will perform well over the foreseeable future. Examples include Boston, Seattle, the San Francisco Bay Area, and Austin.

[54] Boston Properties, As of June 2020.
[55] CBRE. As of June 2020.
[56] PwC, As of June 2020.
[57] Costar, As of June 2020.

New York and Chicago may also benefit from these dynamics, particularly in certain submarkets, even as they contend with other challenges (e.g., a lagging financial sector and fiscal pressures).

- Life Science and Medical Office: Life science and medical office could offer stability and diversification to a traditional office portfolio as healthcare services are in demand irrespective of the economic cycle.[58] While the COVID crisis could cause some short-term disruption to the life science real estate sector, the COVID pandemic will only fuel future demand for life science research and development—and the space that houses it. Innovative sectors such as cell and gene therapies, artificial intelligence, and ancestry and genetic testing are all forecast to grow in the next five years, some as much as 37%, driving demand for R&D lab space, diagnostic centers and healthcare facilities.[59] Moreover, the growing need for medical services at all ages and among aging baby boomers is expected to continue to generate demand for medical office. Our strategy calls for investments in medical office facilities proximate to hospitals and in suburban areas or medical corridors where care can be delivered in an outpatient facility close to a large patient population. These are medical office facilities that offer specialized services (e.g., dialysis centers, ambulatory surgery centers, etc.).

[58] NCREIF, MSCI and DWS. As of June 2020.
[59] Cushman and Wakefield. As of June 2020

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Appendix 1: U.S. House Portfolio

The DWS House Portfolio represents our opinion of the allocation by property sector for core portfolios in the United States which we believe would outperform the NFI-ODCE. We develop the House Portfolio as an unlevered portfolio of properties without regard to tax consequences. The House Portfolio is formulated using both quantitative and qualitative modeling, integrated with our House View. The resulting weights, we believe, aid in providing long-term risk-adjusted outperformance to our portfolios versus the market as a whole and against relevant benchmarks and indices. The analysis focuses on the four major property sectors and excludes hotels. The following table summarizes our conclusions on weightings in comparison with the NFI-ODCE. The analysis results in an active overweight to the industrial sector, a market weight to the apartment and retail sectors, and an underweight to the office sector.

Sector	NPI Weights	ODCE Weights	Research Perspective	House Portfolio	Active Bet (vs ODCE)	Range
Apartment	26%	27%	– Risk from higher unemployment. – Moderately defensive as households defer home buying. – Shortage of affordable housing. – Preference for garden-style product.	30%	+3%	25% - 35%
Industrial	18%	19%	– Risk to properties occupied by vulnerable retailers. – Booming e-commerce supporting demand. – Efforts to secure supply chains may drive further inventory accumulation. – Smaller and mid-sized warehouses poised to outperform.	31%	+12%	26% - 36%
Office	35%	34%	– Rent collections healthy despite work-from-home directives. – Supply generally under control outside a few cities. – Bankruptcies may push occupancies and rents lower later this year. – Recovery expected to be slow, as in past cycles. – Risk around future office needs (working from home vs. de-densification)	27%	(7%)	22% - 32%
Retail	20%	16%	– Bankruptcies among mall-based department and apparel stores. – Necessities (supermarkets, pharmacies, salons) cyclically defensive and grow with population. – New supply is largely nonexistent. – Favor strip centers with good demographics and relative e-commerce immunity (services, in-store pickup).	12%	(4%)	7% - 17%
Other	0%	4%	N/A	0%	(4%)	0%

(1) NPI weights calculated as gross real estate value excluding ownership share. ODCE weights calculated as gross real estate value at ownership share.
Sources: NCREIF and DWS. As of July 2020.

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Appendix 2: Real Estate Target Markets

Investible Metros: We screened top U.S. metros, which represent 86% of the NCREIF Property Index, and identified the investment markets for each property sector that we believe have the best prospects during the market cycle or a portion of it. This metro selection is based on property market size, liquidity, growth characteristics, income, historical returns and other factors indicative of future performance. The list of these metros remains generally static, although some metros may be added or subtracted over time due to structural market changes.

Target Investible Metros: These are a subset of the universe of investible metros and include markets that we expect to outperform or market perform during the next three to five years.

INVESTIBLE AND TARGET MARKETS

↑ Overweight ↓ Underweight ↔ Market Weight

Market	Apartments	Industrial	Office	Retail
Atlanta	↔	↓	↑	↔
Austin	↑	↔	↑	↑
Baltimore		↓		
Boston	↔		↑	↔
Charlotte	↔	↔	↑	↑
Chicago	↓	↓	↓	↓
Dallas	↓	↔	↔	↔
Denver	↑	↔	↔	↔
Fort Lauderdale	↔	↓	↔	↔
Houston	↔	↓	↓	↔
Los Angeles	↔	↔	↔	↔
Miami	↓	↔	↔	↔
Minneapolis	↔			↓
Nashville	↑			↑
New York	↓	↑	↓	↓
Oakland / East Bay	↔	↑	↔	↔
Orange County	↔	↔	↔	↔
Orlando	↑	↔		↑
Philadelphia / Central PA	↓	↔		↓
Phoenix	↑	↔	↔	↓
Portland	↓	↑	↔	↑
Raleigh	↑			↑
Riverside	↔	↔		↔
San Diego	↑	↔	↔	↔
San Francisco	↔	↑	↑	↔
San Jose	↔	↑	↑	↔
Seattle	↔	↑	↑	↑
Tampa	↑			↑
Washington DC	↔	↑	↓	↔
West Palm Beach	↑			↔

Source: DWS As of July 2020.
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Appendix 3: Performance over the past 5 years (12-month periods)

	3/19-3/20	3/18–3/19	3/17–3/18	3/16–3/17	3/15–3/16
NCREIF Property Index (NPI)	5.3%	6.8%	7.1%	7.3%	11.8%
NPI-Apartment	5.1%	5.9%	6.4%	6.7%	10.9%
NPI-Industrial	12.9%	14.0%	13.5%	12.2%	14.3%
NPI-Office	6.2%	6.7%	6.6%	5.7%	10.8%
NPI-Retail	-1.9%	3.2%	4.8%	7.6%	13.1%
NPI-Apartment: High-Rise	3.9%	4.6%	4.8%	5.6%	9.3%
NPI-Apartment: Low-Rise	5.9%	6.0%	7.0%	7.2%	11.6%
NPI-Apartment: Garden	7.5%	8.6%	9.3%	8.8%	13.9%
NPI-Office: CBD	5.4%	6.1%	6.2%	5.7%	11.0%
NPI-Office: Suburban	7.4%	7.4%	7.2%	5.8%	10.5%
NPI-Retail: Malls	-3.9%	2.1%	4.1%	7.8%	13.3%
NPI-Retail: Power	-0.5%	4.1%	4.5%	6.8%	11.1%
NPI-Retail: Neighborhood & Community (N&C)	2.2%	4.7%	6.1%	8.1%	13.6%
	6/19-6/20	**6/18-6/19**	**6/17-6/18**	**6/16-6/17**	**6/15-6/16**
S&P 500 Price Return	5.4%	8.2%	12.2%	15.5%	1.7%
NAREIT All Equity Price Return	-9.9%	8.6%	0.8%	-3.5%	19.0%

Sources: NCREIF, Giliberto-Levy, S&P Global, NAREIT and DWS. As of June 2020. Latest data available.

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_Adverse changes in law and regulation including environmental laws and regulations, zoning laws and other governmental rules and fiscal policies;
_Environmental claims arising in respect of real estate acquired with undisclosed or unknown environmental problems or as to which inadequate reserves have been established;
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