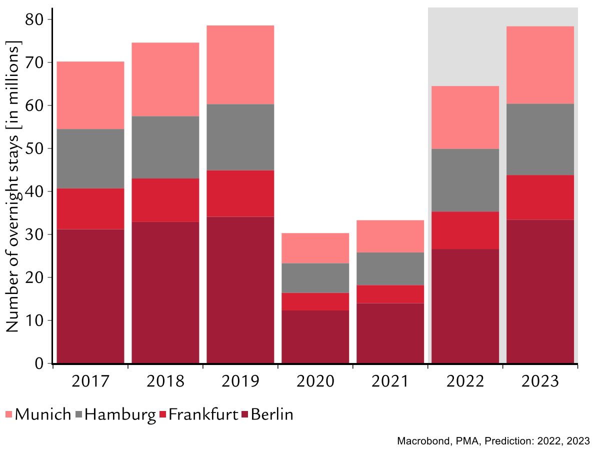
Real Estate House View
Germany

First half of 2023

Key takeaways

- **Market fundamentals intact:** Demand for modern rental space remains unchanged in all real estate sectors, irrespective of temporary economic or geopolitical influences.
- **Rents under upward pressure:** The shortage of living space and modern office space is creating further rental growth potential. However, market differentiation is increasing: low-quality property and decentralised locations are seeing a fall in demand and rental income.
- **Cash flows as performance drivers:** Growth on the rental markets is becoming a key driver of real estate performance.
- **Think of real estate investments over the long term:** The economy, interest rate environment and geopolitical uncertainties are currently weighing on the investment markets. High-quality real estate will more than offset the temporary decline in prices and values through rental growth in the medium term.
- **The importance of asset management continues to grow:** Long-term investment success requires active asset management and (local) market expertise in order to professionally implement the real estate requirements resulting from aspects such as the maintenance of a stable, diversified tenant mix or construction-related ESG issues.

Chart in focus



The tourism industry is continuing to recover: In 2022, the number of overnight stays in Germany increased by 45% compared to the previous year, but was 9% below the level of 2019. The number of foreign guests has more than doubled, although there is still a lot of potential (–24% compared to 2019). As the summer months were already able to pick up from pre-pandemic times, forecasts that the hotel market will be able to weather the slump of recent years in terms of overnight stays in 2023 are not excessively bold. However, cost pressures and price-sensitive customers are hampering the sector and are favouring financially strong operating companies.

Germany's economic data was mixed at the beginning of 2023. Of the major Eurozone countries, Germany is likely to experience the sharpest decline in growth in the first quarter. On an annual average, real gross domestic product will grow by just 0.3%. However, this will not lead to a sharp rise in the unemployment rate. According to surveys by the European Commission, German companies are the most affected by the shortage of skilled workers in Europe and expect this to worsen in the coming months. They are therefore likely to be cautious with regard to redundancies. Inflation rates are expected to fall below 4% over the course of the year, and we anticipate an annual average inflation rate of 5.8% for 2023. However, rates below 2% are not to be expected again until 2024.

Modern offices still in demand

Demand for space in 2022 emphasises the current and future preference for office use: high-quality office space in a central location that offers employees an attractive working environment while meeting ESG criteria. Around 70% of take-up in the top seven markets met these criteria last year. Their low availability – and new builds are not getting any cheaper – is causing rents to rise, even if momentum is set to slow slightly (+7% in the top seven in 2022). On the other hand, low-quality properties are finding it increasingly difficult to find tenants, with corresponding consequences for vacancies and rents.

Housing shortage is worsening

Germany is growing: In the course of 2022, the population increased by at least 1.1 million people due to strong immigration, mainly from Ukraine. Metropolitan regions in particular are experiencing rising numbers of residents and households, and are experiencing insufficient housing – with little prospect of more new construction. Rents for new letting already increased significantly in 2022: Quoted rents rose by 5.7% on a national average compared to the previous year (2021: 4.6%). The imbalance between supply and demand is creating the basis for significant growth in market rents over the long term, which are set to rise by around 5% in major cities in 2023/24. Restrictions remain: Some tenants' budgets are burdened by high ancillary costs, regulations set local limits and could be tightened further.

Stable food retailing

Investors have been focusing on retail formats for food and everyday goods for many years. Low fluctuations in customer demand, low online competition and tenants with good credit ratings underlie this approach. In times of declining purchasing power, the propensity to consume decreases, especially in the non-food segment, and cost awareness also increases for food, although this does not affect the structural factors. Food stores and retail parks overall are less susceptible to crises, while the transformation of high streets and shopping centres is continuing.

Supply chains need logistics

The logistics market in Germany is characterised by a lack of space. Companies are broadening their supply chains and need more modern space for warehouses and production. In addition, e-commerce will pick up again in the medium term and generate additional demand. Due to a lack of land, there is little scope for construction in conurbations. This means that completions are concentrated in less attractive locations, and that prime rents in the top seven regions rose by 8% on average in 2022 according to bulwiengesa. Rental growth of 3-4% is expected in 2023/24 due to the scarcity of space.

Consider investments fundamentally

Whether increasing demand for modern offices, logistics buildings or apartments – the long-term fundamental trends form the basis for institutional real estate investments irrespective of the short-term effects of the economy or capital markets. Market rental growth and indexations will lead to rising cash flows. The market is currently subdued, it is being explored, and individual opportunities are being exploited. If the interest rate environment improves as anticipated in 2023, more transactions are to be expected at the end of the year, as well as the start of a recovery in prices.

Chart 1: Office take-up and rental trend in the top seven markets

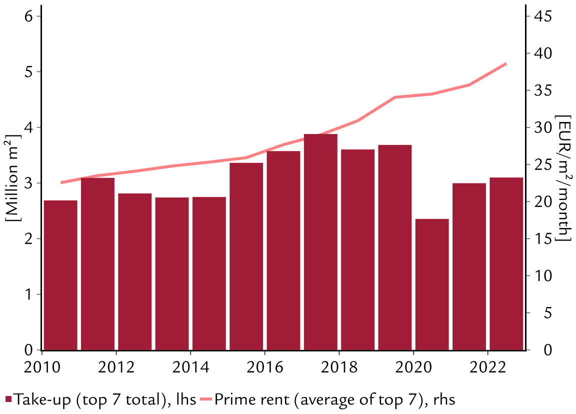
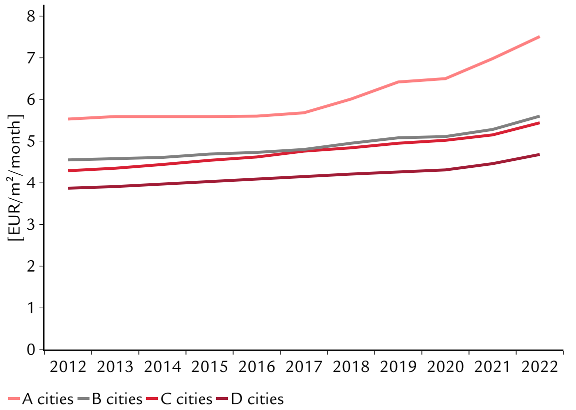


Chart 2: Prime rent for logistics/storage space



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