Investment Market Overview

Germany | 3rd quarter 2020

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Cautious optimism returns

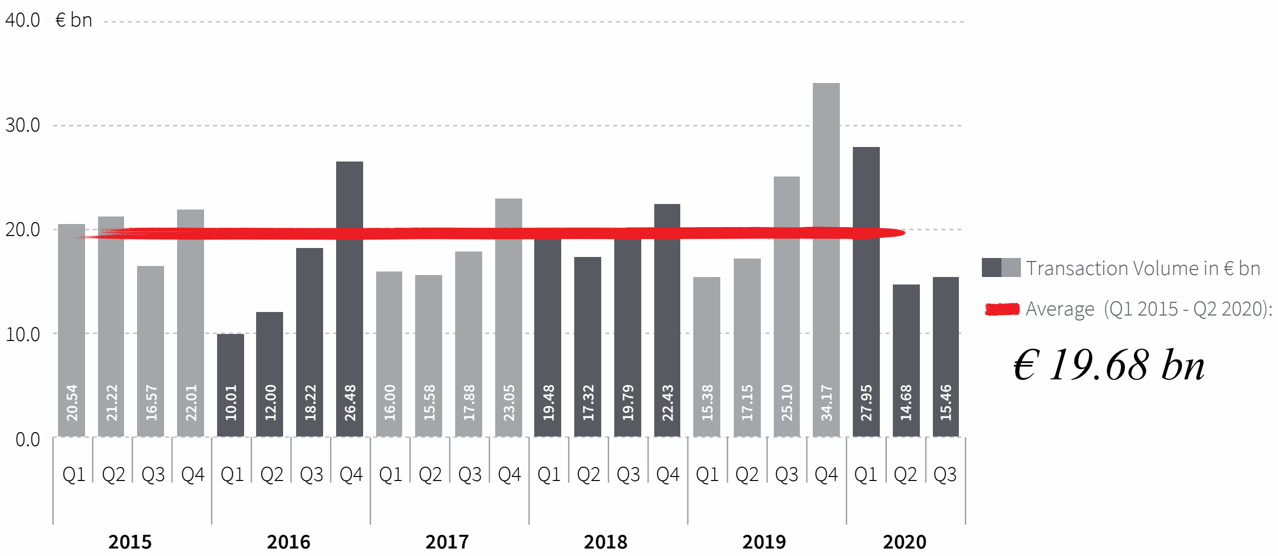
As infection rates fell during the summer months, confidence also slowly returned to the financial and capital markets. However, it is still too early to talk about a return to normality. Rising or stabilising share prices and the low interest rates that have been firmly in place for years already applied before the arrival of Covid-19. In addition to the massive amount of capital liquidity, there has also been a selective easing of travel restrictions in the last three months, which has made it easier for foreign investors to view properties in person — an essential prerequisite for the successful conclusion of transactions.

With beginning of the year 2019 JLL Research modified its calculation for transaction data. The total transaction volume includes both, pure commercial properties but also our new asset class Living which includes residential properties (multi-family properties and portfolios with more than 10 units), student housing, micro living and Elderly Care Homes.

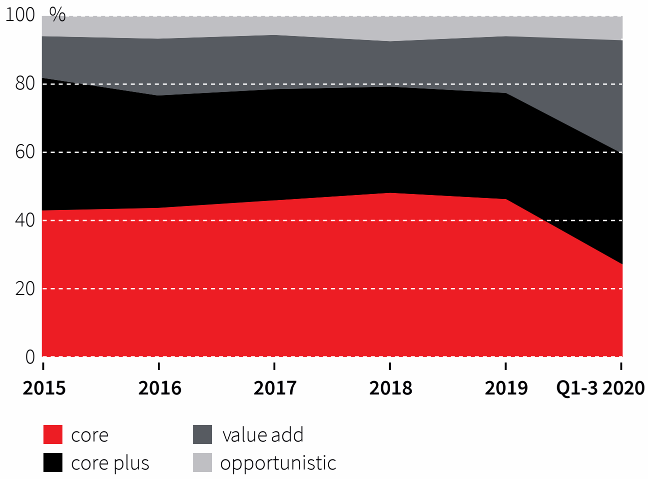
But what will autumn bring? Is the dreaded second wave on its way, or are we already in the middle of it? Can Germany avoid a second wave, or will we see a third or even fourth wave? These are all unresolved questions on which the further recovery of the economy and the duration of the recession depend. As long as there is no vaccine, all players will have to live with a maximum level of uncertainty. Can we get used to this uncertainty, and if so, what are the consequences?

We can at least look at a few fundamental indicators. These include the government's economic support measures, developments in unemployment and corporate insolvencies

Transaction Volume Germany



Transaction Volume by Risk Profile
of the Investments



and, last but not least, the financing and refinancing activities of the banks. This also makes clear that in addition to liquidity, growth and innovation, crisis management by governments and authorities is more than ever becoming an investment criterion for investors. This shows how trust and stability — two unshakable principles for investment — can be created in a sound and sustainable way. And Germany seems to be well positioned in this regard. In addition to the confidence and trust in the political leadership of the country, it remains the case that there is still a lack of alternative investment options.

In the next four years, German government bonds with a total volume of more than €900 billion will expire. This capital has to be reinvested and it seems only logical that the 'alternative assets' will benefit. As well as infrastructure and energy facilities, real estate will also continue to expand its share of institutional investor portfolios. After all, the yield difference between a prime office yield and a 10-year government bond is currently around 300 basis points.

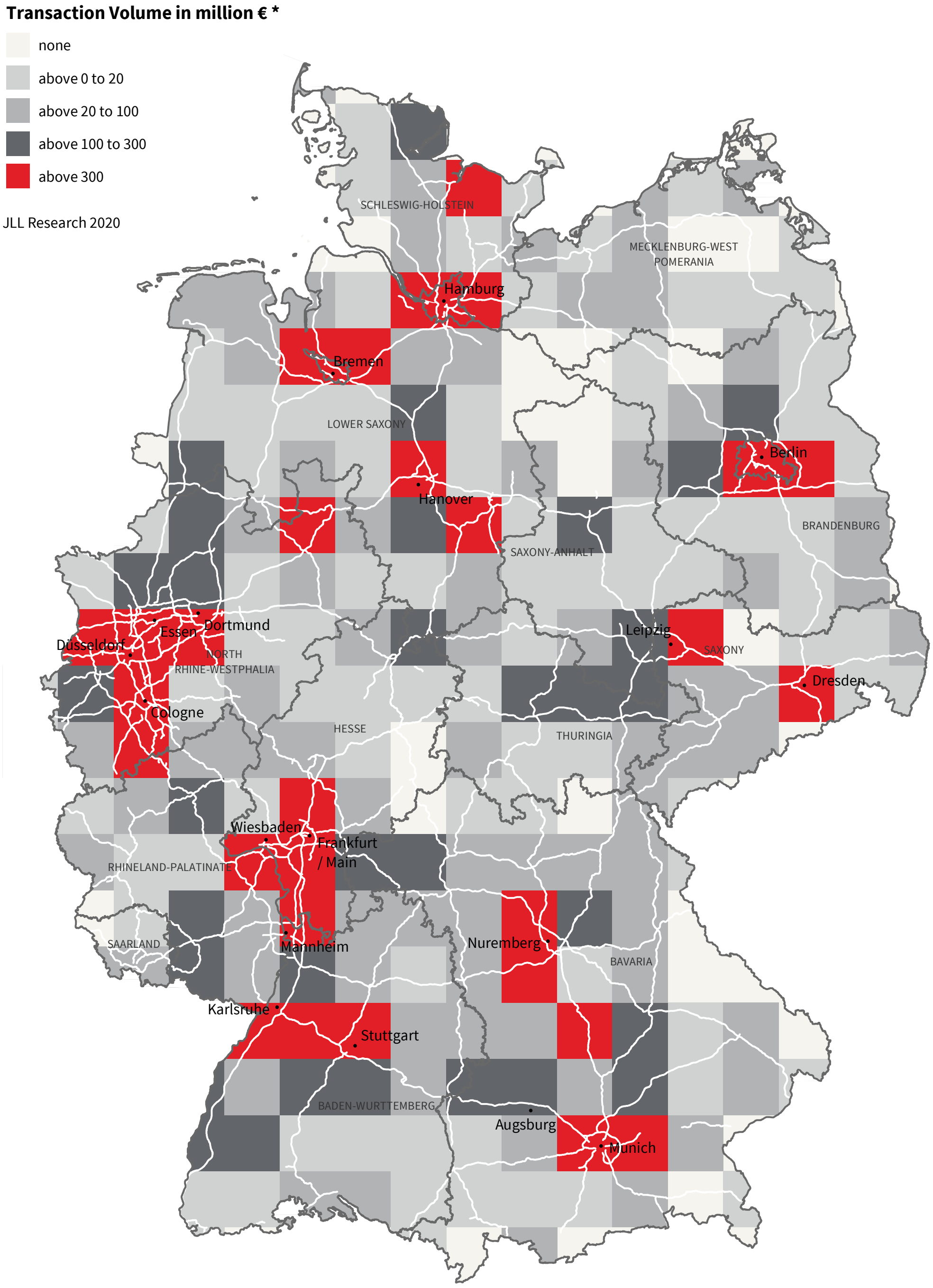
Transaction volume increases again in a quarterly comparison

The property investment market exceeded expectations in the first three quarters of the year with a total transaction volume of about €58 billion (including the Living segment), which was also slightly above the previous year's level. This result is testament to the strength of the Germany property market and its importance for national and international investors. A quick glance at the number of transactions also shows that this increase was not only owing to larger volumes. As in the previous year, around 1,500 single-asset and portfolio transactions were registered between January and September 2020.

It comes as little surprise that there is a sharp divide between the first three months of the year (48% of the transaction volume) and the two subsequent quarters. Nevertheless, the transaction volume still increased slightly in the third quarter to almost €15.5 billion (Q2: €14.7 billion). We are optimistic that this development is sustainable. Discussions with investors suggest that the year will end on a high note. We are increasing our annual forecast to €75 billion, and an even higher result cannot be ruled out.

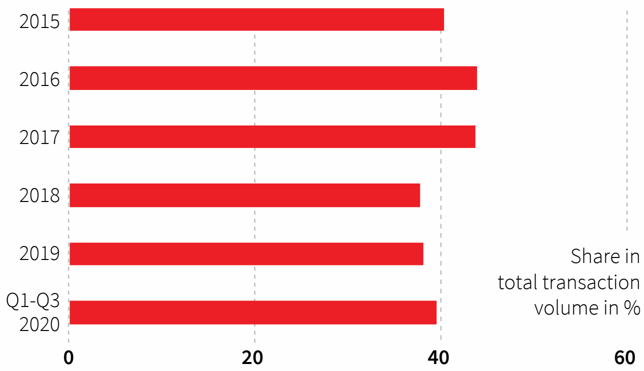
Solid investment products are sought after by both investors and the financing banks. Numerous institutional and private investors are looking for attractive investment opportunities and, as is often the case in times of crisis, demand is increasingly focused on the core segment, especially on products with long-term rental agreements and with public sector tenants. We still do not expect a price discount for these properties. On the other hand, the financing process is more difficult for existing properties with vacancies, or for project developments where pre-letting targets are not achieved. This is especially true for office properties. Here, user preferences for greater flexibility and shorter lease terms are at odds with the requirement of developers and financers for stable and long-term rental income.

Transaction Volume Commercial Real Estate Q4 2019 – Q3 2020



* 2019 Q4 - 2020 Q3, aggregated in 40 x 40 km grids,
nationwide portfolio transactions are disregarded

Purchases of foreign investors



Living is in the lead – logistics properties attract increasing demand …

At the end of the third quarter, the Living asset class remained in first place. A total of around €19 billion was invested here, and the biggest deal that took place between July and the end of September falls within this sector: the acquisition of a portfolio of around 4,000 residential units in Berlin by the Swedish Heimstaden group. The Living segment's share of the total volume fell slightly to 33% compared to the first half of the year, which is partly owing to the fact that other asset classes have gained some ground.

Logistics properties, which registered a further increase of 20% compared to the previous quarter, now account for 10% of the total transaction volume. Five transactions alone, each worth over €100 million, contributed to this result. Properties used for logistics purposes can rightly be called an 'investors' darling' right now. The trend towards online shopping has become more firmly established, and requires increasingly differentiated supply chains and a bigger network of delivery and distribution centres. One of the largest deals of the quarter involved the acquisition of a 50% stake in a new logistics and industrial park in the Munich area by Allianz, at over €250 million.

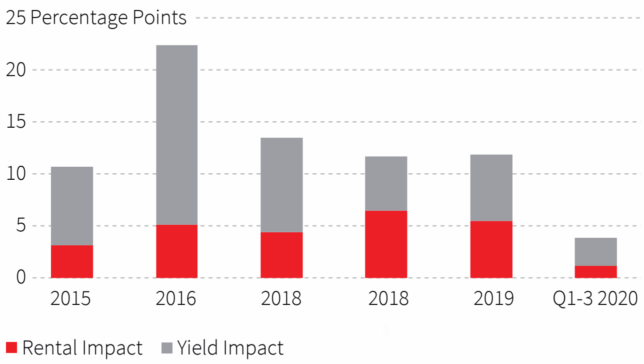
… but what about the office sector with its widely discussed and controversial issues?

You could almost say that investor trust in this asset class is unshakable – at least based on the first three quarters of the current year, with quarterly transaction volumes ranging from €4.5 billion to €4.9 billion. The total office transaction volume amounted to €14.2 billion for the first nine months of this year, although this represents a significant decrease compared to the previous year (around €21 billion). This is not just owing to transactions from the period before coronavirus but also to – sometimes larger — transactions that were postponed during the crisis and have now been completed. These include the portfolio sale of six office properties in Düsseldorf and Berlin for around €400 million. Banks, too, also still seem to have confidence in the office segment, which was at least indicated by the expectations of financers surveyed for the German Real Estate Financing Index (DIFI). For banks as well as for investors, the creditworthiness of office users plays an essential role and, despite all the adversities, these are still rated as comparatively good.

Retail property was at least able to maintain its relative share, which comes as good news in view of the continuing lack of positive momentum in this sector. A total of almost €8 billion euros was invested in German retail properties in the first nine months. Although the occasional transaction again involved shopping centres, the vast majority (€4.2 billion) related to specialist retailers, retail parks, supermarkets and discount stores.

The situation remains difficult in the hotel segment, which accounted for just over 2% of the total transaction volume in the nine-month period. Operators and investors were overjoyed about the recovery in June, with increasing business travel and tourism and the re-opening of hotels, but this proved to be short-lived. As the number of infected people began to climb again in almost all European countries, occupancy rates also fell again immediately. Hopes of a quick return to old travel habits have already faded.

Impact of change in Rents and Yields on Office Capital Value Growth



Aggregated Numbers for Berlin, Düsseldorf, Frankfurt, Hamburg, Cologne, Munich and Stuttgart without combinatory effects

Transaction volume falls in the Big 7; only Hamburg is up

The Big 7 (Berlin, Düsseldorf, Frankfurt, Hamburg, Munich, Cologne and Stuttgart) accounted for an aggregate transaction volume of almost €27 billion. This represents a 46% share of the total German transaction volume and is 17% lower compared to the previous year. Hamburg remains the only one of the seven strongholds to produce a positive result compared to the previous year. Around €4.9 billion was invested in the Hanseatic city, which is 29% more than in 2019. Düsseldorf registered a similar volume to the previous year, while in the other markets the transaction volumes fell by between 15% in Munich and 48% in Stuttgart.

Interest in property outside the established strongholds has continued to rise. From the first quarter to the end of the third quarter, more than €31 billion was invested in these areas (Q1-Q3 2019: €25.6 billion). In addition to the regional distribution of properties in traded portfolios, in-

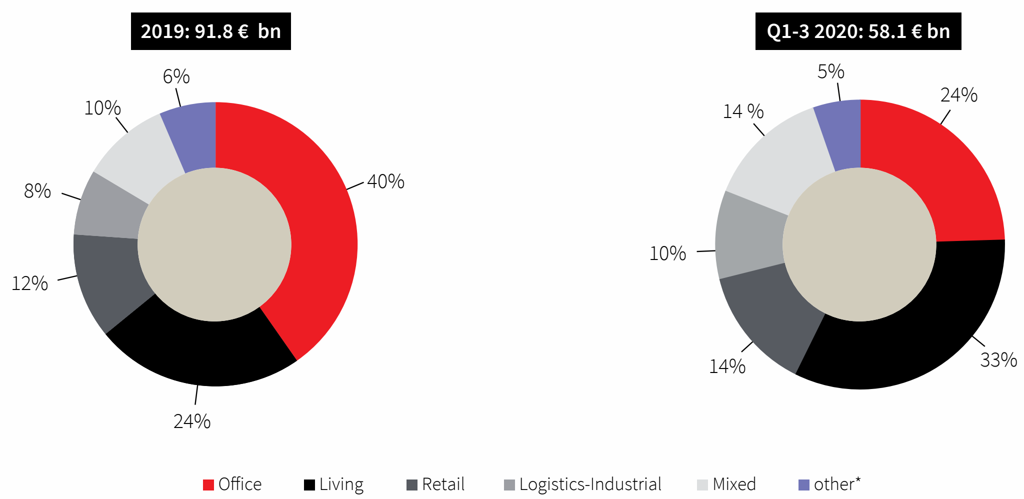
Transaction volume Big 7 (€ mn)

	Q1-Q3 2019	Q1-Q3 2020	%
Berlin	11,790	8,320	-29
Düsseldorf	2,590	2,600	0
Frankfurt/M	5,580	4,650	-17
Hamburg	3,780	4,890	29
Cologne	1,600	1,010	-37
Munich	5,140	4,360	-15
Stuttgart	1,500	780	-48
Total	31,980	26,610	-17

Transaction volume Germany (€ mn)

	Q1-3 2019	Q1-3 2020	%
Single assets	34,500	27,200	-21
Portfolios	23,100	30,900	34
Total	57,600	58,100	1

Transaction Volume by Main Asset Class



* Hotels, Sites, Special Properties; Status: October 2020; Source: JLL

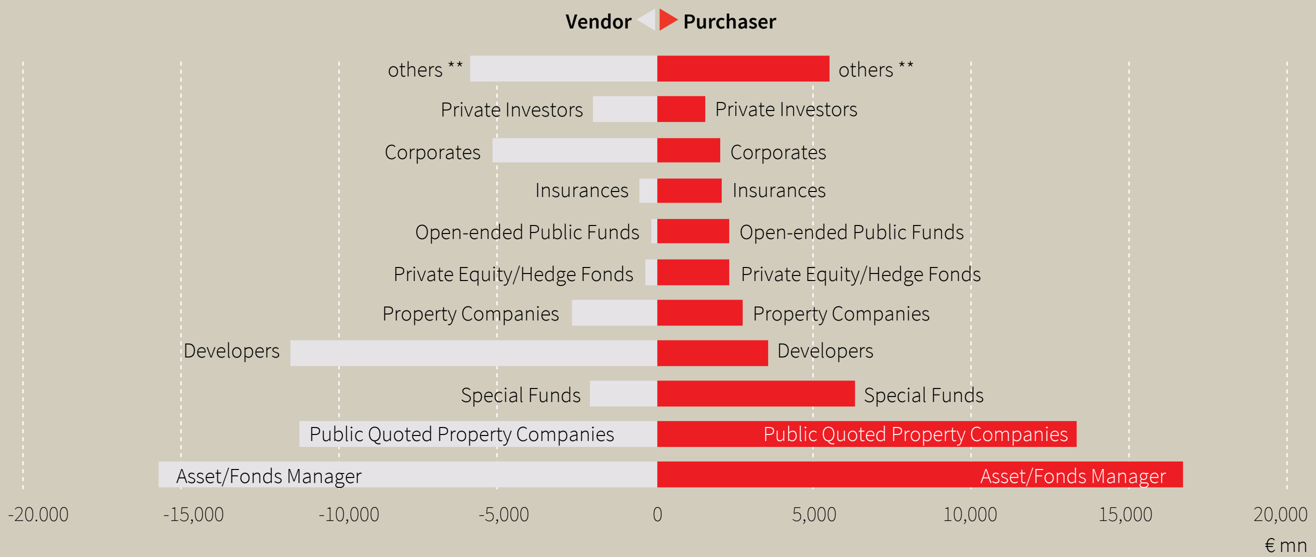
Prime yields in 1a-locations (aggregated net initial yield in Big 7 in %)

	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020
Office	2.97	2.93	2.93	2.91	2.85
Retail: Shopping center	4.40	4.50	4.65	4.75	4.75
Retail: Warehousing parks	4.30	4.20	4.20	4.20	4.00
Retail: Warehousing solus units	5.10	5.00	5.00	4.80	4.60
Retail: High street	2.84	2.84	2.84	2.87	2.89
Logistics-Industrial	3.80	3.75	3.75	3.75	3.53

Office prime yields in %

	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020
Berlin	2.75	2.65	2.65	2.65	2.65
Düsseldorf	3.10	3.10	3.10	3.10	3.00
Frankfurt/M	2.85	2.85	2.85	2.85	2.85
Hamburg	2.95	2.95	2.95	2.85	2.80
Cologne	3.20	3.20	3.20	3.20	3.10
Munich	3.00	2.80	2.80	2.80	2.70
Stuttgart	2.95	2.95	2.95	2.95	2.85

Transaction Volume* by Vendor and Purchaser Type (€ mn)



*Period: Q1 2020 – Q3 2020; **others: Property Companies, Pension Funds, Banks, Municipal Housing Corporations, Public authorities, Closed-ended Funds, Non-Profit Organisations, Cooperatives; Status: October 2020; Source: JLL teresting and sound investment opportunities exist outside the established markets, particularly for products that are currently in high demand such as care homes, retail properties with food anchors or logistics halls. Indeed, 16 single-asset transactions of more than €100 million apiece have been registered so far.

Prime yields pick up where they left off before the pandemic

Have we reached a turning point in prices? Not at all! A glance at the prime yields seems to point to anything but a crisis. The shock-induced paralysis in the second quarter has been overcome and returns have picked up where they left off at the beginning of the pandemic. Market activity in the period from July to September actually drove up prices in three asset classes. The average logistics property yield for the Big 7 regions fell by 22 basis points to 3.53%. For retail parks and individual specialist stores, yields fell by 20 basis points in each case and reached historic lows. Also office properties are an attractive investment product that are favoured by investors. The average office prime yield for all seven strongholds stood at 2.85%. which is six points lower than three months ago.

That may come as a surprise in view of the debates about the future viability of these properties and the headlines about declining corporate office needs. But much of this seems overstated. In the reality of the future working world, the office will keep its place. It's just not yet clear whether this will be in the form of single headquarters in city centres or so-called hubs or satellite offices on the outskirts of cities. It should not be forgotten that a flood of national and international capital fuelled by low interest rates is still not matched by an adequate supply. Investors would do well, however, to closely follow the user markets and, above all, the behaviour of users in the light of social and societal change in relation to the world of work. Here we are also talking about the future viability of the business model, the creditworthiness and the fundamental sectoral trends.

For the stationary retail sector there is still no glimmer of light on the horizon. There was no further yield compression either for central commercial buildings or shopping centres. At most, yields were broadly stable, and even exhibited a slight upward trend. Caution still prevails here. Nevertheless, new opportunities could arise especially in the shopping centre segment, particularly when it is possible to combine the mix of stationary and online retail with the relevant tenants. But changes in use must also be discussed in this context.

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