LINK WEALTH

Germany: Real Estate

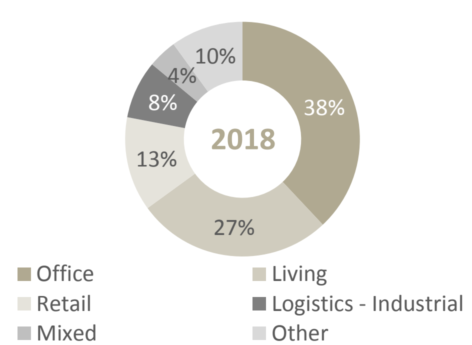
June 2019

Most Populous Country in EU (mn)	**82.89** (2018)

Macro	
GDP	€2.97 trillion (2018)
Inflation	1.4% (May 2019)
Unemployment	3.1% (Feb 2019)
Germany 10Y Bond Yield	-0.32%

Real Estate	
Average Transaction Volume (1Q14 - 4Q18)	€17.57 billion
Foreign Investment (% of total transaction volume)	2018: ~38% and 1Q19: 33%
Prime Yield % (1a Locations; net aggregated in "Big 7")	
Office	1Q19: 3.06 and 4Q18: 3.11
Retail	1Q19 and 4Q18
Shopping center	4.10 and 4.10
Warehousing parks	4.40 and 4.50
Warehousing solus units	5.10 and 5.20
High street	2.87 and 2.87
Warehousing/Logistics	4.00 and 4.10

Transaction Volume - Asset Class



Source: JLL, Bloomberg

Summary

The growth in the cyclical real estate sector is supported by Germany's strong economy, stable population, low interest rates, improving employment rate and steady wage growth. Although, the Big 7 cities (Berlin, Düsseldorf, Frankfurt, Hamburg, Cologne, Munich and Stuttgart) will continue to flourish, investors could explore options in lesser developed cities such as Dresden and Leipzig. In both office and residential real estate, vacancy rates have been falling, given the demand-supply gap. The rising asset value and rental rates, along with positive yield spreads should continue to manifest in additional investments, although government restrictions may emerge as a constraint. Despite fears of growth in the e-commerce sector, the proportion of retail real estate investment seems to have stabilised. Given the strong economy and digitalisation in real estate, we think investments in logistics and warehousing may become very lucrative. The German real estate investment transaction volume reached €77.3 billion in 2018, primarily focused on commercial real estate (€60.1 billion; including €31.9 billion in Office). In 1Q19, the high growth market of Berlin accounted for 46% of the transaction volume in the Big 7 markets.

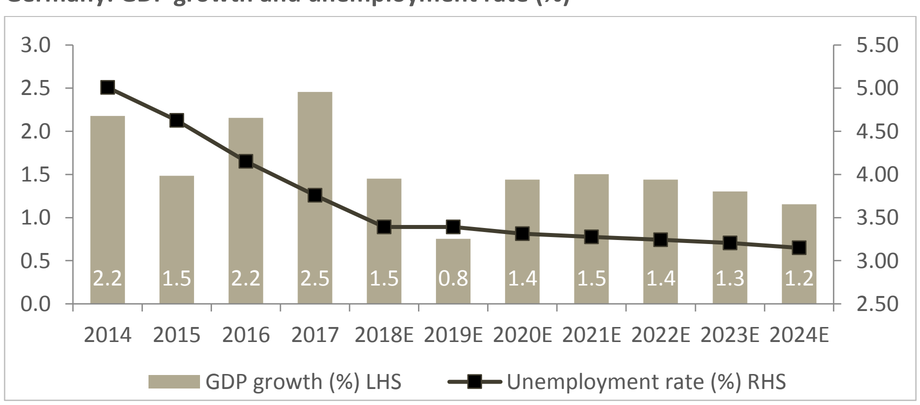
Macro-economic factors and demographics favour sector growth, although concerns persist

Germany, Europe's largest economy, has consistently generated positive GDP growth over the years, despite woes faced by other major European economies. Also, the country's population has risen steadily, while the unemployment rate has witnessed a sharp decline, driving demand for overall real estate as an asset class.

In the next few years, Germany's economy is expected to grow at a relatively steady pace, while population is also expected to be largely stable above 82.5 million. The robust economic growth has also led to a decline in the unemployment rate, which is expected to continue to remain around 3.0% in the coming years. We believe these factors should boost demand for commercial (retail, office, logistics and warehouses) and residential properties.

Although Brexit could weigh on Germany's economy, the possible shift in offices, warehouses and manufacturing facilities by multinational companies to German cities (from the UK) could cushion any slowdown in the domestic real estate sector. Moreover, other externalities such as the US-China trade conflict could also threaten industrial real estate demand.

Germany: GDP growth and unemployment rate (%)



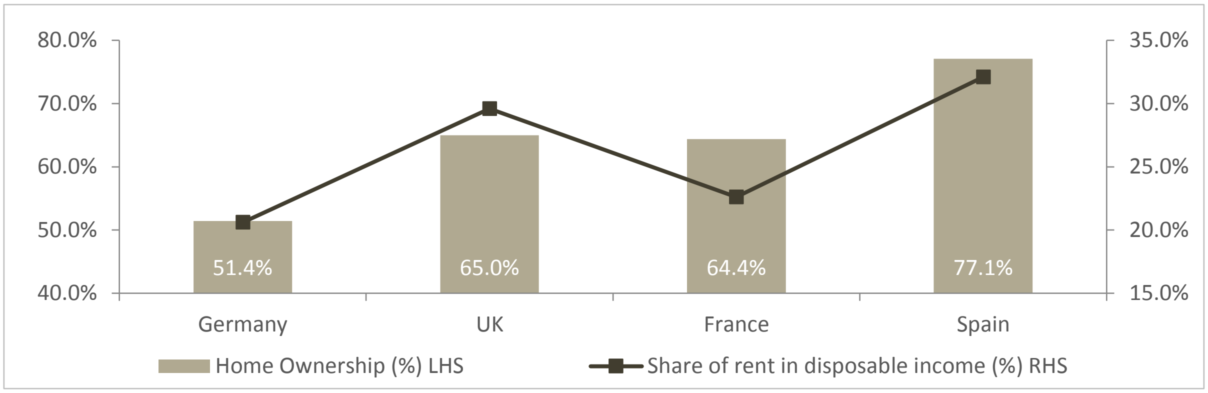
Source: IMF World Economic Outlook, April 2019

Rising home ownership, asset value and low mortgage rates

Historically, property in Germany was government-owned, with most residents preferring rentals over ownership due to high interest rates and a large deposit requirement with the banks. However, growing disposable income along with prolonged low interest rate environment (1.65% vs. more than 4.0% a decade ago) fuelled home ownership demand in Germany.

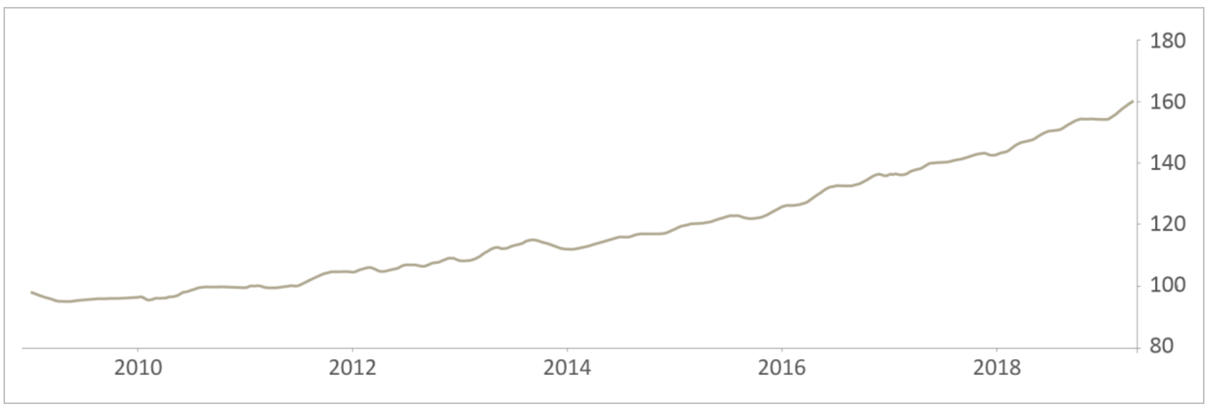
House prices in the country have jumped more than 50% in almost a decade, with the House Price Index reaching its highest level in May 2019. Further, value appreciation in home assets have aided the desire for home ownership, which has languished at relatively low levels (2017: 51% vs. well over 60% for other major European economies). Rent as a proportion of disposable income is relatively lower compared to other European countries, although the current rent momentum could change customer preference towards ownership.

Home ownership and share of rent in disposable income (2017)



Source: Eurostat, Consus Real Estate AG Presentation (June 2019)

Germany House Price Index



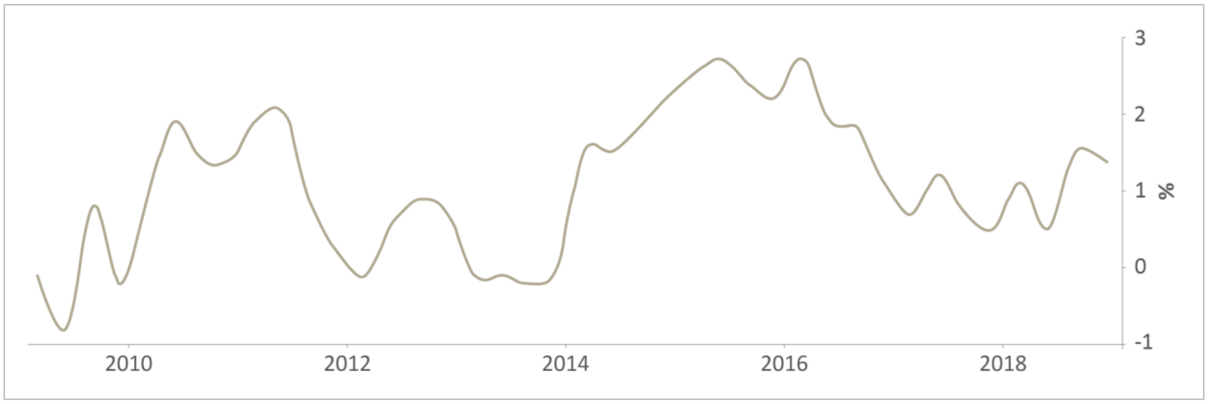
Source: Trading Economics

Immigration and development of new geographies

Germany is an attractive immigration destination for other countries including Eurozone nations, given its high economic growth and positive wage growth rate. Accordingly, the expected net immigration of ~400,000 per annum should support housing market in Germany. Moreover, the influx of immigrants from war-ravaged nations could also be a driver of future demand for housing.

Due to the massive appreciation in the residential real estate sector in major cities in western Germany (Hamburg and Munich), cities in the eastern part such as Dresden and Leipzig have started to gain prominence amongst buyers and investors. As a case in point, the establishment of operations by multinationals such as BMW, Porsche and Amazon has boosted demand for Leipzig's residential and commercial real estate.

Germany real wage growth (y/y)



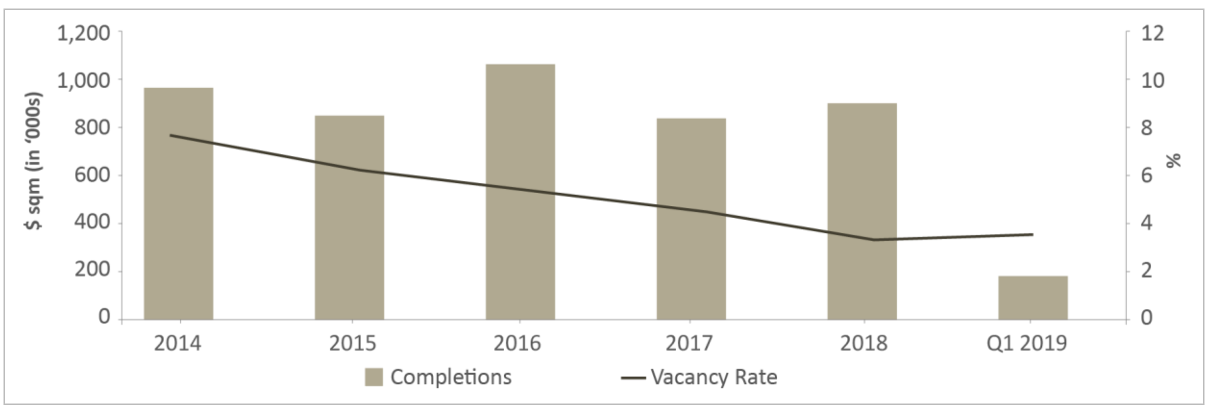
Source: Trading Economics

Falling vacancy rate indicates robust demand and shortage of supply

In residential real estate, the German government is targeting 1.5 million new housing units by 2021, equating to 375,000 new units annually. In context, German builders completed ~285,900 new units in 2018, which was the highest in 16 years. Despite the record, demand continues to outstrip supply, which bodes well for prices in the residential real estate sector.

In office real estate, according to JLL, the aggregated 1Q19 vacancy rate in the Big 7 markets was 3.5% (1% lower vs. 1Q18), which was indicative of the strong demand and rising rents. Berlin, Düsseldorf and Hamburg witnessed the largest declines in vacancy rate, with the rate in Berlin falling below 2.0%.

Big 7: Office completions and vacancy rate



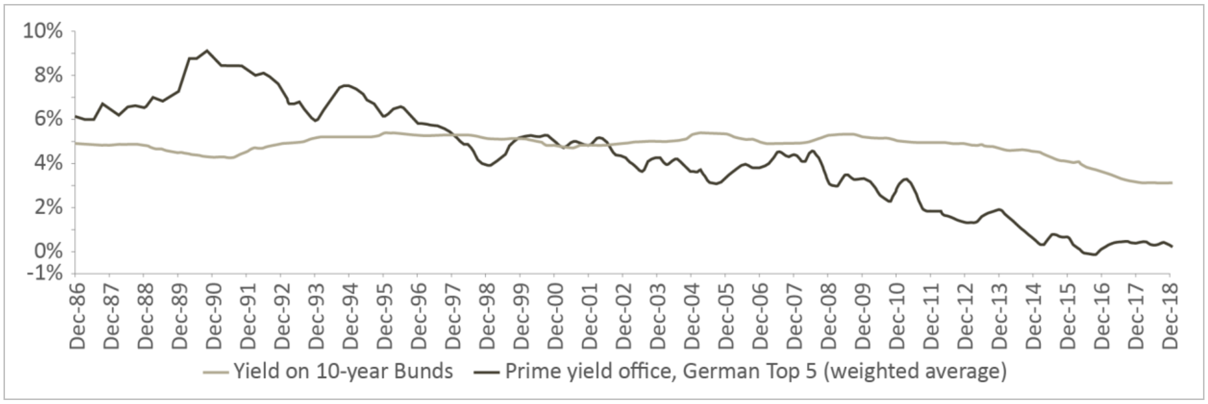
Source: JLL Office market overview, April 2019

The falling vacancy rate has spurred construction by developers (~4.1 million sqm of office space is under construction in the Big 7 markets). The JLL prime rental price index rose for the ninth year in a row, jumping to its highest level since almost three decades, indicating the narrow supply relative to demand.

High rental growth and positive yield spread could support further investments

In 2018, the Big 7 cities experienced robust office rental growth (+6.4% y/y), led by Berlin (+13.3%) and Cologne (+6.8%). In 2019, JLL expects office rent growth to moderate to 3.5%, with Munich likely to replace Frankfurt as the most expensive rental office market. Another major trend is the rent growth of sub-markets outside prime areas outpacing that of prime locations, indicating their emergence as attractive investment alternatives to central locations. According to JLL, office completions in 2018 reached 927,000 sqm (+8% y/y), with ~4.1 million of office space under construction at the end of 1Q19, mostly in Berlin and Munich.

The prime rental yields for Germany's real estate sector remain well above its 10-year bond yield (maintaining a positive spread), affirming its attractiveness as an investment option. Further, completion delay on the back of inadequate capacity with project developers is another key positive for rental growth across sub-segments. However, potential rent freeze in Berlin from 2020 could adversely impact investments and development.



Source: CBRE

Big 7 account for the largest investment share; Berlin maintains top spot

According to CBRE, in 2018 the German real estate investment transaction volume was €77.3 billion, with the commercial real estate investment accounting for €60.1 billion, and the residential real estate for the remainder. In the commercial real estate space, office investment garnered the largest share at €31.9 billion, reflecting strong letting demand. Of the total investment in 2018, the Big 7 markets accounted for 55%. Based on another analysis by JLL, among Big 7 markets, Berlin accounted for 46% of the transaction volume in 1Q19.

We think that the German real estate market offers a range of investment alternatives, most of which remain attractive, given favourable economic and demographic conditions. We opine that potential investors could also invest in logistics real estate, apart from the office and residential sector. In fact, given the strong economic growth as well as the jump in online retail volumes, demand for warehouse and logistics is likely to be strong, in our view. According to Cushman & Wakefield, demand for logistics assets remained well supported from transformation in distribution network on the back of digitalisation which kept demand for warehouses and logistics assets at elevated levels. Accordingly, prime rents for majority of the markets would remain stable while key hubs should witness rental growth; while prime yield for logistics assets would further compress on higher demand. Foreign investors generally invest in large volume property transactions. In 1Q19, the proportion of foreign investors to domestic investors in German real estate fell to one-third of the total, although the ratio is likely to improve in the future once high volume deals go through. Also, domestic demand should continue given strong fundamentals.

In conclusion, multiple growth avenues remain for the German real estate sector, with sub-segments such as office, residential and logistics offering strong potential.

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