

A white outline map of Germany is centered on a blue background. The background is covered with a grid of faint, light blue numbers, some of which are larger and more prominent than others, creating a data-driven aesthetic. A red circle is positioned in the upper right quadrant, containing the word 'Summary' in white.

**Summary**

# **Spring Real Estate Industry Report 2017**

**by the Immobilienweisen Expert Panel**

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## About the Publisher

The ZIA German Property Federation, having its registered office in Berlin, is the German property industry's umbrella interest group for regulatory and economic-policy issues. It represents over 200 direct members, including numerous renowned companies of the real estate and financial sector, as well as more than 20 industry associations. This makes it the mouthpiece of 37,000 businesses in the industry. On the European level, the ZIA maintains a liaison office in Brussels, operating under the name "German Property Federation."

The stated purpose of the interest group is to represent the interests of the real estate economy in a comprehensive single-voice approach that reflects its significance for Germany's national economy. The Federation promotes and facilitates measures that help to preserve and improve the economic, legal, fiscal and political parameters within the industry.

In the context of building public, political and administrative consensus, the ZIA represents the diverse objectives of its members in the form of unified, integrative positions. Representing both corporates and other industry associations, it lends its voice to the entire German real estate industry both on the national and on the European level – and in the BDI Federal Association of the German Industry.

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## Dear Reader,

We are looking back at an exciting and turbulent year on the German real estate market. Although international demand in the residential and commercial real estate segment was nearly as high as during the bumper year of 2015, certain political developments inside and outside Germany caused a sense of unease among market players. The ramifications of the Brexit and its specifics as they emerge in 2017, for instance, remain unpredictable. Equally hard to gauge, in the opinion of many experts, is the impact the policies of the new US administration will have on the German economy. In this fluid environment, the real estate industry plays once again the key role of a stabilising anchor. Meanwhile, the forecasts remain quite upbeat.



Germany's cities and communities continue to present a divided picture: While major cities and university towns have registered fast-paced demographic growth and urgently need affordable new housing, population levels in many rural areas continue to decline. As in previous years, the real estate industry will use the election year of 2017 to take a political stand for flexible parameters and an investor-friendly environment. Other topics likely to define the real estate policy debate in the 2017 election year will include the affordable development of residential and commercial real estate, the acceleration of planning permit procedures and plot sales in regions plagued by bottlenecks, the basis for an adequate infrastructure in economically undeveloped regions, the role of the real estate industry in climate protection and in the successful implementation of the energy policy shift without being unduly burdened, and the need for hands-on federal and EU regulations that stabilise the real estate economy rather than jeopardizing it.

The German real estate industry is entering the discussion from a position of strength. The ZIA will continue to represent the industry interests as always while drawing attention to grievances and misguided regulatory approaches. The ambitious goals for the new year will not be achieved unless political resolve is paired with corporate clout.

Dear Reader, it is our pleasure to present this year's spring report to you, filled with thoroughly researched data, facts and figures that will help you take on the challenges ahead of us. The fact-based brief now before you was compiled by Professor Lars P. Feld and our "Rat der Immobilienweisen" council of real estate experts after surveying a wide variety of factors that influence the major asset classes of Germany's real estate economy. I should like to take the opportunity to thank the experts for their fine work.

Please enjoy your read!



Yours, Andreas Mattner, President of the ZIA German Property Federation



## Spring Real Estate Industry Report 2017 – Summary

### 1. Macroeconomic development

The German economy is in great shape as 2017 gets under way, and looks to continue the upward growth trend of the past three years. In 2016, Germany's **real gross domestic product** rose by 1.9%. This means that the economic output outpaced the production potential which grew by only 1.3%. The forecast ventured by the German Council of Economic Experts (SVR) for 2017 projects a growth rate of 1.3% for the country's gross domestic product. The anticipated slowdown of the growth rate is largely explained by a calendar effect, as 2017 has a higher number of public holidays that coincide with work days.

The economic growth continues to be driven by strong domestic demand. Sound consumer sentiment mirrors the robust situation on the **labour market**. The number of gainfully employed persons totalled 43.7 million by September 2016, the highest figure on record. It coincided with a jobless figure of 4.1% in relation to the entire civilian labour force. Germany has thus the second-lowest unemployment rate in the EU, after the Czech Republic.

On top of that, the **disposable income** has been boosted by low energy prices and low financing costs. Since the spring quarter of 2013, each quarter showed an increase in disposable income over prior-year quarter. The second quarter of 2016 saw a 5.5% rate of change, the fastest growth rate over prior-year quarter since the crisis-related stagnation cycle of the years 2012 and 2013. The surge explains why the change over prior-year quarter was only 1.8% in Q3 2016. However, the energy price effect is unlikely to repeat itself in 2017, because oil prices rallied toward year-end 2016.

German **consumer prices** dropped in the course of 2016, having previously declined in early 2015. As a result, the consumer price index (CPI) undercut the prior-year level by 0.1%. Total consumer price inflation has been slowed by the energy price movement since July 2014. By April 2016, energy prices had dropped by a substantial 8.5% year on year, and petroleum products by an actual 16.3%. As the year progressed, consumer prices rebounded and began to show year-on-year growth. By November 2016, the consumer inflation rate, measured by the CPI, stood at 0.8%, the highest level in two years. In December 2016, the consumer price inflation jumped up to 1.7% in Germany. So the signs have lately pointed toward an accelerating inflation rate.

Meanwhile, the **lending market** for the commercial economy continued to relax in 2016. March and August were the only months in which a slightly higher number of companies noted that bank lending seemed to have become more restrictive. Lately, the development has shown a lateral trend. The ifo Credit Constraint Indicator for the building trade hit a historic low in October when only 15.1% of the survey respondents said they were aware of restrictive lending. However, the trend appears to have rebounded lately.

2016 was also the year in which the ECB lowered its **key lending rate** to 0% for the first time. The low interest rate environment is supposed to boost the economic momentum in the eurozone which has been sluggish since the financial crisis and the European debt crisis, and to address the extremely low inflation rate. As an additional incentives to keep banks from parking their money with the ECB and to put it back into circulation through lending instead, the ECB increased its penalty interest rate to -0.4% in March 2016. Yet the persistently low level of interest rates compromises the effectiveness of key lending rate changes. The ECB has therefore begun to rely increas-

ingly on unconventional monetary policy instruments. These include extending the maturities of refinancing operations or buying up bonds.

The **German real estate industry** is expected to continue its robust growth phase in the coming year. Demand-boosting factors, such as the favourable terms of financing, the rise in disposable income, and the portfolio shifts toward real estate among investors, will keep playing a role. However, demand is not uniformly strong everywhere in Germany. While it is safe to expect the fast growth in demand to persist in the metro regions, demand in rural areas is likely to flatline or indeed to decline. Keen demand in the metro areas will continue to be matched by a chronically short housing supply.

It would no doubt be a good idea to upgrade the parameters for the urgently needed supply expansion. The supply side of the real estate economy is governed by **numerous regulations**. High construction costs and an insufficient land use policy have helped to drive up property prices and rent rates, and triggered a debate about adverse macroeconomic developments on the German real estate market. But real estate market indicators currently show no threats to the financial system as a whole.

## 2. Office, Corporate, Logistics, and Hospitality Real Estate

Historically low interest rates, favourable terms of financing, and rich liquidity positions have ensured that **investments in commercial real estate** remained high on the list for investors in 2016. By the end of the year, commercial real estate transactions totalled 52.9 billion euros. It was the third-highest total in ten years, after 65.3 billion euros in 2007 and 55.5 billion euros in 2015. Once again, nearly half of the amounts committed (47.0%) were spent on office properties, underscoring the enormous significance of this segment for Germany's real estate industry. And as in previous years, the so-called "Big Seven" cities dominated the market by claiming 55% of the transaction total. Demand for real estate will – not least for want of investment alternatives – remain strong throughout 2017. Ongoing property developments will admittedly expand supply, but it will continue to fall short of demand. Commercial investments in 2017 are expected to range between 45 and 50 billion euros.

### Office Real Estate

**Office real estate** has been the dominant asset class in Germany's real estate investment market since 2012. As in prior years, the biggest agglomerations continue to benefit most from the influx of highly skilled professionals and an increase in office jobs. All of the major cities have experienced substantial population growth in recent years. Office employment has been fastest to increase in cities with access to an expanding pool of skilled labour. A sound inner-city infrastructure along with higher education and vocations training options increases the probability that office employment will claim an even bigger share of all insurable jobs in these urban agglomeration areas in the years to come.

While 2016 admittedly saw the **investment volume** in office properties decline slightly by 4.6% to 24.9 billion euros (down from 26.0 billion euros in 2015), its share of the revenue total remained stable at 47%. There was, by the way, quite a number of transactions in the nine-digit price range in the office segment in 2016. In the ongoing year of 2017, Germany's office investment market is likely to show more or less the same robust performance as it did in the previous two years. There is every reason to assume that buyers will stay keenly interested in German office real estate in 2017,



and the one factor expected to keep investments below the mark of 30 billion euros is the limited supply available on the market.

**Rents** for office premises went up in virtually all German office locations in 2016, making it the sixth year of the ongoing growth cycle, the longest since 1990. Among the Class A cities, the weighted average prime rents quoted for offices by the end of 2016 was c. 27.50 euros/sqm RA-C, which implies a one-year increase by 5.0%. The weighted average in the Class B cities equalled 13.40 euros/sqm RA-C, thereby exceeding the prior-year figure by about 0.9%. In Class C cities, the weighted average prime rent toward year-end 2016 was 12.10 euros/sqm RA-C (+1.3%), which compares to 9.70 euros/sqm RA-C (+1.5%) in Class D cities.

**Selling prices** for office properties continued to rise throughout 2016. Prices in Class A cities rose by an average of 22.4% to 8,110 euros/sqm RA-C. The steepest rate of increase last year was achieved in Berlin, where prices surged by 44.0% to 9,090 euros/sqm RA-C, followed by Munich with a 20.9% increase to 11,620 euros/sqm RA-C, and Hamburg with a growth of 14.8% and an office price tag of 7,500 euros/sqm RA-C. The average capital value of office premises in Class B cities is 2,840 euros/sqm RA-C, implying an increase by 6.9% since 2015. The highest prices are currently quoted on the office market in Bonn at c. 4,080 euros/sqm RA-C (+11.6%), followed by Hanover at 3,370 euros/sqm RA-C (+10.6%) and Mannheim at 3,260 euros/sqm RA-C (+9.4%). The growth rate in Class C cities was 5.3% and appears to have slowed slightly. The average price tag for office units read 2,280 euros/sqm RA-C. In Class D cities, the average capital value rose by 2.7% to nearly 1,550 euros/sqm RA-C (an increase by 5.6% since 2015).

**Net initial yields** for centrally located property have been steadily compressing since 2010. In Class A cities, the weighted average for the net initial yields of core property was down to 3.6% by the end of 2016 (60 basis points below the prior-year figure) – the steepest drop since 1990. In Class B cities, the weighted average yield level continued to harden, as in the year before, dropping by 30 basis points to a year-end rate of 5.1%. Net initial yields in the Class C cities declined by an average of 20 basis points to 5.7%, whereas the weighted average initial yield in Class D cities dropped by 10 basis points to 6.7%, which, however modest, is clearly a sign of yield compression.

**Demand for office accommodation** is likely to maintain the current level throughout 2017, but due to the dwindled floor space supply, there is little chance that last year's transaction volume will be topped. Vacancies will continue to dry up while prices and rents will maintain considerable growth momentum that will not be limited to Class A cities. Initial yields rates will keep seeing a modest downtrend in 2017, too. This means inversely that the compression seen last year, which was felt even in remote locations, will not be as pronounced.

## Unternehmensimmobilien

The term “**Unternehmensimmobilien**” refers to mixed-use commercial properties with alternative use potential, and typically with a tenant structure comprising mid-market companies. The mixed use format normally includes offices, warehouses, research, service, and/or wholesale trade and open areas. Unternehmensimmobilien formats include converted properties, business parks, warehouse/logistics properties, and light manufacturing properties.

Germany's stock of **Unternehmensimmobilien** assets (not including hotel real estate) currently adds up to 3.134 sqm. At 945 million sqm or 30.2% of the total, Un-

Unternehmensimmobilien assets represent one of the largest sub-category of commercial real estate, second only to industrial assets (1.359 billion sqm or 43.4%).

The **market value** of Unternehmensimmobilien equals nearly 551 billion euros or roughly 26.5% of the entire market value of Germany's commercial real estate, just behind office real estate with 600 billion euros or around 29%.

In **2015**, the **transaction** volume rose to 2.3 billion euros, a new all-time high. Transactions in 2016, while unable to match this, still added up to 1.8 billion euros. The year-on-year decline is attributable not to slowing demand, but to short supply. The number of business parks traded experienced the most conspicuous decline, because the majority of assets in this rather small group are held of portfolio properties.

**Prime rents** for business parks have gone up steadily except for a short plateau phase in 2014. At the end of 2016, the headline rate was 13.70 euros/sqm, after an increase by nearly 83% from an average of 7.50 euros/sqm as recently as year-end 2013. During the same period of time, rents for light manufacturing units climbed by an equally dynamic 53% from 4.70 euros/sqm to 7.20 euros/sqm. Office and social areas in Unternehmensimmobilien assets virtually flatlined at around 13.00 euros/sqm. By contrast, small-scale warehousing/logistics facilities became around 25% more affordable. Their rents declined from 11.30 euros/sqm to 8.40 euros/sqm between 2013 and 2016.

### Logistics Real Estate

In recent years, investors have increasingly shifted their focus to **logistics and transportation properties**. Comparatively high yields, which are less susceptible to economic cycles than the office and retail sectors, make this segment attractive.

The keen investor interest is reflected in the way the **transaction volume** is trending. Transaction figures have gone up successively since 2011 at the latest. By the end of 2015, sales added up to 3 billion euros. While not all of the deals transacted in 2016 are on record yet, it is already safe to say at this point that it was another banner year for logistics real estate. All things considered, nearly 2.3 billion euros were invested in large-scale logistics centres. If you take warehouse properties as well, the sales total comes to well over 2.6 billion euros. Still, the revenue total of 4.6 billion euros in the commercial real estate sector fell short of the record-breaking year-end total of 2015, which was 5.6 billion euros. The set-back, which may to some extent be blamed on short supply, is also attributable to the recent price spiral that prompted a rapid yield compression over a comparatively short period of time.

The **take-up**, in any case, did not lag far behind the all-time high of 7.15 million sqm of 2015 as it added up to more than 7.11 million sqm by the end of 2016. Although logistics real estate has kept getting more popular in recent years and has kept generating ever higher transaction revenues, it only accounts for a 5% to 7% share of the total investment volume still. This is due to the fact that the total investment volume rose in sync. Investor interest in logistics real estate remains as high as ever, short supply being the one thing holding it back. The brisk building activity and the growing tendency to rent rather than to build both point to a sound future investment potential.

The growing appeal of logistics real estate triggered a fast compression of **net initial yields** between 2011 and 2015. It was not until 2016 that high selling prices put an end to the intense compression cycle. Market evidence suggests that price adjustments more or less levelled out as the year progressed. The priciest location for logistics real estate at the end of 2016 was Munich. Here, net initial yields had dropped by 35 basis



points to 5.0% in the course of the year. The other prime locations, these being Hamburg, Berlin and the Rhine-Main/Frankfurt region, nearly matched the level as their yield were only 10 to 15 basis points higher. Düsseldorf, Cologne and Stuttgart also reported a similar level.

## Hotel Real Estate

Germany's hospitality industry completed 2016 with a robust performance, making it the seventh consecutive year of growth. According to provisional projections, the number of overnight stays increased by 2.5% to around 447 million. The persistently low level of interest rates ensured that investment demand for hotels in Germany remained strong throughout 2016.

Preliminary figures suggest that the 2016 **transaction volume** approximated 5 billion euros. This means that the prior year's record figure of c. 4.4 billion euros was topped again, and substantially so. Investors have been looking at hotels beyond the "Big Seven," with acquisitions reported from Mannheim, Augsburg, Hanover, Essen, Bremen, Würzburg, Freiburg, Heidelberg, Gütersloh and Heilbronn, among other cities. The stock of investment-relevant hotels in Germany currently adds up to a total value of 47.1 billion euros.

Due to the persistently strong demand, **selling prices** for hotels kept going up throughout 2016. Midway through 2016, Motel One, for instance, bought up two of its own hotels from Lloyd Fonds at a multiple of 19.8 times the annual net rent. Eight years earlier, Lloyd Fonds had picked up the assets for a multiple of 14.6 times. But compared to other countries, the value of a hotel room in Germany is still modestly priced, and the hotel valuation index which is published by HVS in London (and which only covers the upscale segment) is quite explicit in saying so. Among the 32 cities tracked by HVS, Munich ranked 8th at c. 300,740 euros per room, while Frankfurt, Hamburg and Berlin made the places 15, 17 and 18, respectively (compared to c. 700,000 euros for a hotel room in Paris, which topped the list).

The **yield rate** for sound leasehold properties has now dropped below 5% in what could well be the peak cycle. Since supply is short and selling prices high, the search for suitable product must necessarily shift its focus beyond the major cities. It stands to reason that resort hotels with plausible formats in thriving holiday regions will increasingly whet the appetite of investors.

### 3. Retail Trade

The year 2016 brought changes for Europe whose ramifications for Germany are not fully predictable yet. The exit of a member state from the EU, such as the imminent “Brexit,” is unprecedented; the new US administration under Donald Trump marks another shift; the persistent migrant issue is subject to an ongoing domestic and foreign policy debate; and the terrorist attacks in Munich and Berlin have caused considerable anxiety among the German population. Headlines over events like these were reflected in fluctuating **consumer sentiment** in Germany, but on the whole the index has maintained its high level, and actually ended the year with a year-on-year gain, according to the GfK Consumer Climate Index. Purchasing power in Germany is expected to see a nominal one-year growth of 2.9% in 2017. This would translate into an imputed average **per-capita purchasing power** of 22,239 euros that Germans have at their disposal for consumer spending, housing, leisure activities and savings – an increase by 1.7%.

There has been another increase in **distance selling**, expanding the segment’s market share to 12.2%. At the same time, however, the growth has lost some of its momentum. In 2017, the segment is expected to increase its market share moderately to 12.8%. Proximity to the customer is gaining steadily in priority for online retailers, and recent months have seen formerly pure players extend their e-commerce activities into the brick-and-mortar retail landscape while other online retailers are expanding their footprint.

Inversely, the **brick-and-mortar retail business** has become increasingly flexible in regard to the distribution channels employed. The options to shop online, offline or via Click & Collect have already become well established, especially among non-food multiples. Cases in point include retail multiples of any kind typically found in high-street pitches, district locations or shopping centres.

**Conventional specialist stores** – locally established, usually owner-operated, service oriented and emphasising product depth – continued to lose market shares last year, and are now at 17.5%. The negative growth is likely to continue in the year ahead, too. Similarly, mid- to large-scale **retail warehouses** were unable to maintain their market share, and suffered a modest set-back to 16.6%. **Department stores** also registered a slight erosion of their market share, ending 2016 at 2.1%, whereas **superstores and hypermarkets** and retained a stable market share of 8.4%. Also unchanged was the market share of **food discount stores** at 16.3%. Meanwhile, **full-line grocery stores** continued to expand, and claimed a market share of 10.8% toward year-end.

German **retail real estate** remains highly sought among domestic and international investors. In the wake of the banner year 2015 with its **transaction volume** of more than 18.1 billion euros in the retail segment, and with prices soaring, the market action slowed considerably in 2016, as expected, and returned a year-end total of c. 12.8 billion euros (-29.6%). That being said, it should be remembered that 2015 was paced by large-scale takeovers such as Kaufhof portfolio by Hudson’s Bay Company, and Corio by Klépierre. In 2016, no deals of comparable magnitude were transacted. Still, it proved to be a year of robust performance, its year-end total topped only by that of 2008. Single-asset deals accounted for the bulk of the sales total with a share of 62%.

On the **buyer side**, open-ended property funds and institutional funds were particularly active, just as they had been the previous year. They bolstered their lead position by investing nearly 4.7 billion euros and expanding their share of the total to 38.9%. Within this group, pension funds and insurance companies considered even high-priced assets an important source of returns and continued buying, whereas asset

managers and fund managers showed reticence with a market share of 22%, a decrease by 4.5 percentage points. Private investors stepped up their activities in 2016 and claimed a share of 12.1%. By contrast, public property companies and REITs dropped into the single-digit range with a share of 7.9%, and this after having topped the list in 2015 with the two single-largest deals.

Pent-up demand in Germany's leading retail cities put further pressure on **yield rates**, which dropped below the mark of 4% across the board. According to estate agency surveys, Munich remains the priciest location with a net initial yield of 3.10% (-40 basis points), followed by Berlin with 3.40%. Düsseldorf, Hamburg and Frankfurt are on a level at 3.50%, and trailed closely by Cologne (3.60%) and Stuttgart (3.70%). The mean rate across all seven Class A cities thus equalled 3.47%.

### Retail Property Markets in the “Big Seven”

**Berlin**, being Germany's largest retail city, continued to benefit from the steady demographic growth of the Berlin-Brandenburg metro region, but also from persistently high tourism demand. As a result, brick-and-mortar retail revenues grew by 3.1% in 2016. However, the retail-space-per-capita declined slightly for the city as a whole, which in turn caused the floor space productivity in Berlin's retail sector to increase to over 3,800 euros/sqm. The property development pipeline remains well filled, while demand for space by domestic and international retailers is as strong as ever. Prime high street rents in the German capital have continued to go up, thereby going against the general trend toward a modest if steady rent performance. The next major contingent of new retail floor space is expected to come on-stream in 2018. In 2016, the retail property market in the high-street pitches of downtown West and East Berlin were dominated by tenant changes and the restructuring of existing schemes. A number of store openings and planning projects resulted in a substantial increase in retail area in the City West sub-district. Prime high-street rents in West Berlin rose from 170 to 180 euros/sqm/month for units between 300 and 500 sqm, whereas smaller units of 80 to 120 sqm reported slower rental growth as the average monthly rate rose from 340 to 350 euros/sqm.

**For Hamburg**, 2016 was yet another year of demographic growth as its population rose to nearly 1.8 million. Germany's largest port city also stood its ground in terms of retail revenues with well over 11 billion euros, placing second after Berlin. The fact that barely 18% of the retail revenues in Hamburg were generated in the inner city highlights the high relevance of retail business for the city's district centres. Prime high-street pitches reported a slight softening of rent rates for small to midsize store units from 320 down to 310 euros/sqm. This is explained not least by the various well-located property developments in downtown Hamburg that are already being let. The current marketing cycle will also show whether the expansion of the luxury and premium labels into peripheral locations of Neuer Wall and Grosse Bleichen has consolidated into a sustainable trend. The rent ceiling for larger high-street retail units of 300 to 500 sqm remained unchanged at 200 euros/sqm in 2016, matching the two previous years. As far as the floor space productivity in Germany's major retail cities goes, Hamburg ranked second after Munich with nearly 5,800 euros/sqm of retail area in Hamburg's prime high-street pitches.

**Munich** completed 2016 with the steepest increase in retail revenues among the country's metropolises. The revenue total of 10.7 billion euros implied a year-on-year increase by 3.3%. Across all size bands, however, prime rents made no further gains toward year-end. The rent ceiling for prime high street pitches remained unchanged

at 370 euros/sqm for small retail units of 80 to 120 sqm, and at 240 euros/sqm for larger units of 300 to 500 sqm. Nearly one third of the retail revenues are generated in the high-street locations of Munich. The inner city retail business benefits particularly from the outstanding purchasing power ratio of Munich's population and the demand created by the permanently prospering tourist trade. These two factors explain why downtown retailers show such a high floor space productivity of c. 6,500 euros/sqm, far above the comparables registered in other German retail cities. The retail area growth in Munich as a whole proved stable year on year. Munich's inner city registered a moderately positive trend due to a number of new rentals and construction measures.

**Cologne's** retail sector made the record with slight city-wide gains both in retail revenues and retail area growth. With its impressive centrality rating of nearly 122, Cologne actually leads the field of German metropolises in 2016, although its ranks fourth in terms of retail revenues. Inner-city retailers achieved an average floor space productivity of almost 5,100 euros/sqm/year, which put Cologne behind Munich and Hamburg but well ahead of nearby Düsseldorf, among other cities. Especially in the inner city, tenant churn, newly constructed buildings and building conversions produced a modest increase in retail area, even though the rent level for small to midsize units remained stable. The going rate for small retail units between 80 and 120 sqm in preferred locations is 280 euros/sqm, while units of 300 to 500 sqm rent out at 150 euros/sqm. In the ongoing year, Cologne's high-street locations will be subject to more changes. Moreover, the periphery of Cologne's inner city has attracted investments into several new development projects that include retail premises. In the high-priced retail segment, Cologne has always trailed the other metropolises, and this continues to be true.

The retail trade in **Düsseldorf** benefits from excellent socio-economic parameters, including steady population growth and a retail purchasing power of 117.6 – the second-highest score among Germany's retail metropolises. On the whole, the city registered a slight increase in urban retail revenues and modest rent hikes in 2016. Peak rents for stores of 80 to 120 sqm in prime high-street pitches rose from 275 to 280 euros/sqm year on year, and from 135 to 145 euros/sqm for retail units of 300 to 500 sqm. However, the retail area growth was negative. The opening of renowned new boutique stores was offset by large-scale closures. But there is reason to believe that this represents but a short-lived trend. The Kö-Bogen II development will bolster the anyway high concentration of retail businesses in Düsseldorf's high-street locations, which account for roughly 35% of the city's total retail area and generate nearly 38% of the urban retail revenues.

**Frankfurt am Main** looks back on a prosperous year for the retail sector as both the retail revenues and the area total in storefront retailing showed positive growth in 2016. While high-street retailing benefited more than other formats from the steady increase in high-spending residents, the major shopping centres elsewhere in the city did rather well too. The city's prime high-street pitch along Zeil was fringed by several development projects at the turn of 2016/2017, and new retail venues have also been developed in other boroughs. The fact is already reflected in a modest increase in the retail-space-per-capita ratio for Frankfurt as a whole. The interest that international premium and luxury brands have shown in retail premises in Frankfurt's prime locations remains as high as ever, although the demand for store units in mid-market retail locations has lost in momentum. Peak rents in the inner city remained unchanged at 300 euros/sqm for small storefronts, and at 170 euros/sqm for larger stores between 200 and 500 sqm.

The retail sector in **Stuttgart** looks back on a comparatively calm year. Moderate gains in revenues are matched by a slightly elevated retail-space-per-capita ratio. The combination of the two results in a more or less stable floor space productivity. With a retail trade centrality of 120, Stuttgart shows one of the highest scores among the retail cities analysed, second only to Cologne. The completion of the two shopping centres Milaneo and Gerber in recent years caused the floor space supply to expand and rent level to soften in 2016. At the moment, the prime rent quoted for smaller units is 260 euros/sqm, and 140 euros/sqm for midsize units. Especially Stuttgart's main high-street pitch along Königstrasse is undergoing a metamorphosis and repositioning itself vis-à-vis the competing mall complex of Milaneo and the Dorotheen Quartier complex expected to come on-stream in 2017.

#### 4. Residential

**Residential rent rates** (asking rents, hedonic, any building age) rose by 2.6% over prior-year period (Q3 2016), which is slower than last year's growth (3.4%). Concerns that the massive incoming migration (migrants) would result in a serious rent hike in Germany thus proved to be unfounded. What sort of effect it might yet have on the market in the coming months is hard to say. For the time being, however, there is no demonstrable evidence of such an effect. The median rent across Germany is c. 7.20 euros/sqm, which implies an increase by 1.10 euros/sqm or 18% since 2010. When adjusted for inflation, the growth rate is still 9.4%.

**Condominium prices**, too, continued to go up. The current price growth of +8.4% implies a slightly accelerated trend compared to the previous year (+7.7%). Nationwide, selling prices in 2016 (Q1-Q3) exceeded the comparative value of 2010 by 48%. The inflation-adjusted growth rate since 2010 is still quite substantial at 37%. For the past five years, selling prices have shown a faster relative growth than rents, and the fact has fuelled general fears of a real estate bubble. However, the nationwide selling price inflation relative to rents (on new leases) is still so low at around 16% – assuming 2004 as mean base year – that it could also be attributed to the low interest rates or to catch-up effects, among other reasons.

The situation in Germany's "**Big Seven**" cities is quite different. The excessive price inflation ranges from 36% in Düsseldorf, to over 40% in Frankfurt and Hamburg, to roughly 50% in Cologne, Berlin and Stuttgart, and all the way to 75% in Munich. The group that used to be referred to as swarm cities has so far included all of Germany's "Big Seven" cities (Berlin, Hamburg, Munich, Cologne, Frankfurt, Düsseldorf and Stuttgart). These cities succeeded in attracting incoming migration from virtually all parts of Germany (not including their own metro areas). However, this has lately changed in Berlin, Munich and parts of Hamburg. The selling prices currently quoted here, especially in Berlin and Munich, have ceased to move in plausible relation to their local parameters. Quite obviously, a significant rent upside is already factored into the prices. But rents on new leases are not actually expected to keep rising, and this is true particularly for Berlin and Munich, and possibly for Hamburg, too.

Germany's nationwide **vacancy rate** dropped from 3.6% in 2010 down to 3.0% in 2015. With a view to the fast increase in the number of planning permits issued and the volume of developments now under way, however, there is reason to believe that they will not drop any further, at least not nationwide. Things look different in some of the "Big Seven" cities, where the number of private households has skyrocketed in recent years. The gap between the rate of residential completions and the rate of increase in the number of households has been largely, but not fully, bridged by the



absorption of vacant housing. In the case of Munich, this has brought the vacancy rate down to just 0.2%, the lowest level anywhere in Germany. The fastest vacancy reduction was registered in Berlin where the rate dropped from 2.6% in 2010 to 1.2% today. In all of the “Big Seven” cities, though, the residential vacancy rate has now cut into the fluctuation reserve, that is, the minimum level deemed necessary for a well functioning housing market.

Meanwhile, Germany’s population is likely to have increased further in 2016, making it the sixth year of growth in a row. By the end of 2015, the country had around 82.2 million residents, and thus 2.4% more than it did in 2010. As far as the consequences for the **housing demand** go, it needs to be remembered: Germany owes its ongoing demographic growth exclusively to strong incoming migration. Since 2009, the last year with a negative balance of international migration, nearly 2.9 million people have moved to Germany on balance. But at least two of three waves of immigration into the country are drawing to a close now. Historically speaking, each wave of immigration was succeeded by an – albeit smaller – emigration wave (the “echo effect”). Given the sizeable immigration volume over the past few years, the next outbound migration wave could actually be large enough to turn the balance of international migration negative for a while. But in no case would it be safe to assume that the immigration balance will remain as favourable as it has been in recent years.

What is striking to note when looking at the development of the **housing supply** is that compared to 2014, the number of planning permits continued to increase by 10% in 2015, whereas the number of completions stagnated. This, the fact that building completions lag behind the number of permits issued, implies that the volume of unfinished building projects is growing. Almost 300,000 flats are currently somewhere “in the pipeline” between fundraising, construction and completion. It is a volume that more or less equals a year’s output in new flats, which is in no way alarmingly high for the country as a whole. On the local level, however, the rise in planning permits far outpaced completions in some of the “Big Seven” cities, and typically caused the backlog of unfinished buildings to grow. This is true in particular for Berlin, where the volume of unfinished developments in varying stages of completion now adds up to five times the annual output. Other cities in which ample new housing is about to come on-stream include Hamburg, Frankfurt, Düsseldorf and, on a lower scale, in Munich.

As a result of the slowing pace of immigration and growing supply, there is little reason to expect rents on new leases to keep rising in Berlin, Munich and possibly Hamburg. By contrast, passing rents will probably continue to go up because of the wide gap that separates them from rents on new leases. The point being that, notwithstanding the low rates of interest, today’s selling prices are justified only by an assumed upside rent potential. So even a stagnant rental growth would impact selling prices. This makes a break in trend virtually certain in Berlin, likely in Munich, and possible in Hamburg and Frankfurt as far as condominium prices go.

## The “Immobilienweisen” Council of Real Estate Experts

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