Summary

Spring Real Estate Industry Report 2019

by the Immobilienweisen Expert Panel

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Dear Reader,

With its 817,000 enterprises, roughly three million gainfully employed persons and a share of around 18 percent in the gross value added, the real estate industry is one of Germany's key business sectors. The body politic keeps talking about the "social issue of our times" whenever the subject of affordable housing comes up. But at the same time, our industry is being addressed in an increasingly strident voice. Companies belonging to the real estate sector have collectively become suspect—and some parts of the body politic are sharing the misgivings in the hope of regaining lost votes by doing so. Possible consequences of such smearing are ignored. In the past, our community has already experienced a number of interventions whose main effect was to create unease among investors and drive up production costs without helping in any way to ease the strain on the country's real estate markets.

We, for our part, have always said and will keep reiterating: We see ourselves as partners of Germany's policymakers, not their adversaries. Government cannot solve the present urban planning challenges on its own but needs the real estate industry players to make progress in a sustainable, contemporary way. We are therefore taking a pragmatic and solution-driven approach to the tasks now before us: What Germany needs is a standardised building code and the promotion of serialised construction, an increase of the straight-line deduction for depreciation (AfA) from two up to at least three percent, and a nationwide reduction of the real estate transfer tax, an improved tax depreciation of energy-efficient building refurbishments, support for the municipal planning and zoning authorities and a reform of the property tax that takes a simply, fair and income-neutral approach without causing extra burdens on tenants and occupiers—to name but a few items on the to-do list.

Against this background, the (economic) policy environment of our industry naturally plays a key role in this year's spring report. We, as Germany's leading professional association, will use this report once again as an opportunity to highlight political aspects that call for improvements and adjustments. At issue here are not just the housing markets but, in keeping with tradition, all other major types of use as well, with nursing care properties included as subject area for the first time this year.

Cities should take a holistic approach to growth. They need space for offices, housing, retail and logistics. Since all of these types of use mutually influence each other in their development, a holistic approach to the growth of cities and communities would take aspects of liveability, affordability and sustainability into account.

I hope you will find this issue of our report an insightful and inspiring read.

Dr. Andreas Mattner

President of the ZIA German Property Federation

Spring Real Estate Industry Report 2019 – Summary

1. Macroeconomic Development

Germany's national economy was off to a sluggish start into this year of 2019. After a 0.2% dip in the third quarter and a fourth-quarter growth that was minimal at best, its real gross domestic product amounted to a year-end total of 1.5% in 2018. The growth rate is therefore likely to be lower in 2019. The threat of an imminent recession has increased.

The situation of the labour market remains reassuring as the creation of jobs continues unchecked. In 2018, the number of gainfully employed persons crossed the mark of 45 million for the first time. This implies a growth of 1.3%. Inversely, unemployment kept declining rapidly. Between September and November 2018, a mean total of 2.19 million people were out of work, which is 7.7% fewer than during the prior-year period. The unemployment rate equalled 4.8%.

Meanwhile, the disposable income has gone up steadily since 2013. Despite the slowdown of the economic output during the third quarter of 2018, it did increase by 3.5% quarter on quarter. And even though the quarterly growth was negative during the first half-year, the macro-economic disposable income was 2.2% higher than the prior-year level.

Consumer prices experienced brisk upward growth in 2018. The mean inflation rate for the Consumer Price Index (CPI) amounted to 1.9%. The same inflation rate, an annual average of 1.9%, was registered for the Harmonised Consumer Price Index (HCPI). This means that the ECB came very close to its monetary policy target of just under 2%. In October 2018, the inflation rate of the HCPI topped the target benchmark at 2.4% over prior-year month, as it had done repeatedly in previous months. The upward trend in 2018 was driven mainly by the development of energy prices.

The credit trend remains positive. The terms of financing are still quite affordable for all market participants. Banks actually eased their standards (credit guidelines) further in the course of 2018. Specifically, they lowered their margins for average high-risk corporate and residential property loans and covenants. Credit demand in the private sector increased as the year progressed, most notably during Q2 2018. During the third quarter of 2018, the volume of bank loans achieved its steepest growth rate since 2011 at 1.4% quarter on quarter. The latest figure of 2,700 billion euros is the highest overall lending volume ever recorded in Germany. The sustained low-interest policy by the ECB makes it reasonable to expect this trend to remain stable in the near future and the borrowing total to keep rising.

Since spring of 2016, the key lending rate in the eurozone has permanently stood at 0% and will not be raised before the end of the summer of 2019, according to the most recent ECB Council meeting on 13 December 2018. The monetary policy continues to show a very accommodative stance. However, if the return to a normal monetary policy came too late, it would risk a faster rise in inflation, a misallocation of capital and an end to the financial stability.

For the time being, the German real estate economy will continue to be sustained by the favourable terms of financing, the sound economic situation and the keen demand for housing in the conurbations. Despite the high level of orders on hand, there are signs of a gradually waning optimism so that only moderate growth rates, albeit on a high level, should be expected as the year progresses. High capacity utilisation and a shortage in skilled labour increasingly hamper a faster expansion of the development activity. This is likely to make building work more and more expensive. One of the most interesting fiscal developments in 2019 will be the imminent reform of the property tax. Measures such as the child tax credit for first-time home buyers or the extension of the rent freeze limit themselves too often to symptoms and are unlikely to bring sustained relief to the housing market. With this in mind, it is high time to discuss various fiscal and regulatory aspects affecting Germany's residential property market.

2. Office, Corporate, Logistics and Hospitality Real Estate

According to provisional figures, transactions on Germany's commercial real estate market added up to 61.1 billion euros last year. It would mean another year-on-year increase, this time by 5.2%. The bulk of the invested capital (47.1%) was spent once again on office real estate. Investments continued to be dominated by the "Big Seven" cities Berlin, Cologne, Düsseldorf, Frankfurt am Main, Hamburg, Munich, and Stuttgart, which accounted for around 63% of the total sum transacted. However, 2018 may have marked a peak in investments. In 2019, the sum invested in German commercial real estate will probably decline in the wake of the anticipated economic slowdown.

Office Real Estate

At the moment, the economic parameters outlined above are (still) having a favourable impact on the 127 largest office real estate markets in Germany: Robust economic figures and employment gains have steadily increased the office space requirements, and not just in 2018, but successively over the past few years. The willingness to hire among domestic employers is likely to persist throughout 2019. This continues the upward trend in job growth of recent years while demand for office accommodation should keep following a positive trajectory in 2019.

As in previous years, office properties proved the most popular type of commercial real estate investments in 2018. Year on year, the capital invested rose by 18.0% to c. 28.8 billion euros (2017: 24.4 billion euros). The office share in the total volume equalled 47.1%, slightly above the five-year mean of 45.2%. Responsible for the excellent result was not least a number of large-scale deals in the triple-digit millions, most of which were closed in the Class A cities ("Big Seven"), as usual.

In terms of take-up, 2018 was nearly as successful as the banner year of 2017. On the 127 biggest office markets, 6.1 million sqm of lettable commercial floor area (RAC) was rented. This exceeds the 10-year mean (5.4 million sqm RAC) by 600,000 sqm RAC (+12.0%). Despite the minor one-year dip by almost 560,000 sqm RAC (-8.5%), this is is take-up of well over 6.0 million sqm RAD for the third time in a row. About 3.65 million sqm or more than 60% of the floor space total was absorbed in the "Big Seven" office centres. Many transactions for owner-occupancy and the steep rise in pre-lets and lettings for premises under construction reflect the office space shortage.

Office rents (prime rents) have gone up for the eighth time in as many years. In the Class A cities, the weighted average of the prime rent stood at 30.70 euros/sqm of office space, which implies an increase by 5.9% year on year and by an actual 36.3% since the last cycle trough in 2010. The average rate in the Class B cities was 14.00 euros/sqm RAC by the end of 2018 and thus topped the prior-year figure by about 2.5% and the prime rent of 2010 by 15.9%. In Class C markets, the prime rent went up by 2.7% to 12.90 euros/sqm RAC (+19.3% since 2010) while in Class D cities it rose by 2.1% to 10.20 euros/sqm RAC (+16.0% since 2010).

Selling prices easily broke the record set the previous year. Prices in the Class A cities gained by an average of 11.6% and at 11,050 euros/sqm crossed the threshold of 10,000 euros/sqm for the first time. The city with the steepest price hike was Berlin. In 2018, the capital value equalled 12,600 euros/sqm RAC and thus 14% above the prior-year figure and more than 100% above the price of 2015. Munich remains the most expensive city at nearly 13,750 euros/sqm (+6.9% year on year), trailed by Frankfurt at 13,650 euros/sqm RAC (+9.2%). Office accommodation sold for 10,160 euros/sqm RAC (+10.9%) in Hamburg, for 7,140 euros/sqm RAC (+9.0%) in Stuttgart, for 6,930 euros/sqm RAC (+10.9%) in Cologne and for 8,370 euros/sqm RAC (+18.8%) in Düsseldorf. The average capital value in the Class B cities was 3,400 euros/sqm RAC (+6%). Prices in Class C cities climbed to 2,800 euros/sqm RAC (+7.5%). The square-metre price for office space in Class D cities achieved an average of 1,810 euros and is stable.

In the course of 2018, net initial yields continued to harden for the ninth consecutive year since 2009 across cities of all classes, setting new record levels. In Class A cities, the weighted average for core real estate stood at 3.0% by the end of 2018, just 10 basis points below the prior-year figure. Yields gradually seem to be finding a stable basis. At 2.8%, Berlin is actually ahead of Munich and Hamburg with 2.9% each, and Frankfurt next at 3.0%. Slightly more affordable are the cities of Düsseldorf, Stuttgart and Cologne with yields between 3.2% and 3.4%. Meanwhile, 11 out of the 14 Class B markets have dropped to a yield level of 4.5% or below. The most expensive markets in this group are Nuremberg and Bonn with 4.0% each. Out of the 22 Class C markets, 8 matched or exceeded the level of 4.5%. In the lead were Freiburg (4.0%), Heidelberg (4.1%), and Mainz (4.2%).

The vacancy rate declined for the eighth consecutive time. The vacancy rate across Germany's 127 largest office markets in 2018 averaged 4.2% in 2018, which implies a year-on-year drop by 70 basis points. In the Class A cities, the supply in office space shrank by nearly 570,000 sqm RAC to a vacancy rate of 3.4% while the Class B cities reduced vacancies by around 220,000 sqm RAC (4.0%), Class C cities by 90,000 sqm RAC to 4.6% and Class D cities by 110,000 sqm RAC to 5.6%. In 35 German office markets, the vacancy level has now dropped to or below the threshold of 3.0%, which is tantamount to full occupancy if you take the usual fluctuation reserve into account.

It is unlikely that the keen demand on the market will be met in 2019. The keenly sought type of new-build accommodation available on short notice is in particularly short supply. The situation in cities with a very low supply level might even get worse in 2019, so much so that some companies will be relocating to alternative locations.

Unternehmensimmobilien

Unternehmensimmobilien is the German term for a type of commercial real estate that is internationally known as "light industrial" property. Characteristics that set it apart from logistics real estate include mainly a certain size, locational and structural parameters, as well as tenant and occupier line-up. While the properties owned by large industrial firms are similar in structure, the latter are essentially covered by the term "corporate real estate" unless they are heavy industry assets (e. g. steel mills, refineries).

On the investment market, the year-end total of 2018, while exceeding the long-term mean by around 20%, marked a year-on-year drop by c. 2.5 billion euros. Underlying causes include the short supply in product and a shifting market environment. The majority of properties available on the market were already traded in previous years—some of them in the form of large-scale portfolio transactions. Most of these transactions involved well-documented assets in locations marked by advanced market transparency. The largest share of it at 800 million euros was spent on business parks during the second half-year of 2018. Nearly 500 million euros were invested in light manufacturing properties.

For some years now, gross initial yields have also declined for Unternehmensimmobilien, albeit at a certain delay compared to other real estate asset classes and not as swiftly as the now very pricey office and retail real estate. For converted properties (revitalised commercial properties supplemented by infill densification and put to new use), the standard market yield spectrum ranges from 4.3% to 6.0%. Business parks still generate 6.0% to 9.3%, whereas the going rate for warehouse/logistics properties is 4.7% to 6.6% and light manufacturing properties move in a standard market bracket of 5.2% to 7.4%.

Prime rents for Unternehmensimmobilien have gone up steadily in recent years, but vary from one floor space type to the next. Prime rents for office and social areas averaged 14.20 euros/sqm toward the end of H2 2018, whereas the monthly rate for flex spaces was noticeably higher at 17.25 euros/sqm and light manufacturing units were available for 8.67 euros/sqm on average.

Logistics Real Estate

On the investment market, logistics real estate continued to expand their share in commercial real estate, up from 10.7% in 2017 to 11.5% now. Nonetheless, the investment volume experienced its first year-on-year decline since 2013 in 2018. Overall, more than 7.0 billion euros were invested in commercially used real estate with logistics share (including Unternehmensimmobilien and industrial real estate) in 2018. This implies a decrease by around 23% since the banner year of 2017. While demand remained strong, it was short supply that curbed the possibilities to invest. Not least, a large share of the available assets already changed hands during the fast-trading years just behind us.

The new-build construction of logistics facilities also experienced a dip in 2018, the first since 2015. Although the first quarter was the strongest since the start of the survey, the comparatively modest output in new-build logistics facilities during the second half-year caused the year-end completions total of 3.9 million sqm to fall short of the threshold of 4 million sqm. It brought the new-build completions total in logistics real estate between 2013 and 2018 up to nearly 24 million sqm. A look at the floor space volume in the pipeline for 2018 and 2019 makes it safe to assume that the building activity will remain high.

The demand for logistics facilities will continues to be driven in 2019 by the dynamic growth of online retailing. Smaller assets and those located close to metro regions will be particularly popular. Private consumption and the manufacturing industry ensure a permanently strong demand for adequate logistics solutions—and all of this should be seen in context with the limited supply in floor area.

Hotel Real Estate

The annual number of overnight stays went up for the ninth time in as many years in 2018. Provisional calculations show that the number of arrivals in the German hospitality industry rose by 3.8% to around 185.1 million in 2018, and the number of overnight stays by 3.9% to around 477.6 million.

The investment market for hotel real estate registered a transaction volume of nearly 4 billion euros in 2018, and thus narrowly missed the prior-year result of 4.2 billion euros. Undaunted by rising prices, demand remains strong, yet the right kind of asset is hard to find on the market. Major portfolio deals were transacted mostly during the early months of the year. Then again, there was a flurry of minor transactions with price tags of less than 25 million euros. The short supply in available products also drove up the share of forward deals, which accounted for around 20% of the transactions in 2018. Investors were particularly busy picking up properties in B- and C-class cities (Kiel, Lübeck, Essen, Oberhausen, Eschborn, Freiburg, Hanover, Darmstadt, etc.).

The drop in yields that had been anticipated in 2018 did come to pass. Prime yields in all of the Class A cities are now below 5%, and have indeed dropped below the 4% mark in the case of Munich with 3.75%. Hamburg is in second place with 4.0%, trailed by Frankfurt with 4.1%, Stuttgart with 4.15%, and Cologne and Düsseldorf with 4.5% each. The rate in Berlin is 4.75%.

Notwithstanding the increased prices, the value of hotel rooms in Germany remains on a low level compared to other countries. According to the Hotel Valuation Index published by HVS London (which only covers the upscale segment, though), Munich ranked tenth among the 33 cities covered in 2017, unchanged from the previous year. With c. 307,200 euros per room, Munich lags far behind the top-ranking city of Paris (674,100 euros/room). The cities of Hamburg and Frankfurt placed in ranks 15 and 17, respectively (previous year: 16 and 17) while Berlin improved to rank 19 (c. 218,900 euros/room).

3. Retail

Consumer sentiment in Germany proved to be immune to any unease that anxious headlines and unsettling events could have triggered. As a result, the GfK Consumer Climate Index spent 2018 on a higher level than the one it had reached the previous year, yet did show a mild downward trend toward year-end. But on the whole, the parameters for the retail business were favourable last year.

This has fostered a further increase in retail area by 0.6% to 119.8 million sqm and a robust dynamic on the occupier market, although it should be added that it also reflects the ongoing transformation of the retail landscape. For 2018, we registered a nominal sales growth of around 1.9% for the entire German retail sector (incl. distance selling).

The forecast for the ongoing year of 2019 projects a growing per-capita purchasing power by nominally 3.3% to 23,779 euros. It is boosted by rising wages, a stable labour market and rising pensions and monetary social benefits. In conjunction with the demographic growth, these factors result in a substantially higher total disposable income that Germans will have at their disposal for consumer spending, living, leisure or saving. Although segments unrelated to retailing are likely to benefit from it slightly more, the retail sector is predicted to experience a nominal revenue growth by around 1.8% (incl. distance selling), in which even the brick-and-mortar retailers will participate with a growth by around 0.8%.

All of Germany's seven leading retail cities reported an upward trend in retail revenues on the city-wide level in 2018, exceeding the average growth of in-store retailing as a whole. The trend in retail-space-per-capita, by contrast, differs from one city to the next, although it should be added that some of the retail area taken off the market will be replaced shortly.

In most cases, prime rents have remained stable, as the premium high-street pitches appears to generate sufficient demand. Some areas of Berlin and Düsseldorf actually registered an increase in prime rents, whereas the rent level in downtown Stuttgart, including in high-street pitches, has softened and remains under pressure. Particular momentum was reported from Berlin, where two new shopping centres opened, among other venues.

The retail investment market is looking back on an altogether sluggish performance in 2018. Although the transaction volume still topped the long-term mean at c. 10.5 billion euros, the total result undercut the prior-year figure by more than a quarter. Particularly conspicuous was the drop in shopping centre commitments. But trading was also down for retail warehouses and retail warehouse parks even if these claimed the largest chunk of the overall market.

Prices have continued to go up because demand for interesting retail property is outpacing supply, but this is not true for all of the "Big Seven" cities. Munich remains the most expensive city with a net initial yield of 2.6% at the top end. Next in line is Hamburg with 3.0%. Third place is shared by Frankfurt (3.1%, stable) and Berlin (3.1%, yields slightly hardened). The gap between the other retail cities has narrowed and they all share a net initial yield level of 3.2% at the moment. This puts the net initial yield rate across all seven cities at a mean rate of 3.16% (previous year: 3.06%). It implies a year-on-year decline by ten basis points.

The Seven Leading Retail Property Markets

Berlin continues to develop at break-neck speed, fuelled by persistent demographic growth and and an increase in tourism, especially from abroad. In-store retailing has benefited from the trend with a revenue growth of 1.8% year on year. As in 2017, the city-wide retail-space-per-capita ratio increased substantially in a parallel development, which is explained by the completion of two shopping centres. The positive dynamic in Berlin is also mirrored in the rental trend. The prime rent for modern standard retail units of 80-120 sqm in size went up by a noticeable 5.6% from 360 to 380 euros/sqm, running counter to the downward or stagnant trend seen in the other cities. In secondary locations, however, prime rents rose only in some cases, even in Berlin. For instance, the rent for shops of 300-500 sqm stayed at 180 euros/sqm.

In Hamburg, the demographic growth, which has been continuously positive lately, the increasing integration of the conurbation and the particularly brisk increase in tourism in 2018 ensured that the city achieved a nominal growth in retail sales last year, too, once again generating the second-highest retail revenues of any city in Germany after Berlin with a total of c. 11.4 billion euros. The retail-space-per-capita, by contrast, has remained more or less unchanged, so that the average retail space productivity perked up slightly to just below 4,300 euros/sqm across the city. The collectible prime rent remained stable year on year. In fact, it has stood at 310 euros/sqm for smaller shops (80-120 sqm) and at 200 euros/sqm for larger retail units (300-500 sqm) since 2016.

Munich keeps offering very auspicious conditions for the retail business. The population increase, the robust job growth and the low unemployment rate make the retail purchasing power significantly higher than in other German metropolises. It is supplemented by the large number of tourists that come to Munich expressly to go shopping, including a lot of international visitors. So, it was another year of surging retail revenues. Retailers achieved the highest sales per square metre in the inner city, which boasts the second largest retail line-up among Germany's cities, outdone only by the polycentric and much larger city of Berlin. For the fourth year in a row, peak rents for the prime high street pitch 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.

Cologne registered a sizeable one-year increase in retail revenues. Even the retail trade centrality increased slightly and now equals 122. Apart from supplying a large catchment, Cologne draws a large number of tourists. It should be added that the trend in revenues in 2018 coincided with an expansion of the growth in retail floor space—both downtown and elsewhere in the city. But the level of prime high-street rents remained stable. Retail units between 80 and 120 sqm here are let for a maximum of 270 euros/sqm, larger stores (300-500 sqm) for 145 euros/sqm.

Düsseldorf, boasting the second-highest purchasing power index (117.8) among the reference cities, is sustained by a high local demand potential that is supplemented by visitors from the greater metro area, daily commuters and tourists. The city's retail-space-per-capita is comparatively high, the inner city accounting for a high share of around 35% of the gross retail area. In 2018, Düsseldorf experienced a moderate top line sales growth that was driven to some extent by demographic growth and by new retail areas coming on-stream. The prime rent for retail units of 80-120 sqm in prime high-street pitches nudged up by 1.8% to 290 euros/sqm year on year. Even larger stores with 300-500 sqm of retail area became more expensive. Their prime rent went up to 155 euros/sqm (+3.3%).

Frankfurt started into 2018 with a comparatively fast demographic growth of 1.4% since the January of the previous year. Combined with the high personal purchasing power level of its residents and the increased number of daily commuters, this resulted in an improved platform of retail-relevant potential. Frankfurt's retailers converted this into an upward trend in revenues, all things considered. The development was matched by an increased in the local retail-space-per-capita. As a result, the retail space productivity improved only marginally to now 3,800 euros/sqm. The prime rent remained unchanged at 290 euros/sqm for small stores of 80 and 120 sqm. Analogously, rents for larger retail units proved stable at 165 euros/sqm.

Stuttgart thrived on its robust economic momentum in 2018 while also experiencing sustained demographic growth and an increase in purchasing power. The retail trade centrality of Baden-Württemberg's state capital is also high at 117. Despite the favourable parameters on the demand side, the city-wide retail revenues rose disproportionately slow pace compared to the other metropolises while the retail-space-per-capita declined slightly. Prime rents suffered a noticeable year-on-year dip in 2018. In the case for small stores of 80-120 sqm, they dropped by 8% from 250 to 230 euros/sqm, in the case of larger units between 300 and 500 sqm in high-street locations they decreased to 120 euros/sqm (-11.1%).

4. Residential

Residential rent rates (rents on new leases) continued to go up last year. Across Germany, the median asking rent in Q3 2018 stood at 7.06 euros/sqm, which implies an increase by 3.9% over prior-year quarter. It means that rents on new leases gathered momentum compared to the prior-year period when the growth rate had been 3.6% (between Q3 2016 and Q3 2017). The development in the course of last year was relatively steady, and there is no evidence suggesting that the rental trend has slowed lately. During the third quarter of 2018, the change over prior-year quarter equalled 1.0%. Nationwide, rents on new leases went up by 36.8% since the start of the time series in Q1 2017.

The swiftest rent growth last year was reported from in West Germany with independent cities (+4.3%) in the lead, followed by rural counties with a growth rate of 4.1% (between Q3 2017 and Q3 2018). The western part of the country also tops the list in terms of rental level with 8.29 euros/sqm (independent cities) and 7.02 euros/sqm (rural counties). Slightly slower growth rates by contrast, were registered in the East German independent cities (not including Berlin) and East German rural counties with +2.4% each. The East German level is also significantly lower for rents on new leases at 6.48 euros/sqm (independent cities without Berlin) and 5.67 euros/sqm (rural counties).

The growth in condominium prices also continued its upward momentum last year. Existing flats nationwide sold for a mean price of c. 1,875 euros/sqm during the third quarter of 2018, implying a price growth rate of 8.2% compared

to the third quarter of the previous year. It is the same growth rate that condominium prices had experienced the previous year. However, the price dynamics have slowed slightly since. Condominium prices, for instance, increased by a mere 1.8% quarter on quarter during Q3 2018, down from a growth rate of 2.5% quarter on quarter during Q1 2018. This does not, however, suggest there is evidence for a fundamental trend reversal. Nationwide, condominium prices climbed by 77.1% since the start of the time series in Q1 2017.

The steepest price hikes were registered in West Germany last year at +8.8% in the independent cities and 8.6% in the rural counties (in each case between Q3 2017 and Q3 2018). At 2,340 euros/sqm (independent cities) and 1,900 euros/sqm (rural counties), West Germany also showed the highest absolute price level. While selling prices for existing flats in independent cities of East Germany pushed up by 8.1% to now 1,585 euros/sqm, the price growth in East German rural counties moved at a rate of only 4.4%. At c. 1,165 euros/sqm, selling prices for condominiums in East German counties continue to lag far behind the national mean. But while quarterly growth rates both nationwide and in West Germany began to lose momentum lately, growth rates in the East German independent cities (not including Berlin) and the East German rural counties accelerated slightly as the year progressed—with condominium prices going up by 2.3% and 1.4% quarter on quarter in Q3 2018.

Selling prices for detached and semi-detached homes increased by 7.6% to c. 2,455 euros/sqm on average nationwide (between Q3 2017 and Q3 2018). This means that prices for free-standing homes grew slightly faster than they had the previous year when a price growth of 6.5% (Q3 2016 to Q3 2017) had been recorded. In the course of the year, the price trend followed a steady curve, with home prices showing a quarter-on-quarter growth by 1.9% in Q3 2018. Since the first quarter of 2007, selling prices for detached and semi-detached homes have thus increased by 62.3%. A drill-down by type of region reveals that rents on new leases and condominium prices evolved along comparable trajectories.

In terms of new-build construction, the number of completions rose by 2.6% or 7,100 to a total of around 284,800 year on year. The last year with a yet higher completions total was 2002 with around 289,600 flats. The positive trend in building activity that started in 2010 thus continued in 2017, although it must be added that it lost considerable momentum since the brisk increase by 12.1% in 2016. Given the requirement of at least 350,000 new flats annually, the year 2017 must actually have caused an increase in pent-up demand.

Housing Markets in the “Big Seven” Cities

Rents on new leases kept pushing up in all of the seven Class A cities last year. Between Q3 2018 and the corresponding prior-year quarter, the growth rate ranged from 4.7% in Cologne to 9.2% in Berlin. At the same time, growth accelerated in the majority of cities, e.g. in Berlin (+9.2%, after +8.0% the previous year) and Hamburg (+5.7%, after +4.6% the previous year). Conversely, the growth in Munich and Stuttgart slowed a little, year on year. Yet the growth rates were still quite substantial at +6.8% in Munich and +7.8% in Stuttgart last year. They only slowed from the yet faster rates of +7.5% and +8.1%, respectively, the previous year. Indeed, it would be premature to infer from the annual rate that the rental trend will permanently slow down in response to the already high rent level in these two cities. The most recent figures show that rents on new leases have outpaced the growth rates of early 2018. In Q3 2018, the rents on new leases registered a quarter-on-quarter growth by 1.9% and 2.6%, respectively. The highest rents are still quoted in Munich with 16.54 euros/sqm, followed by Stuttgart and Frankfurt with 13.16 euros/sqm and 12.58 euros/sqm, respectively. In Hamburg, rents on new leases averaged 10.90 euros/sqm, ahead of Düsseldorf with 10.42 euros/sqm and Cologne with 10.23 euros/sqm. Even Berlin has crossed the 10-euro mark with 10.04 euros/sqm after an ongoing period of particularly brisk growth. The quarter-on-quarter growth of rents on new leases has persistently topped 2% since the second quarter of 2017.

Analogously, condominium prices continued to go up in all of the "Big Seven" cities last year (Q3 2017 to Q3 2018). Berlin (+15.2%) reported the steepest hike, trailed closely by Frankfurt (+13.2%). The other Class A cities recorded price increases between 9.6% in Düsseldorf and 10.7% in Cologne and Munich. The growth in condominium prices in 2018 generally grew faster than the previous year, Stuttgart and Düsseldorf being the sole exceptions with a certain slowdown year on year. Prices increased by 2.3% in Cologne and by 1.9% in Stuttgart. Asking prices most recently quoted for a standard existing flat in the "Big Seven" cities ranged from 6,390 in Munich and 3,240 euros/sqm in Cologne (each in Q3 2018). Somewhere in between were Frankfurt with 4,350 euros/sqm, Hamburg with 3,850 euros/sqm, and the cities Berlin and Düsseldorf with price tags of less than 3,500 euros/sqm each.

Meanwhile, yields have kept hardening as selling prices outpaced the rental uplift. The mean gross initial yield (median) in Munich, for instance, dropped to 2.7% in 2018 (Q1 – Q3 2018). It implies a price-to-rent ratio of nearly 37 annual net rents. Berlin trails closely behind with a gross initial yield of 2.8%. The going rate in Stuttgart is 3.3% and is 3.4% in both Frankfurt and Hamburg. The cities with the highest yield rates among the "Big Seven" are Cologne (3.7%) and Düsseldorf (3.9%).

Although the present cycle is now in its eleventh year, there are no signs for a fundamental trend reversal. Given the persistent shortfall in supply, the price upsurge on Germany's residential property market is likely to continue in 2019. Especially in the conurbations, it is quite safe to expect substantial price hikes. Evidence of excessive pricing is manifest most notably in Class A cities, their greater areas and in a number of other major cities subject to keen demand, and these pricing spikes could result in adjustments. Then again, there are no signs of a real estate bubble that affects the overall market in Germany. Tell-tale signs such as an inflated credit growth or runaway building activity are missing from the picture.

5. Residential Real Estate in Major Independent Cities (Not Including the "Big Seven" Cities)

The development of Germany's major cities is decidedly heterogeneous. On the one hand, so-called swarm cities attract an inflow of new arrivals, especially young people. Their housing markets are strained while rising rents and prices for residential real estate have long crossed the record level, boosted not least by the low level of interest rates. Gross initial yields are inversely approaching record-breaking lows, and in some cities it is doubtful if even the preservation of capital will remain possible. On the other hand, there are a number of major cities that either fail or struggle to attract young people This is true particularly—but not exclusively—for rust-belt cities in North Rhine-Westphalia and elsewhere. Here, the housing demand has increased only marginally or not at all. Rent rates and selling prices are low, the gross initial yields comparatively high.

The highest rents in major cities not included in the "Big Seven" are quoted in Ingolstadt and Freiburg with c. 10.80 euros/sqm for a standard flat (hedonic, all building ages, 60-80 sqm, higher-end fit-out, supply-side data), in both cases narrowly exceeding the rent level of the Class A cities Hamburg and Cologne. Asking rents also exceed a mean level of 10.00 euros/sqm in the cities of Mainz, Regensburg, Darmstadt, Heidelberg and Wiesbaden. In another 19 cities, rents between 8.00 and 10.00 euros/sqm are quoted, among them the two East German cities of Potsdam and Jena. Conversely, the most affordable flats with rents between 5.00 and 6.00 euros/sqm are listed in cities in the Ruhr as well as in Chemnitz, Bremerhaven, Cottbus, Salzgitter, Halle and Magdeburg.

The highest selling prices, after Munich and Frankfurt, are currently quoted in Freiburg (4,000 euros/sqm), Ingolstadt (4,000 euros/sqm) and Regensburg (3,700 euros/sqm). Prices in a total of 17 cities with populations of

more than 100,000 now top the mark of 3,000 euros/sqm while the going rates in 23 cities range between 2,000 and 3,000 euros/sqm. The most affordable condominiums with selling prices of just over 1,000 euros/sqm are available in rust-belt cities in North Rhine-Westphalia, such as Hagen or Oberhausen, and in cities like Salzgitter, Bremerhaven or Chemnitz. The city with the lowest price level nationwide is Gelsenkirchen with a mean selling price of barely 1,000 euros/sqm. The average (unweighted) square-metre price across all major German cities is 2,400 euros.

The combination of fast-rising prices and slower rental growth has caused gross initial yields in nearly all of the cities to drop significantly over the past few years. As recently as 2012, the acquisition of occupied flats offered an average gross initial yield rate of 6.1% across the independent cities. By 2018 (January through November), the rate had dropped to 4.7%. The lowest gross initial yields were lately identified, apart from Munich and Berlin, in Regensburg (3.0%), Freiburg (3.2%), Augsburg (3.3%), Ulm (3.3%) and Ingolstadt (3.3%), the highest with more than 7.0% in Salzgitter, Chemnitz and Gelsenkirchen. Another eleven cities still promise gross initial yields of over 6.0% percent and nine other cities more than 5.0%. But in a total of 22 of Germany's 68 major independent cities, they are now below 4.0%.

6. Healthcare Real Estate

The market for nursing care property continues to follow a growth trajectory. In 2017, there were around 3.41 million care-dependant individuals in Germany. This equals 4.1% of the total population. By 2030, the number people in need of care will have gone up by around 675,000 or 20% to nearly 4.1 million people overall. The vast majority of the care-dependant individuals are cared for at home. Predictably, care is mostly provided by the next of kin. Only around 23% of the affected individuals are in permanent in-patient care. This group of over 792,000 peoples will quickly grow in sync with the demographic trend. Depending on the projection variant, their number could rise by as many as 293,000 to a total of 1.1 million people nationwide before 2030.

At the same time, supply lags behind the rising demand. By late 2017, there were barely 876,900 spots for permanent in-patient care in just over 11,200 care homes. This means the supply ratio in nursing care equalled almost 50 spots for every 1,000 residents aged 65 years or older. Although the supply side in this segment is growing as well, the growth has slowed even though capacity utilisation appears to have reached a high level overall.

While completions figures remain on the low level of recent years, the projected increase in supply would not even suffice to cover half of the extra demand. Add to this the need to replace an estimated 210,000 care spots in existing institutions.

The national demand forecasts, which seem highly auspicious at first glance, require an in-depth examination for each region before an investment decision is made. The number of care-dependant individuals and the proportion of older people in care homes or requiring care in some other way are all subject to considerable regional deviations. As often as not, they are defined by administrative boundaries, and amazingly few facts are known about the underlying causes.

A closer look also reveals the intense dependencies of the nursing care market on political and institutional rules and regulations that differ from one state or administrative district to the next. Add to this certain key challenges such as the availability or land and contractors, the availability of care professionals, the funding environment or the capped investment costs on the part of the plan sponsors.

The “Immobilienweisen” Council of Real Estate Experts

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About the publisher:

ZIA Zentraler Immobilien Ausschuss – German Property Federation is the leading association for the German real estate industry. Through its members, which include more than 25 associations, it speaks on behalf of some 37,000 companies in the sector, covering the entire value chain.

The association gives the real estate industry, in all its diversity, a comprehensive and consistent representation of interests that reflects its importance to the economy. As an association of entrepreneurs and associations, it gives the entire real estate industry a voice at national and European level – and in the Federal Association of German Industry (BDI). Dr. Andreas Mattner is President of the Association.

ZIA is active at the European level and also a founding member of the European Real Estate Forum, an association of organisations related to institutional European real estate investment.

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