# Investment Market Overview

**Germany I 2nd quarter of 2014**
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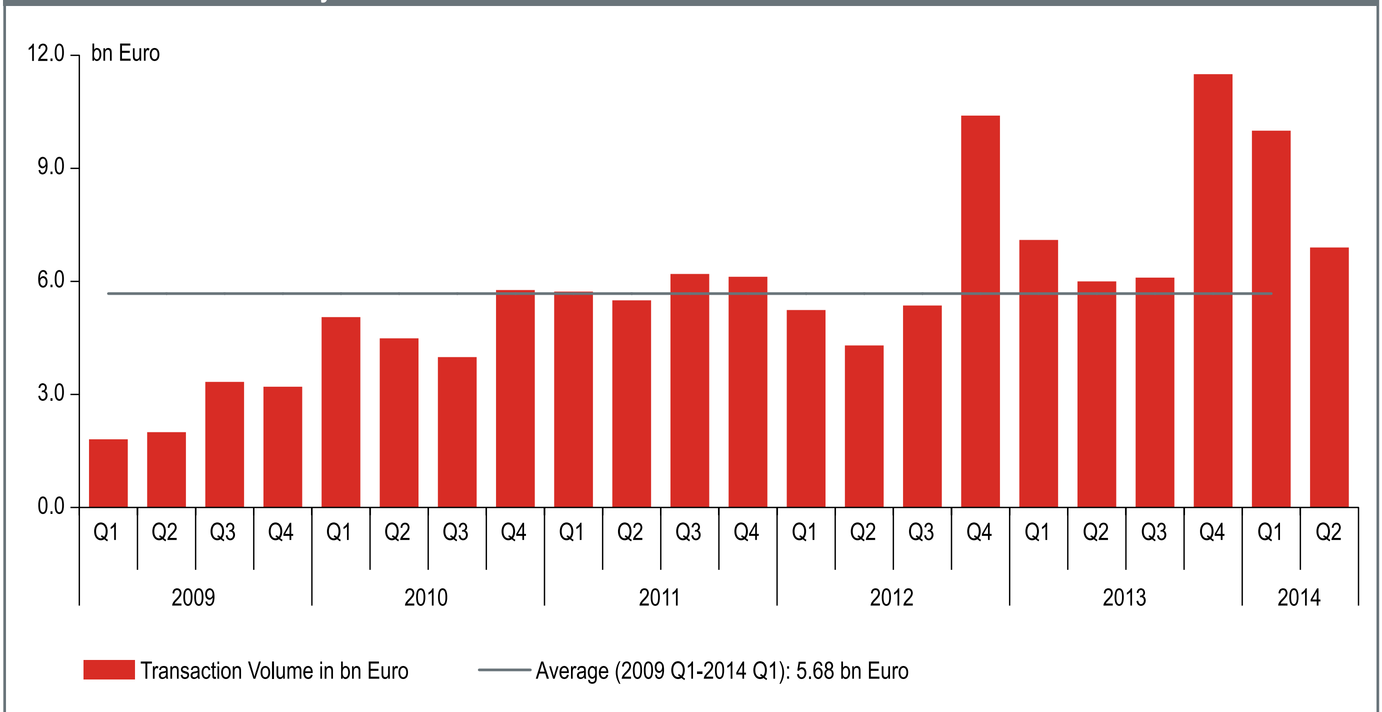
# Strong momentum on the German investment market

The German investment market continues to run smoothly with a good tailwind behind it as it enters the second half of the year. In the period from April to June, a transaction volume of €6.9 billion was registered on the German investment market for commercially used property. Thus the transaction volume for the first half of the year amounted to a total of €16.9 billion, which is around 29% higher than in the corresponding period of the previous year.
The momentum is partly fuelled by the continuing huge demand from international capital for investment opportunities, and partly by an attractive financing environment. From the perspective of the real estate sector, the European Central Bank's decision to cut the benchmark interest rate further to 0.15% strengthens the transactions scene in Germany and acts as a driving force for increased investment in the property asset class. Against the background of the growing investment needs of domestic and global institutional investors, coupled with this continuing low interest rate, questions about overheating tendencies will naturally arise. Given the stable fundamental data and the positive economic outlook, we do not see this at present.
In terms of investment returns, the comparison of property yields with 10-year government bonds plays an important role. The recent interest rate decision by the ECB tends to have the effect of decreasing yields for short-term government bonds, while a slight increase is seen as more likely in the medium term for the 10-year bonds as a consequence of the hoped-for economic revival and the diminishing threat of deflation. But even in this case the yield gap between real estate and government bonds will still be large and property will continue to offer an attractive return in relative terms compared to alternative investments.
In view of the price increases in the core segment, the popularity of

**Transaction volume Germany**



prime properties and prime locations has nonetheless dipped slightly. Investors are seeking higher-yield properties and are therefore also accepting higher levels of risk. With respect to such core-plus, value-add or opportunistic investment strategies, Germany tops the list of target countries particularly among foreign institutional investors. In 2013, globally active private equity funds alone amassed capital of almost US$160 billion that is to be invested in property worldwide. This is more than in the boom years of 2006 to 2008. We expect to see further growth in the current year. The enormous capital stock of foreign investors prompts a desperate search by these investors for alternative investment options in the light of the continuing low interest rates. As well as the established large government and pension funds, we expect a growing number of different investors that have so far not been active in Germany to now seek an entrance on the market.

## Transaction activity remains buoyant

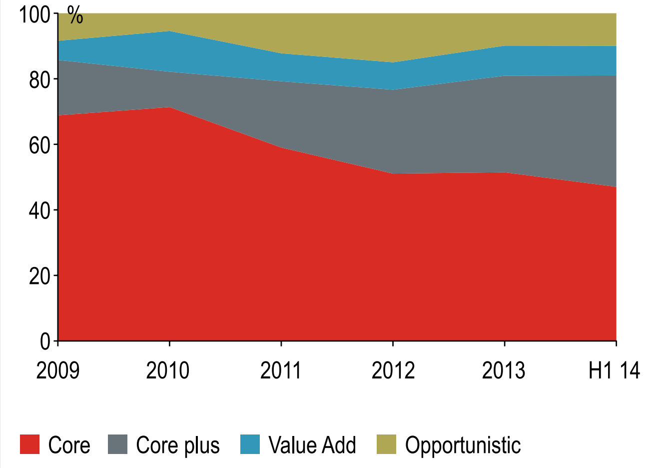
The decline in the transaction volume compared to the first quarter did not come as a surprise, and in no way signifies that the strong interest in German commercial real estate is waning. On one hand, the period from January to March benefited from some transactions carried over from 2013 as well as a portfolio deal worth billions (Leo I). On the other hand, the transaction volume in the second quarter shows that buyers in the core-plus and value-added segment are not always prepared to cooperate with sellers when it comes to expectations on price.
The increased interest in portfolios that was noticed three months' ago manifested itself at the end of the first half with a volume of €6.15 billion registered over six months. This represented an increase of 82% compared to the previous year's volume. Individual transactions amounted to €10.8 billion, an increase of 11%. Four of the five largest transactions in the second quarter were portfolio transactions, of which the biggest was the sale of 67 hotels from the Accor brand portfolio for around €430 million. The sale of the Kö-Galerie in Düsseldorf for around €300 million represented the largest single transaction in the second quarter.

**Transaction volume Germany**

| | Transaction volume (million Euro) | | |
|---|---|---|---|
| | H1 2013 | H1 2014 | % |
| Single assets | 9,720 | 10,750 | 11 |
| Portfolios | 3,380 | 6,150 | 82 |
| **Total** | **13,100** | **16,900** | **29** |

% is defined as percentual change between H1 2014 and H1 2013

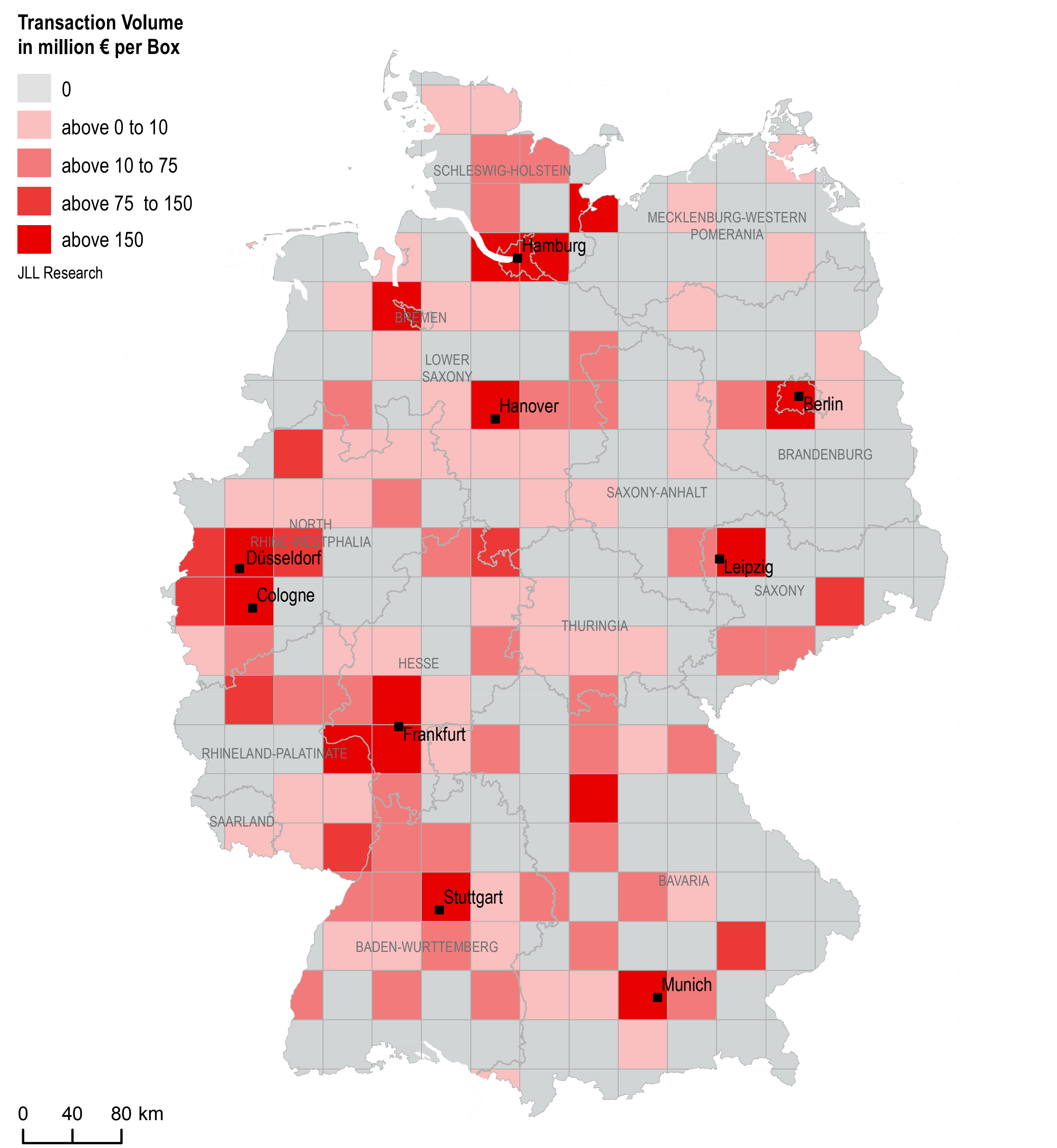
**Transaction volume by risk profile**




## Strongholds increase their share further

The transaction volume in the seven property strongholds reached almost €8.2 billion in total by the end of June. This also includes properties in portfolio transactions across multiple locations. Contrary to the overall downward trend in the transaction volume at national level, a quarterly comparison in the Big 7 showed a small increase in the share of the commercial investment volume from 41% to 50%. Thus the same can be said of the Big 7: a quarterly decline does not indicate a sustained slow down in demand.
Munich retained its position as the number one investment stronghold in the first half of the year (+21%) with a volume of €1.9 billion, ahead of Frankfurt with almost €1.6 billion and Hamburg with more than

## Transaction volume commercial real estate H1 2014



€1.4 billion. While the most northerly property stronghold enjoyed strong year-on-year growth in the first six months (+22%), Frankfurt registered a 15% decrease in its volume. This will certainly change over the course of the year. Stuttgart registered the strongest growth: properties with a volume of €670 million changed hands, representing a year-on-year increase of 49%.

## Office investments dominate nationwide

Investors continued to focus on the office asset class in the first half of 2014. With a 40% share of the transaction volume (corresponding to €6.8 billion), this segment is clearly ahead of the retail property segment with its 29% share (€4.85 billion). The share of hotels increased to at least 8% (€1.4 billion), due partly to larger portfolio transactions. Three investor types accounted for almost half of the investment volume in Germany in the first six months (around €8.3 billion): asset/fund managers, special funds and private equity investors. Transactions among these investors were also slightly lower in the second quarter. Only corporates, insurance companies and private investors invested somewhat more than in the previous three months.

## Prime yields largely stable

Prime yields were little changed at the end of June despite the continuing strong investor focus on top properties. In the office segment, the aggregate yield for the Big 7 fell slightly again to an average of 4.57%. This was primarily due to the drop by 10 basis points in each of Düsseldorf, Cologne and Stuttgart. The prime yields in the Big 7 are therefore becoming increasingly uniform, ranging from 4.30% (Munich) to 4.70% (Stuttgart and Frankfurt).

Office yields outside the top locations, or for office properties that have vacancies, are of poor quality or have short remaining lease terms, were unchanged. For prime properties in secondary locations in one of the Big 7, the average yield was 5.47% across all strongholds, representing a gap of 90 basis points between this and the prime yield.

We are registering strong demand from investors for products other than in the core segment. That this increased interest has nevertheless so far not been reflected by the yields is, in our view, a sign that the German investment market is currently not prone to exaggeration – an important difference from the last boom phase in 2006/2007.

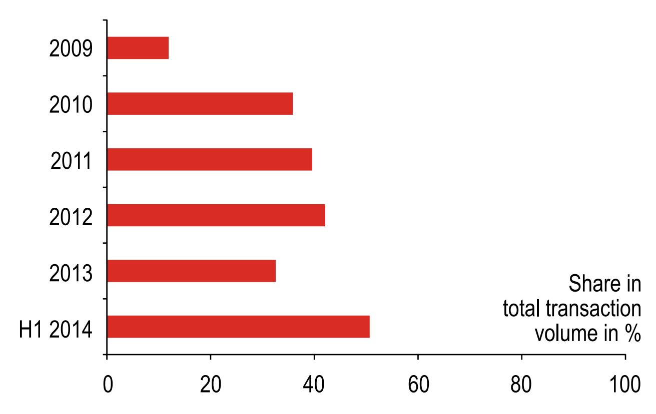
Among the other asset classes, only logistics properties registered a decline in yields: the average yield for all logistics regions of the seven strongholds fell by 5 basis points to 6.51%. Initial yields of 5.65% continued to be achieved for good specialist store products. The yield for shopping centres has also stabilised at 4.60%.

**Investment market in Big 7**

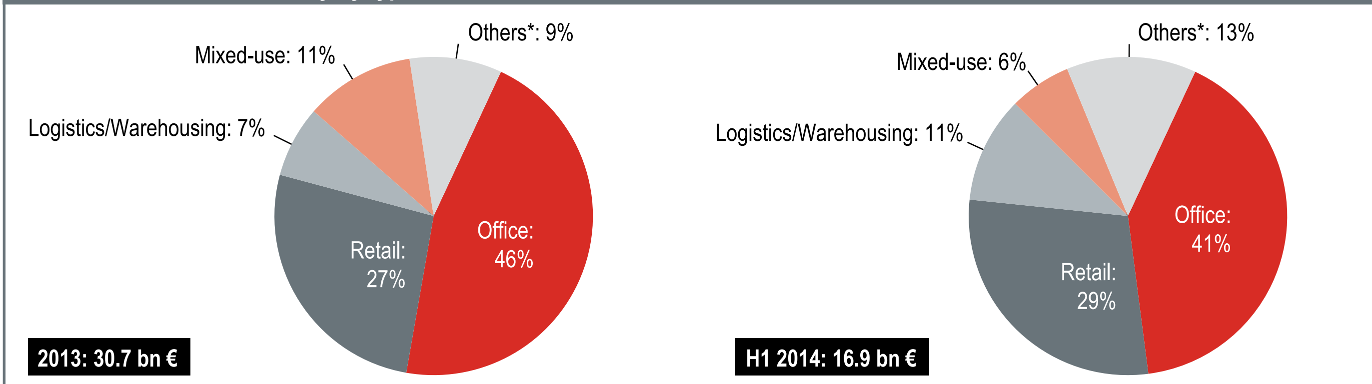
| | Transaction volume (million Euro) | | |
|---|---|---|---|
| | H1 2013 | H1 2014 | % |
| Berlin | 1,550 | 1,180 | -24 |
| Düsseldorf | 1,160 | 1,200 | 3 |
| Frankfurt/M | 1,830 | 1,550 | -15 |
| Hamburg | 1,170 | 1,430 | 22 |
| Cologne | 360 | 295 | -18 |
| Munich | 1,530 | 1,860 | 22 |
| Stuttgart | 450 | 670 | 49 |
| **Total** | **8,050** | **8,185** | **2** |

% is defined as percentual change between H1 2014 and H1 2013

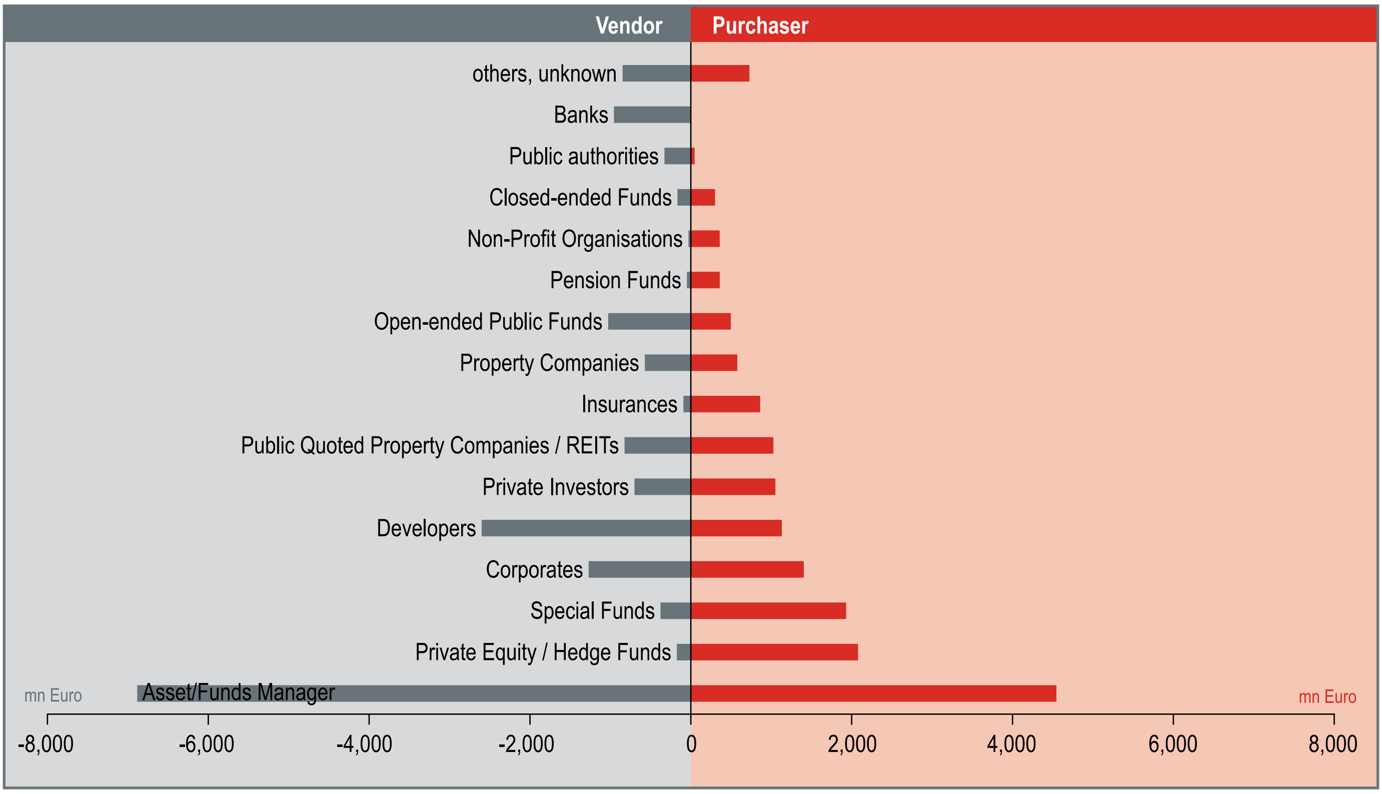
**Purchases of foreign investors**



## Transaction volume Germany by type of use




* Hotels, Land, special properties

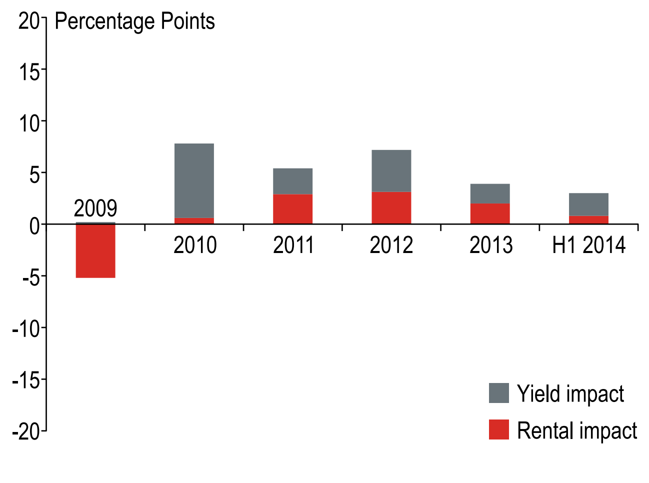


| Prime yields in 1a-locations (aggregated net initial yield in Big 7 in %) | | | | | |
|---|---|---|---|---|---|
| | Q2 2013 | Q3 2013 | Q4 2013 | Q1 2014 | Q2 2014 |
| Office | 4.74 | 4.73 | 4.67 | 4.61 | 4.57 |
| Retail: Shopping centre | 4.75 | 4.75 | 4.70 | 4.60 | 4.60 |
| Retail: Warehousing parks | 5.80 | 5.75 | 5.65 | 5.65 | 5.65 |
| Retail: Warehousing solus units | 6.50 | 6.25 | 6.15 | 6.10 | 6.10 |
| Retail: High street | 4.13 | 4.11 | 4.05 | 4.04 | 4.04 |
| Warehousing/Logistics | 6.72 | 6.57 | 6.57 | 6.56 | 6.51 |
| **Office prime yields (in %)** | | | | | |
| | Q2 2013 | Q3 2013 | Q4 2013 | Q1 2014 | Q2 2014 |
| Berlin | 4.80 | 4.80 | 4.70 | 4.60 | 4.60 |
| Düsseldorf | 4.70 | 4.70 | 4.70 | 4.70 | 4.60 |
| Frankfurt/M | 4.75 | 4.75 | 4.70 | 4.70 | 4.70 |
| Hamburg | 4.65 | 4.65 | 4.60 | 4.50 | 4.50 |
| Cologne | 5.05 | 5.00 | 4.80 | 4.70 | 4.60 |
| Munich Region | 4.40 | 4.40 | 4.40 | 4.30 | 4.30 |
| Stuttgart | 4.80 | 4.80 | 4.80 | 4.80 | 4.70 |

## The highest transaction volume since 2007 is possible

On the whole, business sentiment remains extremely positive on the German property investment market. Political and economic risks will not play a decisive role at least in short-term investment decisions, and market participants regard neither inflation nor the risk of deflation as direct risk factors with a strong influence. “In the event of higher rates of inflation, indexation clauses that are frequently included in commercial lease contracts are able to mitigate the erosion of a property’s real value. Deflationary trends are currently more evident in the peripheral EU countries. As before, economic growth in the different economies is also still valid as a core indicator for investors. Demand for space in property markets as a benefit of this growth, combined with rising rental prices, ensures an increasing flow of capital into the property segment. In the second half of the year, we also still expect the increased capital flow to be reflected by large investments above €100 million. We therefore maintain our forecast made at the beginning of the year that the transaction volume in 2014 will reach €35 billion-40 billion.

**Impact of change in rents and yields on office capital value growth**




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

# Residential investment market enjoys high turnover

In the first half of 2014, the German residential investment market enjoyed sustained strong demand. During this period, €6.9bn was invested in the German market for commercially-traded residential investment property. Overall, around 117,000 apartments changed hands in approx. 160 transactions. This means that by mid-year there had been around the same volume invested as in the same period the previous year, and some 20% more apartments traded than in the first half of 2013.

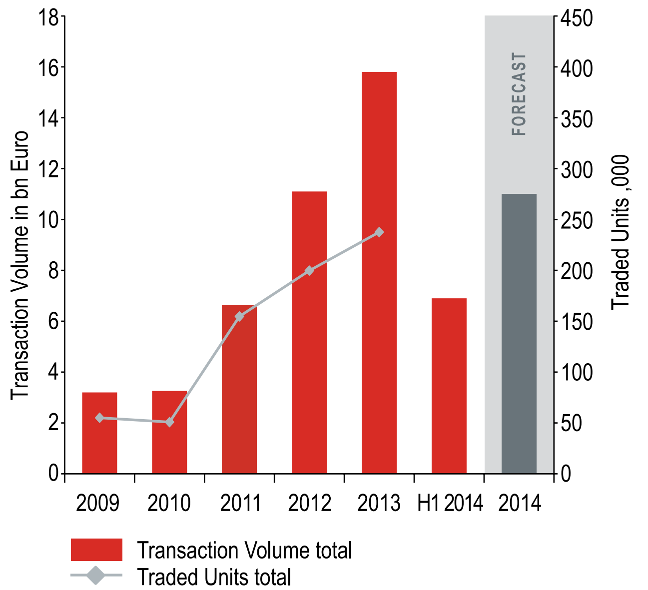
The lion's share of transaction activity took place in the first quarter of the year: the housing companies Vitus (30,000 apartments) and Dewag (11,500 apartments) were sold to Deutsche Annington for a total of €2.4bn; and the DGAG portfolio (Prelios) was purchased by the Austrian company Buwog for almost €900m. The total value of the first quarter's deals was around €4.7bn. In the second quarter, there were no large-scale transactions with more than 10,000 apartments. The sale of a portfolio of around 7,700 properties including residential complexes in Saxony, Saxony-Anhalt and North Rhine-Westphalia to Adler Real Estate was by far the largest transaction in the past quarter, followed by a number of transactions with volumes between 2,000 and 3,500 apartments. The total volume of transactions in the second quarter was €2.2bn.

As before, it is primarily German institutional investors who view domestic residential property as an alternative to currently low yielding products in the financial market. They made up 75% of all purchasers and include mainly listed housing companies and asset and fund managers, who  ccounted for the lion's share of all purchases. It is also this investor group which purchased project developments in the city centres of large German conurbations by way of forward deals, in order to increase their stock in the prosperous city centre areas.

In regional terms, the German capital is still the top investment location for residential property. A total of around €450m was invested in Berlin. Hamburg (€250m), the Rhine-Ruhr region (€170m) and Frankfurt (€90m) followed at a considerable distance behind. However, the price for residential portfolios in the first half year was around €900/m², thus below the previous year's level (€1,000/m²) which was driven by high-quality large-scale portfolio deals. The price for project developments sold as forward deals is rising continually. The average price is now almost €3,300/m²; in the previous year this was just under €3,000/m².

The outlook for the second half of the year remains positive. The continuing trend is towards portfolio restructuring at the same time as a diversification. Participations of domestic and international lenders in German housing companies are also being observed. By year end, it is anticipated that the transaction volume will be around €11bn.

**Residential investment market – Germany**



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