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The German Office Property Market

By Andreas Krone, SIOR



Economic Environment

Germany, which is the most densely populated country in the euro zone, has experienced robust and continuous economic growth in recent years while the economies of many other countries in Europe have continued to struggle. The gross domestic product (GDP) increased by 1.7 percent in 2015, thus outperforming previous years. Consumption remained the strongest growth engine. The manufacturing sector made a significant contribution to GDP with a growth of 2.2 percent, while business and government investments also increased. The Institute for the World Economy (IfW) in Kiel expects the positive economic development to continue in 2016 and 2017 with rising levels of growth.

The stability of the German economy has also brought about a significant decline in unemployment in almost every year since 2005. The German jobs market even escaped relatively unscathed from the recession in 2009. After already reaching a record low in the previous year for the period since 1992, Germany's unemployment rate fell further to 6.4 percent in 2015. At the same time the number of people in active employment has been on the rise since 2003, reaching a new record level of 43.1 million in 2015. The

positive situation on the employment market also helped boost purchasing power compared to the previous year. In 2016, the average purchasing power in Germany stood at € 21,879 (roughly \$24,000 USD) per inhabitant.

In demographic terms, population levels in some parts of Germany began to decline significantly from 2002 onwards. A return to growth was first registered in 2012 and Germany's population has been rising since then, increasing further to around 82.2 million people last year. Since the 1970s, population growth in Germany has resulted primarily from positive net migration and no longer from a surplus of births over deaths. The Federal Statistical Office reported that positive net migration was higher than ever before in 2015, reaching around 1.14 million people. This was due to the arrival of large numbers of refugees in Germany before the closure of primary refugee routes. Thus the decline that was predicted by many research institutes has been halted for the time being. Latest studies nevertheless indicate that a decline will again become evident longer term after 2020.

Financial markets stimulate the office investment market

Following ongoing reductions as a consequence of the economic situation in

Southern European countries, the base rate set by the European Central Bank reached a historic low of zero percent in March 2016, and has remained at that level since then. Hand-in-hand with this development, the steady decline in returns from German government bonds as risk-free benchmark bonds has enhanced the attractiveness of German commercial property compared to other forms of investment, with prime yields of 3-6 percent. Accordingly, there has been an increase in demand for commercial property. For example, insurance companies and pension funds have increased their real estate quotas in the form of direct investments as well as via special funds.

In addition, international investors have, to some extent, shifted their focus towards Germany and away from European countries that are grappling with economic turmoil and/or high public debt. At the same time, the decision by the U.K. to leave the European Union is also expected to stimulate further strong interest in German real estate. Against the background of an expected cooling of the U.K. market, there is a strong probability that international investors will rethink their investment allocation in favour of Germany.

In an international comparison, commercial property in German metropolises produces much higher rates of return compared to London, Paris, or large cities in the United States. It

therefore comes as no surprise that about half of the investment volume in the German commercial property market came from abroad in 2015. During 2016, however, the highly competitive market and a shortage of products have caused a slight dip in investments by foreign players.

Future expectations are that Germany's thriving economy and favourable financial conditions will continue to ensure strong investment activity on the German commercial property market in the coming years.

Office Lettings Market in a Healthy State

In contrast to France with Paris and Great Britain with London, Germany is based on a federal structure and is not dominated by one single city. Instead there are a large number of metropolises and cities that, taken together, constitute the overall market. The top markets include Berlin, Düsseldorf, Frankfurt am Main, Hamburg, and Munich. Generally, these cities are called the Top Five markets and are the primary focus of interest. On a long-term average, around two-thirds of the national office investment volume is allocated to these markets, meaning that they are characterised by strong fungibility and liquidity. Overall, office property has accounted for more than 40 percent of the total commercial

property investment market in recent years, making it the strongest property asset class in Germany.

As the capital city, Berlin is not only the political centre of Germany but also the largest German city and the second-largest city in the European Union (EU) after London. Hamburg is the second-largest city in Germany, with a port that is the biggest in Germany and the third largest in Europe based on cargo handling. Munich is the most densely populated city and the third-largest city by population size in Germany. The city's broadly diversified business structure, with a large number of different sectors including the information and communications industry, medical technology, culture and creative industries, provides a stable foundation for its economy. Frankfurt am Main is Germany's fifth-largest city and home to a large number of companies from the financial, credit and insurance sectors. The city is also the headquarters of the European Central Bank. Düsseldorf is the seventh-largest German city and is an important cultural and creative industry centre. The headquarters of numerous well-known corporations are also located here, especially from the telecommunications sector.

Munich is the largest office property market with a total stock of more than 20 million sqm, followed by Berlin (18.41 million sqm), Hamburg (13.60 million sqm), Frankfurt am Main (11.54

	POPULATION	OFFICE SPACE Q2 2016 (IN M SQM)	OFFICE TAKE-UP H1 2016 (IN SQM)	PRIME RENT Q2 2016 (IN €/ SQM P.A.)	OFFICE INVESTMENT VOLUME H1 2016 (IN M EUR)
BERLIN	3,469,849	18.41	412,000	306	760
HAMBURG	1,762,791	13.60	239,000	300	1,220
MUNICH	1,429,584	20.09	386,000	414	1,290
FRANKFURT	717,624	11.54	221,000	468	1,300
DUSSELDORF	604,527	9.12	223,000	318	520

million sqm) and Düsseldorf (9.12 million sqm). The highest prime rent is traditionally achieved in the banking metropolis of Frankfurt am Main and currently stands at 39.00 €/sqm per month. Elsewhere, only Munich is able to register a prime rent of above € 30, at 34.50 €/sqm per month. Prime rents in the other three top five markets, Düsseldorf, Berlin, and Hamburg, lie very close together at 26.50 €/sqm/month, 25.50 €/sqm/month and 25.00 €/sqm/month respectively. The average rent in Frankfurt am Main is also higher than in the other markets, and currently stands at 19.40 €/sqm/month. Munich is again in second place here with 16.50 €/sqm/month, while average rents in the other markets are around 15.00 €/sqm/month.

Based on the stable economic situation combined with rising employment figures in Germany, take-up on the German office lettings market is expected to increase further in 2016. Indeed, growth is seen as a certainty for the full year following the positive development in 2015 and the good performance in the first half of 2016.

As take-up continues to rise in the Top 5, most of the markets are also experiencing a decline in vacancy rates. In some cases, the rate has come close to 4 percent. The reduction in supply reserves provides enormous potential for new project developments that are also in the process of being realised. New spaces will quickly find customers as a result of the ongoing economic prosperity and the related continuation of demand.

Hence not only is the German commercial property investment market characterised by strong demand, but the office lettings market is also in an exceptionally healthy state and will remain so in the coming years. ♥

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Andreas Krone SIOR
andreas.krone@nai-apollo.de
Tel +49 (0) 69 – 970 505-104

apollo real estate GmbH & Co. KG
Schillerstraße 20
60313 Frankfurt am Main
www.nai-apollo.de

NAIapollo group