Q1 | April 2021

Research Germany

Investment Market Overview

Continuing confidence in the German market

German property investment market makes a solid start to 2021

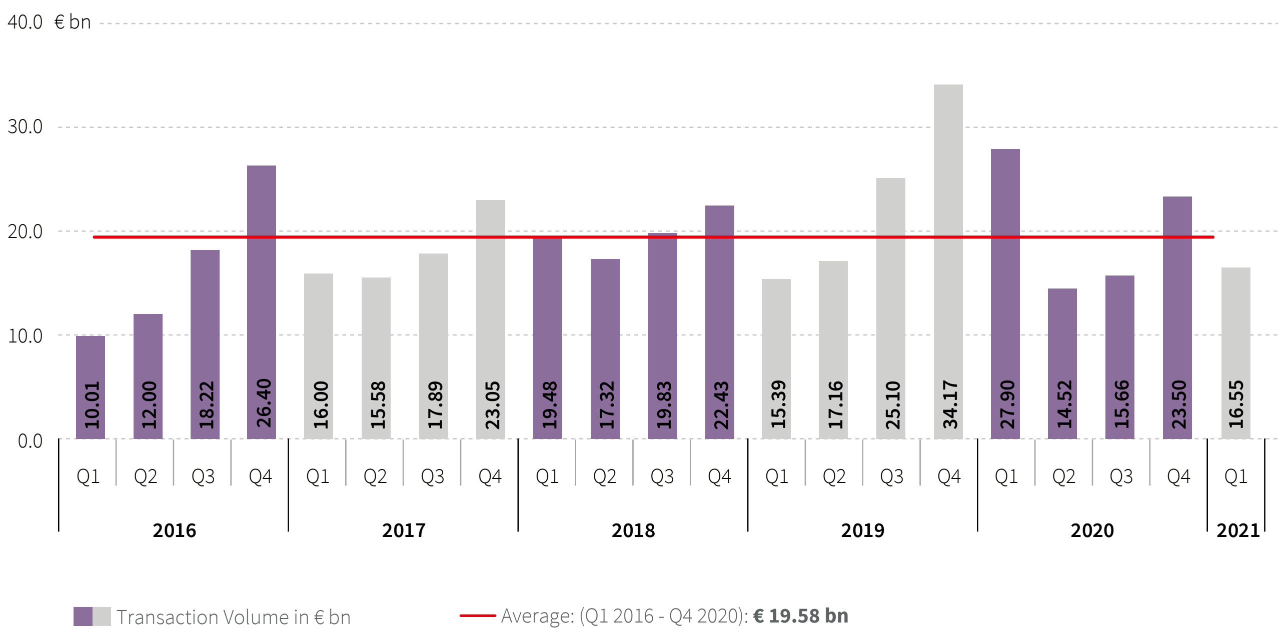
Social, political and economic life in Germany remain in the grip of the coronavirus pandemic at the start of this year. At the same time, players in the (financial) economy are dealing more intensively than ever with two topics in preparation for the post-pandemic era: sustainability and inflation. According to Google Trends, the number of searches for the keywords “sustainability” or “ESG” has doubled in Germany since 2016, and there has been a steady increase in searches for “inflation”, especially since mid-2020.

The European Union has developed guidelines that aim to direct capital flows within the EU towards ecologically sustainable economic activities. These include the Green Deal, the EU regulation on sustainability (environmental, social and governance/ESG) disclosures for certain financial services sector firms (Sustainable Finance Disclosure Regulation/SFDR), and the EU Taxonomy.

With beginning of the year 2019 JLL Research modified its calculation for transaction data. The total transaction volume includes both, pure commercial properties but also our new asset class Living which includes residential properties (multi-family properties and portfolios with more than 10 units), student housing, micro living and Elderly Care Homes.

Investments in accordance with ESG criteria, including investments in sustainable real estate, are no longer primarily pursued out of legal obligation or social responsibility alone, but also because it is also financially worthwhile to do so. A comparison of an ESG equity index with a counterpart index without ESG components demonstrated that the former outperformed the latter by 7.9% over a period of 156 months. Here, the “MSCI ACWI ESG Leaders Index” was compared with the “MSCI ACWI Index”. Furthermore, a study by Morningstar reveals a significant increase in

Transaction Volume Germany



sustainable assets in recent years. According to the study, in Europe they increased by 52% to €1.1 trillion by December 2020. An increase in new inflows to €233 billion was also reported. The inflow in 2020 was thus twice as high as in 2019. Although only a small part of it flows into the property market, if we assume an allocation of 10%, this would already result in an inflow of €23.3 billion.

While sustainability can be classified as a mega-trend, debates on the topic of inflation have only really started in recent months. Since the beginning of the year, consumer prices in Germany and the euro zone have risen, although the inflation rate remains low. Coupled with the rise in interest rates in the USA and for federal bonds, this has nevertheless caused a certain amount of unease for one or another property investor. Inflation is unlikely to return permanently, but we should expect a temporary increase to 2-3%. According to Consensus Economics, prices should drop to 1.6% as early as 2022. After years of barely measurable inflation, these growth rates roughly reflect the price target of the ECB. Only when prices and interest rates rise significantly and sustainably again will demand for property be affected. On the other hand, rental contracts are often linked to inflation, so as inflation rises, rents would also increase.

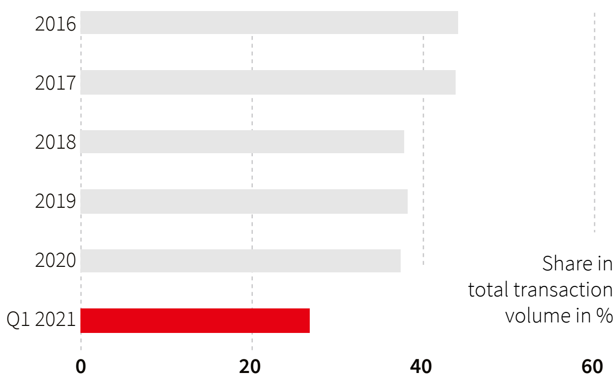
Transaction volume falls year-on-year – but a more nuanced view is required

Compared to the first quarter of 2020, when the market had yet to experience any effects of the pandemic, the result for the beginning of 2021 is a rather modest but, under the circumstances, still respectable €16.5 billion (including Living). This comes as no surprise, although a 41% decline is of course a strong reaction to the crisis. However, a comparison with the previous three quarters and years is more relevant when assessing the market situation. And the recent quarterly transaction volume is in fact higher than the figures for the second and third quarters. Furthermore, we can list only three of the last six years when the investment market got off to a better start: 2020, 2018 and 2015.

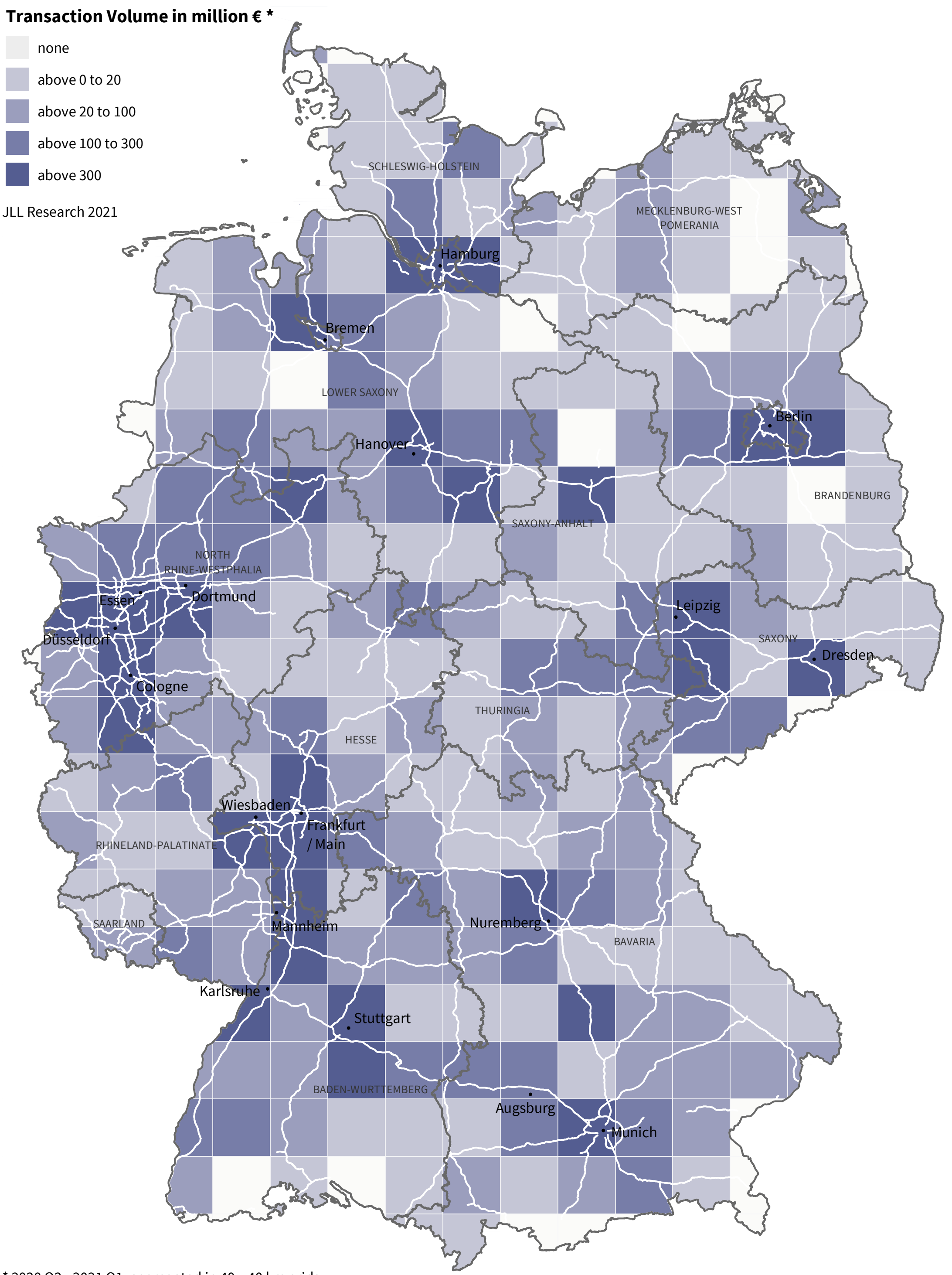
The next few weeks will be decisive in determining whether or not the investment market is embarking on a sustainable recovery path. If sales opportunities have not been initiated by then, it will be difficult to successfully conclude a transaction this year because of the tendency towards more protracted negotiations. In any case, there is evidence of an uptick in the award of sales mandates to property consultants, which also suggests that investors have not lost their underlying confidence in the German market, and that they have faith in a revival of the occupier markets during the year as a fundamental pillar. In addition, owners are still expected to generate high revenues from sales processes.

Still currently missing from the market are large-volume transactions as well as portfolios. Only ten transactions over €200 million were registered. In contrast, there was unusually strong momentum in the small and medium-size segment. In the case of portfolios, the year-on-year decline in the transaction volume was 62%, while single-asset transactions fell by only 7%.

Purchases of foreign investors

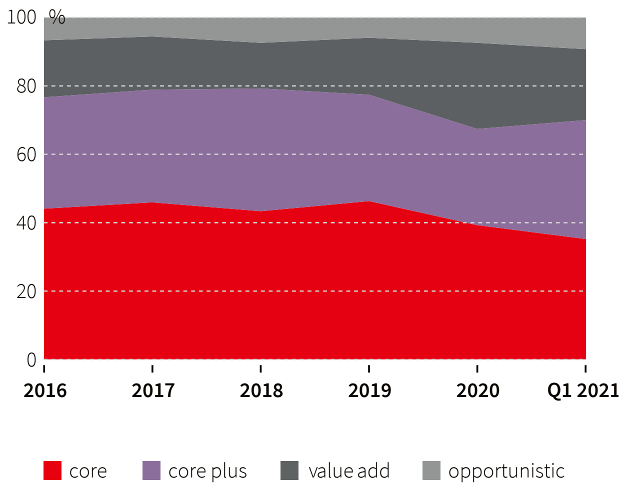


Transaction Volume Real Estate Q2 2020 – Q1 2021



* 2020 Q2 - 2021 Q1, aggregated in 40 x 40 km grids, nationwide portfolio transactions are disregarded

Transaction Volume by Risk Profile of the Investments



Living dominates – office investments are weak - hotels produce a notable quarterly result

The four largest and eight of the ten largest transactions in the quarter all related to sales of residential portfolios or nursing and retirement homes. So it is not surprising that the Living segment generated over 45% of the quarterly result at just under €7.6 billion. Office properties follow at a considerable distance with a share of 24% (€3.9 billion).

After the final rally in the last few weeks of 2020, many office investors took their time at the beginning of this year to sound out market developments and their respective investment strategies. The travel restrictions that are still in force as a result of the renewed increase in the number of infections have proven to be not insignificant – and are an obstacle especially for foreign investors. Owing to this, there is a dearth of potential buyers especially from the Asian region.

So these statistics by no means suggest we must now bid farewell to office property as an investment product. Properties of stable value that come with long-term rental agreements and tenants from sectors that are not affected by the pandemic, such as the public sector, are still in demand. And as companies gradually go back to their offices as expected, we are sure that this asset class will return to its usual strength.

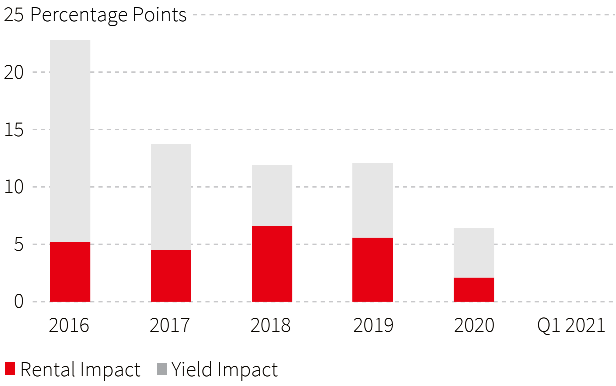
Property used for retail purposes registered a volume of over €1.5 billion. In addition to the successful development of retail parks anchored by food retail tenants, local retail centres and supermarkets and discount stores, which account for well over a combined 60% of this asset class, a few central commercial buildings and larger retail parks changed hands. Overall, retail property still only accounts for 9% of the total volume. We do see a slight increase in demand for high street retail properties with good rental levels. However, the overall package of tenant creditworthiness, lease terms and price has to be right. Logistics property generated a slightly higher transaction volume of €1.7 billion compared to retail, and accounted for a 10% market share.

Stability at a high level – that's how the situation can be summed up here. Sellers cannot complain of a lack of demand, but there is still currently a shortage of suitable products for interested buyers. Last but not least, hotels achieved the best quarterly result since the strong start to 2020 at over half a billion euros.

Transaction volume falls in the Big 7 as large transactions fail to materialise

In line with the overall market development, the transaction volume in the Big 7 (Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich and Stuttgart) fell by 42% to around €6.7 billion in a 12-month comparison. Within the Big 7 cities, the decline fluctuates between 62% in Düsseldorf (to around €460 million) and "only" a third in Cologne (€310 million).

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

Is the glass half empty or half full? There is no clear answer to that at the moment. The absence of large deals is particularly noticeable in the Big 7. However, since some large-volume transactions are currently at the marketing stage, we anticipate a significant recovery over the year. Especially in these unusual times because of the pandemic, the first three months are not a real indicator of the investment dynamic in German cities.

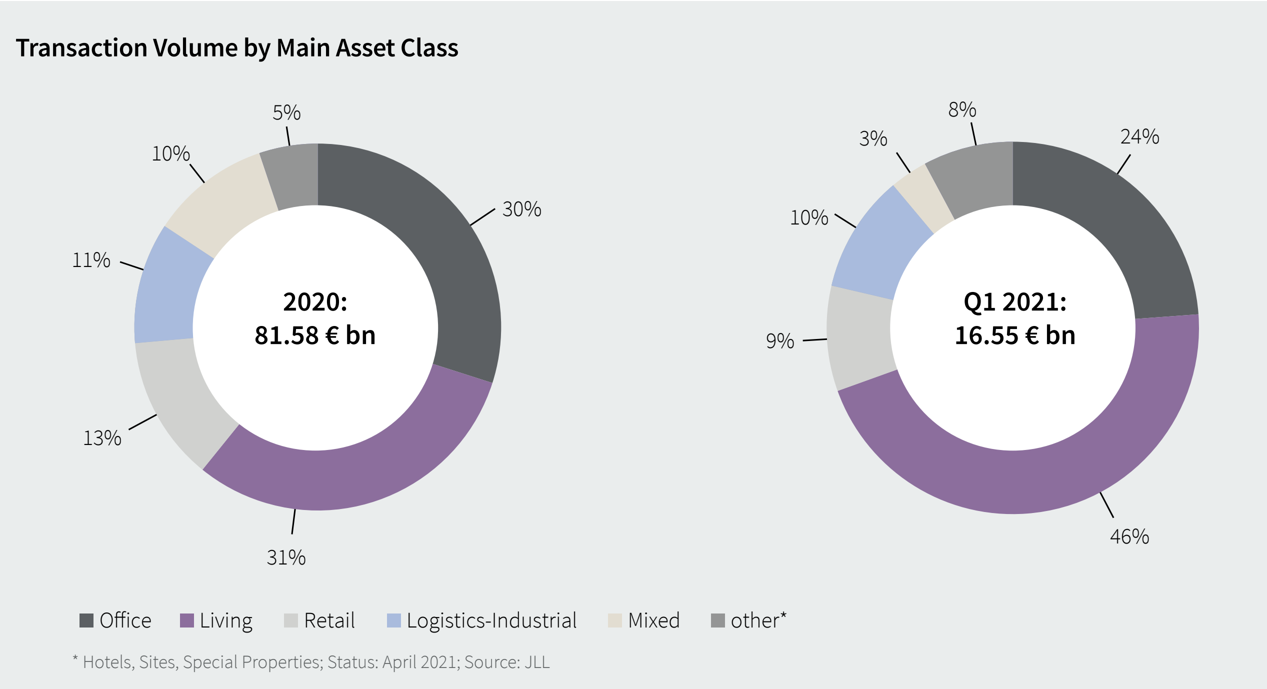
There has also been no fundamental change outside the established strongholds. Other cities and regions accounted for around €9.8 billion or almost 60% of the total German transaction volume. This means that the share has remained relatively stable compared to the last few quarters.

Prime yields are stable almost across the board; further yield compression expected for office and logistics

There has been almost no movement in prime yields. The “almost” here refers to retail parks, whose prime yields continue to point downwards. Such products have increased in price following a yield compression of ten basis points to 3.80%. Here, it is still an essential condition that the majority of rental income is generated by a food retail tenant. This also ties in with the fact that yields for supermarkets and discounters have fallen

Transaction volume Big 7 (€ m)	Q1 2020	Q1 2021	%
Berlin	3,800	2,180	-43
Düsseldorf	1,220	460	-62
Frankfurt/M	2,410	1,590	-34
Hamburg	1,800	1,080	-40
Cologne	460	310	-33
Munich Region	1,460	890	-39
Stuttgart	370	190	-49
Total	**11,520**	**6,700**	**-42**

Transaction volume Germany (€ m)	Q1 2020	Q1 2021	%
Single assets	10,700	10,000	-7
Portfolios	17,200	6,500	-62
Total	**27,900**	**16,500**	**-41**



even further, dropping 10 basis points to 3.9% for supermarkets and 4.5% for discount stores. Yields for all other property use types have remained unchanged from their respective previous quarterly levels.

Activity on the investment market is still very subdued, and does not indicate any clear direction. It should be evident, however, that desirable top-quality products, especially in the logistics sector but also in the case of selected office properties, will certainly not be cheaper. Even the slight rise in interest rates at the beginning of the year will not be enough to put upward pressure on yields. As demand picks up, we expect office yields to compress by ten basis points to 2.71% by the end of the year. For logistics products, we even anticipate a reduction of a further 20 basis points to 3.15% for the Berlin, Düsseldorf, Frankfurt, Hamburg and Munich regions and 3.25% for Cologne and Stuttgart. The pandemic, in conjunction with a profound structural change, has caused a rise in shopping centre yields in the past year. There is still no clear prospect as to when centres will be able to reopen their doors to customers, allowing operators to stabilise their rental income. This is also why we assume that yields will continue to rise over the course of the year. By the end of December, they should reach 5.0%.

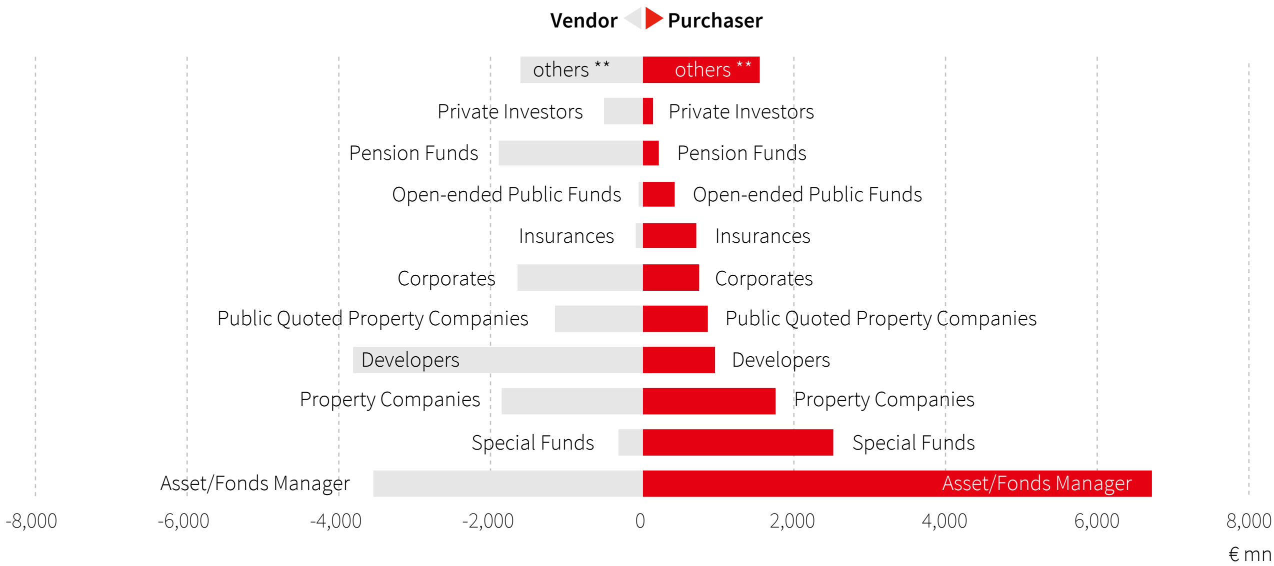
2021 will be a challenging and exciting year for all players in the investment market. In times of crisis, the main focus is traditionally on core products, but we also see interest from buyers in riskier core-plus or value-add products. Investors believe that leasing markets will restart, but a resurgence of occupier activity is also a prerequisite for financing and pricing riskier property investments. In addition, it is important to anticipate trends and embed them in investment decisions. These include the reduction in CO_2 emissions, flexible workplace models, the increase in e-commerce/omnichannel, and the focus on employee needs such as safety, health and well-being. New opportunities will arise here, so that from today's perspective we are expecting a transaction volume of around €80 billion for the year as a whole.

Prime yields in 1a-locations	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
Office	2.93	2.91	2.85	2.81	2.81
Retail: Shopping center	4.65	4.75	4.75	4.85	4.85
Retail: Warehousing parks	4.20	4.20	4.00	3.90	3.80
Retail: Warehousing solus units	5.00	4.80	4.60	4.60	4.60
Retail: High street	2.84	2.87	2.89	2.91	2.91
Warehousing/Logistics	3.75	3.75	3.53	3.38	3.38

aggregated net initial yield in Big 7 in %

Office prime yields in %	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
Berlin	2.65	2.65	2.65	2.65	2.65
Düsseldorf	3.10	3.10	3.00	2.95	2.95
Frankfurt/M	2.85	2.85	2.85	2.80	2.80
Hamburg	2.95	2.85	2.80	2.70	2.70
Cologne	3.20	3.20	3.10	3.00	3.00
Munich Region	2.80	2.80	2.70	2.70	2.70
Stuttgart	2.95	2.95	2.85	2.85	2.85

Transaction Volume* by Vendor and Purchaser Type (€ mn)



*Period: 2021 Q1; **others: Private Equity / Hedge Funds, REITs, Banks, Municipal Housing Corporations, Public authorities, Closed-ended Funds, Cooperatives, Non-Profit Organisations; Status: April 2021; Source: JLL

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