bulwiengesa BEITEN BURKHARDT TLG IMMOBILIEN

5% STUDY 2019 – WHERE IT STILL PAYS OFF TO INVEST

Desperately seeking real estate investments

With the valued support of the BEITEN BURKHARDT law firm and TLG IMMOBILIEN AG, bulwiengesa has analysed the yield potential of the German real estate markets for the fifth time.

The results in brief

- **Investors accepting ever lower yields**
- **Residential properties in A markets close to 2%**
- **Offices in top locations offer hardly any protection from inflation**
- **Only shopping centres are recording rising yields**

Berlin/Frankfurt, 11 September 2019 – With the exception of shopping centres, yields (IRR)[1] in all asset classes have fallen significantly again. This is the key finding of the *5% study 2019*. The study reports that German properties are still in very high demand, although there are a growing number of question marks as regards the macroeconomic environment. Investors are accepting the ever lower yields.

This year's study was the first in which no type of use could be identified that had an IRR of at least 5.5% in the core segment, i.e. for stably let properties in sustainably good locations. "Those pursuing an investment target of 5% still have to switch to smaller markets and niche segments. However, there is increasingly limited choice here as well: Only in office markets in D cities and with industrial parks and production properties can yields of 5% or more be achieved," says Sven Carstensen, manager of bulwiengesa's Berlin branch and author of the series of studies.

Residential properties in A markets close to 2%

It is evidently becoming more and more of a challenge to make economically advantageous investments in existing residential properties in Germany's major cities. The increase in multipliers is continuing, leading to a further rise in prices. This is chiefly due to the attractive market environment and very high demand on the investment market.

Despite rent controls, an upward trend could be seen on the housing market in major urban centres again this year. Prices for residential properties have once again increased year-on-year, albeit at a slower pace. The attainable yield for core properties in the A cities is between 1.6% and 2.5% (previous year: between 1.9% and 2.6%). The yield level for residential properties in B markets has also fallen again and is now between 2.4% and 3.2% (previous year: between 2.8% and 3.3%).

1 IRR = internal rate of return. This figure is used to estimate the profitability of potential investments. A holding period of ten years is assumed.

"Apartments in A markets offer investors stable investment opportunities with very low yields. Regulatory obstacles are increasingly curbing the possibility for rent adjustments," says Sven Carstensen. "For security-focussed investors, we generally recommend markets with positive population development and a sustainable economic structure, where the risk of revenue losses or strong market price fluctuations tends to be low. However, it remains to be seen to what extent politicians will continue to intervene in the market. The introduction of a rent cap, as is currently being debated in Berlin, may result in huge losses in value. Therefore, the political environment should also be examined when making an investment decision."

Micro-apartments have also long been established as an asset class on the investment market. Their yields have now fallen to the same level as standard apartments. However, it is unclear whether they also have a comparable risk profile. It remains to be seen how sensitively this product will react to market fluctuations.

Offices in top locations offer hardly any protection from inflation – investors desperately seeking non-core

Demand for core properties in the office sector is undiminished. Accordingly, the yield compression is continuing. The yield for such properties in the A cities is between 0.9% and 3.3% (previous year: between 1.1% and 3.5%). The range shows that an investment in core properties can be slightly lower than the inflation rate of around 1.7% at present.

"Almost all A markets are characterised by high excess demand, which is reflected in low vacancy rates," says Sven Carstensen. "The attainable yields are at a very low level. Many investors are still hoping for rising rents and are almost desperately accepting ever lower yields."

The upshot is that investors are increasingly looking for non-core properties that have vacancies and thus yield potential. However, these products are growing ever rarer, as the office markets are in very good shape. "With market vacancy rates of less than 2%, properties and locations that generally have difficulties in normal market phases are also benefiting. This also has an impact on prices. They are thus losing their appeal as investments for many opportunists," says Carstensen.

The yield expectations in B markets also remain modest at 3.28%. The C and D markets still represent high-yield alternatives. However, the supply of properties is very limited due to the small market sizes, and the ranges are huge. A detailed analysis is essential.

Retail: Growing nervousness

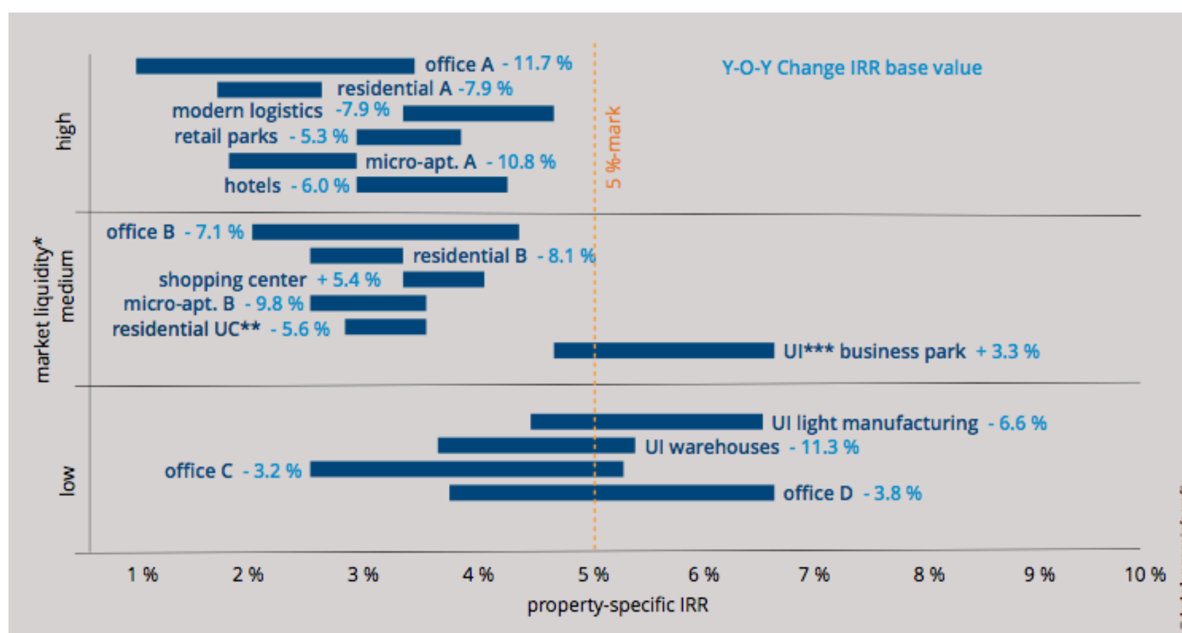
Alongside office properties, retail properties are still the second-strongest segment on the German property investment market. However, there is growing scepticism due to the low product available and uncertainty regarding the future development of retail.

Shopping centres are particularly affected by the structural changes in retail. Changes in consumers' shopping habits with a shift towards online offers are casting doubt as to how sustainable the rental income generated by retail tenants is. With a base value of 3.88%, shopping centres are once again the only asset class in which yields are rising. This can give rise to opportunities for market experts who want to invest on a large scale – the usual deal size on this market is around EUR 80 million to EUR 500 million.

Specialist Retail Parks remain unfazed by this trend. These are recording falling yields again and have replaced shopping centres as *the* core investment product in the retail sector. After 4.74% in 2015, they are now generating yields of 3.59%. Specialist stores are seen as being less at risk from online retail.

"Despite all the upheavals, retail properties will still be needed and in demand from users in the medium and long term," says Sven Carstensen. "Investors must analyse the extent to which the respective retail offers are affected by the current changes so that they can price in potential re-purposing. In contrast to other asset classes, market prices for shopping centres are falling again."

Diagram: Core matrix



* Liquidity of asset classes regardless of investment cycles. Within the categories shown in the diagram (low/medium/high market liquidity), there is no further assessment of the individual types of use. ** UC = university cities *** BP = business properties

Note: For the purposes of this study, core properties are defined as properties with a stable letting situation and sustainable location parameters. The matrix shows the relationship between the probable internal rate of return on a property investment and the liquidity of the respective market. Here, market liquidity refers to the ability to generate demand for transactions independently of the respective investment cycle and to offer exit opportunities even in years of low demand.

About the 5% study

Since 2015, the 5% study has been offering a compact overview of the market and providing a new approach for describing property markets. The study uses a dynamic model to determine the probable internal rate of return (IRR) on an investment, assuming a holding period of ten years. This makes it possible to calculate annual returns for investments and compare the yield prospects of different asset classes. The internal rate of return method differs from the static yield assessments that are typical on the market and is used by many investors.

Real estate investments are classified as core or non-core assets based on the criteria of cash flow reliability and liquidity.

This 5% study examines the performance expectations in the main asset classes that currently dominate the German investment market:

- Residential
- Office
- Shopping centres and specialist retail parks
- Hotels
- Logistics properties
- Micro-apartments
- Unternehmensimmobilien

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The study can be downloaded for free at:

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About bulwiengesa

bulwiengesa is one of the major, independent real estate industry analysis companies in continental Europe. For over 30 years, bulwiengesa has supported its partners and clients in questions of real estate, including with location and market analyses, sound data services, strategic advice and bespoke surveys, analyses and valuations. Meaningful individual data, time series, forecasts and transaction

data are supplied by the information system RIWIS online. Users of the data from bulwiengesa include the Deutsche Bundesbank for the ECB, BIS and OECD.

With valued support from:

BEITEN BURKHARDT Rechtsanwaltsgesellschaft mbH is an independent, international corporate law firm with a focused consulting service and around 300 lawyers at nine locations. The Real Estate segment is an important focus area for the law firm. The property experts advise their clients on all issues relating to real estate law, covering the entire "lifecycle" of a property. They provide advice on all phases of property management and infrastructure projects, from project planning to construction preparation and support through to marketing. Furthermore, the lawyers are already available during the purchase or sale of the land or existing building. The Real Estate industry group consists of around 49 lawyers.

The listed company **TLG IMMOBILIEN AG** has owned and let commercial properties at selected promising German locations for over 25 years. It continuously actively develops its portfolio to add value with targeted investments and selected property acquisitions. As at 30 June 2019, its portfolio comprised properties worth EUR 4.6 billion. The adjusted EPRA net asset value per share came to EUR 29.77 as at this reporting date. The portfolio includes office properties in Berlin, Dresden, Frankfurt am Main, Leipzig and Rostock, among other cities. In addition, the company has a regionally diversified portfolio of retail properties in highly promising micro-locations with a focus on local supply, as well as seven city-centre hotels. TLG IMMOBILIEN AG's properties are characterised by good or very good locations and long-term rental and lease contracts. Its skilled employees ensure a high level of local market expertise at the individual locations.