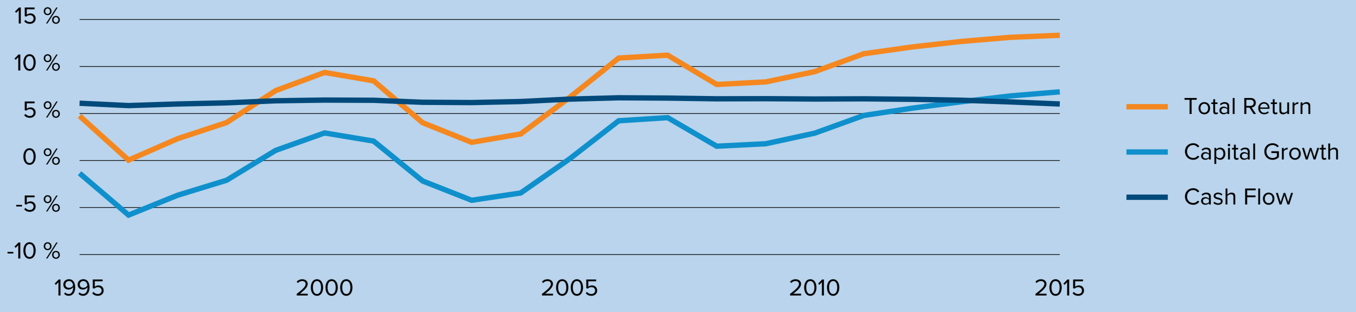
German Property Index für Deutschland



as at February 2016

March 2016

German Property Index 1995-2015

German Real Estate Concludes 2015 with Record Returns Exceeding 13 %

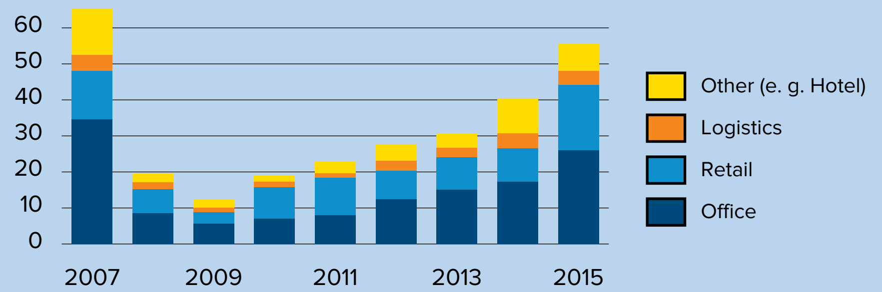
- **bulwiengesa anticipates further price growth in 2016**
- **Decoupling of letting and investment markets now extends to non-core property**
- **Stable cash flow yield from the rental income of properties is gaining in significance**

Keen investor demand ensured that the upward price trend on Germany's real estate market was sustained throughout 2015. The German Property Index (GPI) shows a nationwide total return of 13.3 % across segments, which is the highest-ever rate of return since Germany's reunification in 1990.

Historically low interest rates, favourable terms of financing, and rich liquidity positions made sure that real estate investments remained high on the shopping list of investors in 2015. Last year, the volume of commercial real estate transactions increased for the sixth time in six years: After 40.5 billion euros in 2014, the year-end total in 2015 was 55.8 billion euros – a whopping year-on-year increase by 38 %. Office real estate accounted for nearly 47 % thereof (an increase by 51 % since 2014). Once again, more than half (56 %) of all investments were committed in Germany's Class A cities.

The high ranking of German real estate on the shopping list of national and international investors is also reflected in the German Property Index (GPI): The total return for German real estate investments once again topped the prior-year figure in 2015, rising from 13.1 % (2014) to 13.3 %, and thus setting another record for the time since the German reunification. A bright outlook for the financial markets and the real economy has caused the parameters of the real estate industry to improve steadily. To use the example of the office market, the situation is as follows: The capital values of domestic office properties clearly outperform rents. The diverging trends of rents and capital values on the markets for office real estate and other income-producing property are the result of falling net initial yields. When considering the long-term average, it is obvious that their levels have dropped to an exceptionally low level. Especially prime assets in first-class locations have dropped significantly lately. The development is closely connected to the ongoing phase of declining low capital market rates. The trend is driven by the keen demand from institutional investors for income-producing real estate investments. The nominal year-end transaction total also suggests as much, having experienced consistent fast growth in recent years and steadily narrowing the gap to the pre-crisis level. Among the drivers of this process are, most notably, foreign investors who seek to exploit the yield and/or foreign exchange differences to their domestic currency. Here, the near-zero interest policy

Investment Volume in Germany, by Segments (in bn Euros)



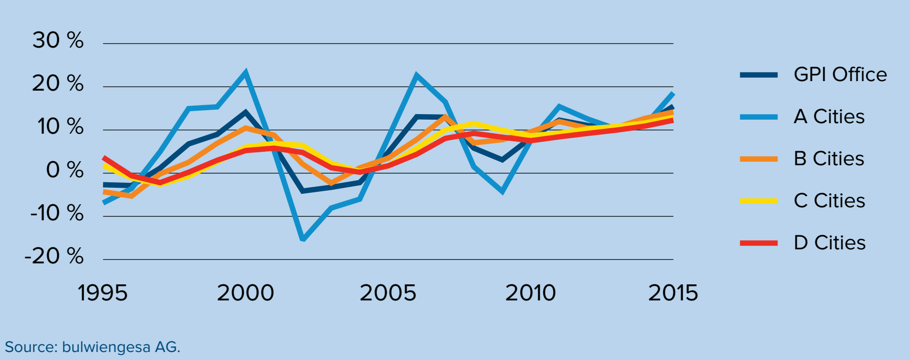
Source: RIWIS database of bulwiengesa AG. * Estimate for 2015 (as at December 2015) pursued by the ECB has fuelled the current market action, because the associable weakness of the euro against other currencies encourages foreign investors to step up their commitments on the German market. When weighing risk and reward in such a market environment, the decision to intensify the search for prime income-producing real estate is principally plausible. Compared to non-prime assets, properties of this type promise a more stable cash flow and a higher degree of liquidity. Then again, it is a risky strategy. Due to the high interest responsiveness of real estate values, even minor absolute changes in interest rates will seriously impact the capital values of this property type, more so than other types. For it is safe to say: The lower the level of net initial yields, the greater the impact of absolute interest rate changes will be on future capital growth.

The main reason for the historic peak is the excess demand that continues to define the investment market. The markets for commercial real estate in Germany's "Big Seven" cities have been particularly popular in recent years, with core properties having been considered comparatively safe investments since the financial and economic crisis at the latest (and the lack of investment alternatives). Perhaps the easiest way to obtain an outlook for 2016 is by looking back at 2015, because the baseline situation is identical: Assuming the economic parameters remain the same, there is every reason to expect Grade A office space requirements to remain high. Although the number of property developments has increased virtually everywhere, the supply now on the market cannot be considered sufficient. Especially in the office real estate segment, the brisk growth in office employment is matched by a keen demand for Grade A office accommodation in urban agglomeration areas. The reluctance to start new construction projects – a sentiment which has set the pace on the market since the financial and economic crisis – caused a supply shortage in 2015 that remains unrelieved to this day: The growth in prime rents and the elimination of vacancies is likely to continue in 2016. The massive buyer interest in this market segment has exacerbated the yield compression.

The fact is reflected not least in the elevated capital growth registered by the GPI, because it was definitive for the accelerating trend in total returns in the various segments. The capital growth value for office real estate, e. g., surged from 5.5 % (2014) to 9.7 % (2015). For the first time since 2007, the cash flow figures, averaging 6 %, are contributing less to the total return than the capital growth component. The anticipated rent growth and a further, if modest, hardening of initial yields in response to pent-up demand will ensure that real estate prices in virtually all commercial property classes will keep going up in 2016.

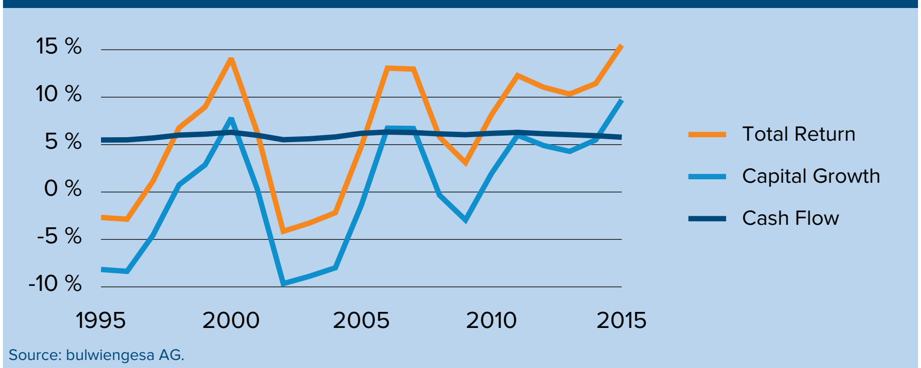
Compared to lower-tier cities, metropolitan markets are characterised by more extreme peaks and troughs in their capital growth rates. During recessive periods, the capital growth return drops faster here than in smaller cities, but the "Big Seven" are also the first to recover at the start of the next boom cycle. It is during this market cycle that great yield opportunities present themselves to investors in addition to a relatively constant cash flow return. This means conversely that the high prices for properties in top locations will now cause investor interest to shift increasingly to near-prime locations (German "1b"), which also promise a relatively secure cash flow, and which include properties on the metropolitan periphery or in mid-sized cities. Finding so-called "hidden champions" implies, in addition to a stable cash flow yield, an opportunity to benefit from (future) value changes.

German Property Index – Office Real Estate by City Classification



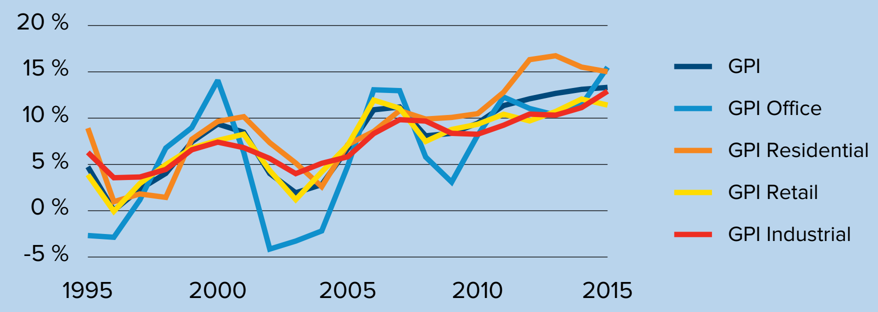
Source: bulwiengesa AG.

German Property Index – Office Real Estate



Source: bulwiengesa AG.

German Property Index by Real Estate Segments



Source: bulwiengesa AG.

Aside from office real estate, drivers of the national GPI score also included logistics properties: Half of the real estate segments mapped in the GPI, meaning two segments each, shows a one-year increase or decrease, as the case may be.

Among the groups that registered growth were the office and logistics segments, as said above. Logistics (12.9 %, up from 11.1 % in 2014) and office (15.5 %, up from 11.4 % in 2014) prospered last year, boosting the total return nationwide to a new peak level. Conversely, retail (11.4 %, down from 12.1 % in 2014) and residential (15.0 %, down from 15.5 % in 2014) suffered drops in segment-specific total returns. That being said, slowing growth rates are not an indication for a weakness of the respective sub-market, but express a less dynamic development compared to prior years. Differently put, they help to stabilise the market.

Given the already mentioned positive parameters (e. g. the sound income and monetary asset situation), there is reason to assume that the demand for condominiums will remain high, and that private consumption will support the retail sector in its performance. The only difference to previous years: The corresponding prices grew at a slower pace than the growth witnessed in the recent past.

Within the market segments, it was noted that investment markets decoupled from the letting markets in 2015, and this trend will spill over from the metro regions into the regional cities, and be felt there. As far as commercial property categories go, it is safe to say that the low initial yields are primarily interest-rate-driven and hardly justified by fundamentals. Moreover, Germany's real estate markets are highly attractive for domestic and foreign capital. Since 2010, the quest for profitable investments has generated a sustained high demand for yield-driven properties in Germany, and the trend is set to continue in 2016.

About the German Property Index (GPI)

Total Return (= Capital Growth + Cash Flow)

With a staff of nearly 80 professionals, **bulwiengesa AG** counts among the largest independent market research and consultancy firms in Germany, covering the areas real estate, municipalities, and regional economics. For more than 30 years, the company has taken a market-driven approach to address challenges in the real estate economy. Our work covers the real estate market of Germany and of other German-speaking countries (Switzerland, Austria) as well as Central Europe. The market profile covers the commercial sector including office, retail, logistics as well as residential and operator real estate.

Decisions are based on analyses, competition monitoring, valuations, and database management. Quantitative and qualitative questions that we address on short notice include location quality, development prospects and long-term use opportunities. We review individual properties and entire portfolios. The RIWIS-Online database and analytic service permits the retrieval of individual data, time series, forecasts and deals.

With its **German Property Index (GPI)**, bulwiengesa provides a real estate performance index that is calculated on the basis of available market data. The GPI maps the total return, and represents the sum of the capital growth return and the cash flow return. It provides performance indices for 127 cities in the segments of office, retail, residential (new schemes, existing stock) and logistics. This differentiation by region and sector for example lends itself to the calculation of benchmark figures for German real estate portfolios. Forecasts that take available market data into account can be used to help to anticipate market developments and facilitate investment decisions.

In the absence of official statistics, Deutsche Bundesbank bases its price watch for commercial real estate on data provided by bulwiengesa, among other sources. Due to its cumulative multiplication of the GPI capital growth rates, this price index is considered the key ratio for the current observation and analysis of the price trend of commercial real estate (see Deutsche Bundesbank's monthly report for May 2013, pp. 55-57 or additional information on the internet pages of Deutsche Bundesbank under the following link: http://www.bundesbank.de/Navigation/DE/Statistiken/Unternehmen_und_private_Haushalte/Preise/preise.html).

GERMAN PROPERTY INDEX (GPI)

Depending on availability, the following real estate economic market and planning data are taken into account:

- **Office market**:
  floor space stock, vacancy rate, completions, prime rents, prime yields
- **Retail market**:
  floor space stock, vacancy rate, prime rents, yields in high-street locations
- **Residential market**:
  housing stock, vacancy rate, average rents in new schemes (first lettings) and existing ones (re-lettings), gross rent multiplier for multi-dwelling buildings
- **Logistics market**:
  prime rents for warehouse/service areas, prime yields
- **Transactions**:
  real estate sales in about 85 cities

The section below elaborates the method used to calculate the total return, the capital growth return, and the cash flow return for the 127 market cities. For one thing, the calculation ignores the impact of debt finance on the performance. Also, bulwiengesa takes into account assumptions concerning management, maintenance and other non-recoverable operating costs for each market segment that are based on the company's long-term market know-how. These costs diminish the owner's revenues and produce the net profit from rents (net operating income).

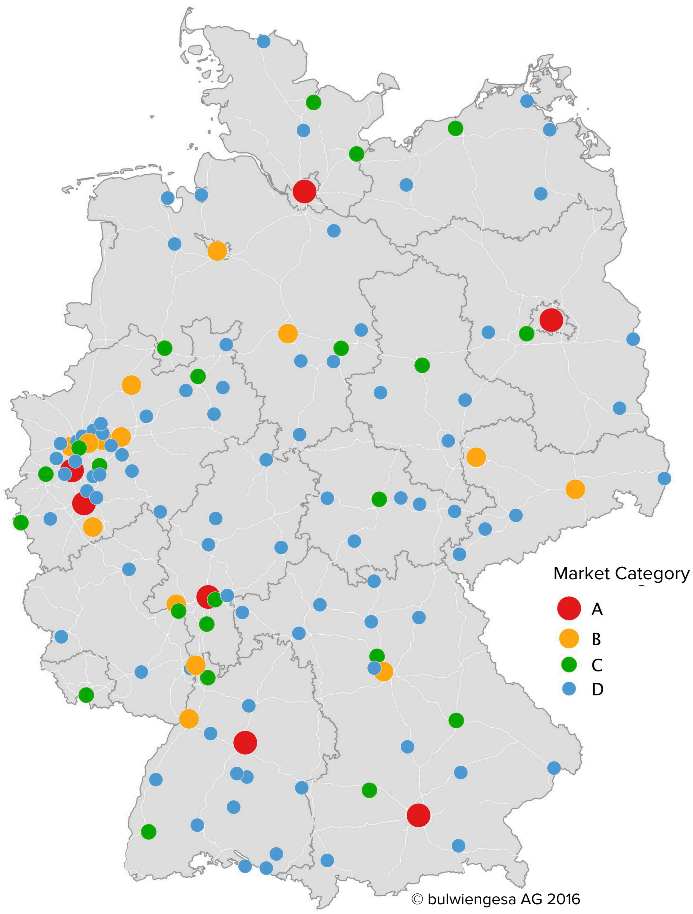
The consistent market data and the standardised calculation of total return, capital growth return and cash flow return permit a comparison between cities and sectors.

The national GPI (= total return) of each real estate market sector is derived from the weighted sum of the capital growth returns (CG) and the weighted sum of the cash flow returns (CF) of the 127 cities. The weightings are differentiated by sector, and are not constant over time.

$$TR_{Sektor} = \sum_{i=1}^{127} q_i \cdot (CG_i + CF_i)$$

The weight factor q_i represents the share of the respective sector's tradable property assets in the entire property market. Reliable data on tradable property assets in Germany, broken down by type of use, remain a scarce commodity even now.

bulwiengesa uses the weighting of the German Property Index to appraise the tradable property assets. Long-term experience and the competence of many years in the field enable bulwiengesa to use in-house market data, market observation and available market intelligence to venture reliable estimates.



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