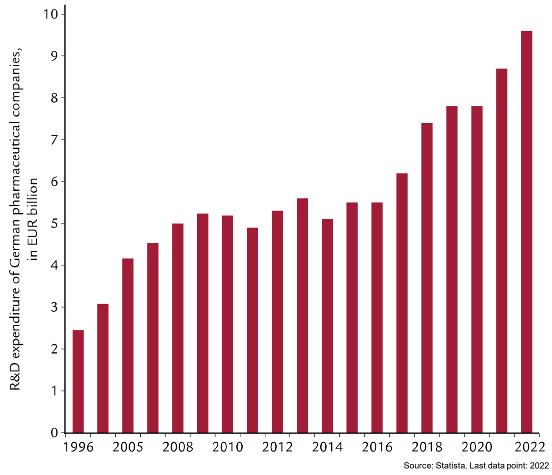
# Real Estate House View
## *Germany*

*First half-year 2024*

## Key takeaways

- **More liquidity, higher yield tolerance:** With the end of monetary policy tightening and falling financing costs, momentum in the investment market is set to increase. Moreover, surveys show that investors are willing to accept a lower spread between real estate yields and bonds compared to recent history.
- **Prime remains top:** Prime rents are continuing to rise for virtually all segments – even selectively for prime retail locations from 2024 onwards. The driver is always the same: excess demand for prime stock. Problems concerning positive rental growth expectations are expected in second-class (existing) properties.
- **Brown discount:** Second-class properties are also causing problems in the investment market. Residential property is already demonstrating what will apply to the entire market in the long term: sustainable properties – including new-builds – offer stable value, while second-class (unrenovated) properties are losing value.
- **Active asset management:** However, new-builds alone are not sufficient to outperform in an environment of higher bond yields. Active asset management, which makes a significant contribution to earnings growth, makes a subtle difference.
- **Government coalition as an uncertainty factor?** The current and in some cases unpredictable course of the German government – such as halting subsidy programmes at short notice – is serving as a cost driver and factor of uncertainty.

## Chart in focus




Currently still a niche market in the German real estate investment universe, the life science sector is founded upon various megatrends – headed by the ageing population and spread of diseases among civilisation. At the same time, people of all ages are increasingly willing to spend money on their health. Life science companies are representative of high investments in research and development, as seen in the pharmaceutical industry. These have been rising in Germany for years. Linked to this is the need for real estate. Demand for rental space is increasing.

Germany will benefit from the cyclical recovery of the global economy more quickly than the other major European economies. In industry, there is already a slight improvement in incoming orders from abroad. In 2024, the domestic economy will benefit from tailwinds related to the first rise in real wages since 2021. The trend towards lower financing costs for the real economy will also support growth. However, consequences of the Federal Constitutional Court's budgetary ruling remain uncertain: the fiscal drag is likely to be significant. We therefore expect zero growth for 2024 following a decline in real gross domestic product in the previous year.

## Is the worst over?

At EUR 28 billion (-51% according to RCA), the volume of transactions in 2023 was lower than at any time in more than ten years. At the same time, yields rose significantly, in some cases almost 200 basis points from the trough in Q1 2022. In addition, a wide variety of factors – from liquidity problems to increased construction costs and falling demand – forced many project developers to their knees. While there will be further insolvencies in 2024, the initial rate cuts should lead to a revival of the investment market and an end to yield adjustments. The commercial rental market also shed feathers in 2023, at least in terms of demand for space. The projected zero growth and at times unpredictable actions of the German government are likely to fuel uncertainty in 2024 and influence demand for space.

## Logistics: normalisation

Following record sales in the preceding years, the industrial and logistics sector faced a decline in demand during 2023 (Q1-Q3 2023: 4.5 million m$^2$, -32% y-o-y). However, this regression is also due to companies' readiness to renew existing contracts as renting new space has become considerably more expensive (2023: +12% in A cities) owing to the limited availability of modern space. Demand for modern space is holding up but overall demand should normalise, among other things, in view of the weak economy and the migration of some industrial enterprises.

## Retail: consumer climate turning

Real incomes are expected to rise in 2024 (+1.8% according to Oxford Economics) after having fallen since 2021. This increase in real wages is expected to boost consumer spending. Consequently, prime rents for prime locations, which continued to decline in 2023 (A cities: -4%), can be expected to stabilise in 2024. For high-revenue cities and those with strong tourism, such as Munich, rents can even be expected to increase. Retail parks and supermarkets are likely to show their best side again in 2024. Although they also felt the impact of negative consumer sentiment in 2023, they were much less affected: for example, real food sales stabilised after having risen for many years.

## Top offices still in short supply

While office take-up in 2023 fell to a level similar to that seen during the Global Financial Crisis, prime rents are defying the decline in demand fuelled by a slowing economy, a stable home office rate of around 25%, the impact of AI (12% of companies made use of this in 2023) and saturated demand for space by the public sector, which had previously proved an active tenant. However, these challenges are offset by significant declines in completions, which are in turn supporting prime rents: PMA expects the volume of completed office space to fall significantly from 2024 and to reach 50% of 2023 in 2026. And as we all know, shortages drive rents.

## Chaff separating from the wheat

The relevance of sustainability is exemplary in the private residential market: while new-builds (which automatically meet the sustainability criteria) continue to perform well in terms of value despite rising interest rates, the wind has changed for existing (generally unrenovated) properties where prices have been falling since H2 2022. However, this is not the case for rents: due to the lack of housing, asking rents are rising for both existing properties (up to year of completion 2015: +4.3% from January to October 2023) and new-builds (+6.3%). However, in the institutional market, prices for new-builds are also falling as a new price equilibrium needs to be found.

**Chart 1: Take-up and prime rent in the top seven markets in the German office sector**

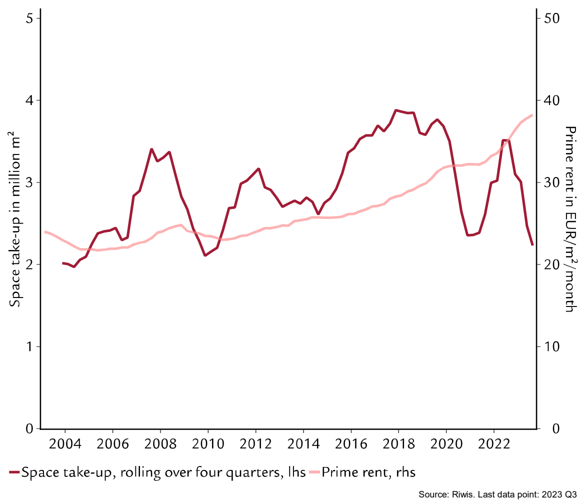
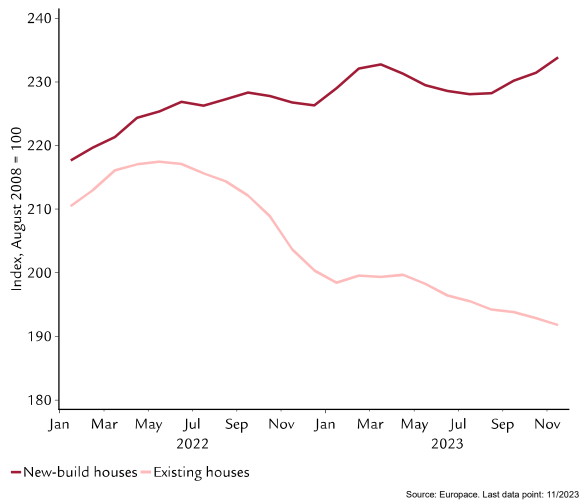



**Chart 2: EPX Germany house price index**

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