

German Real Estate Markets: Back on the Agenda

8th German Corporate Conference



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Frankfurt, 1 June 2005

Deutsche Bank Research



Overview

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German Real Estate: Biggest Market in Europe

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Residential Property: For Foreign Investors only?

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Office Markets: Towards an End of Recession

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The Demographic Challenge

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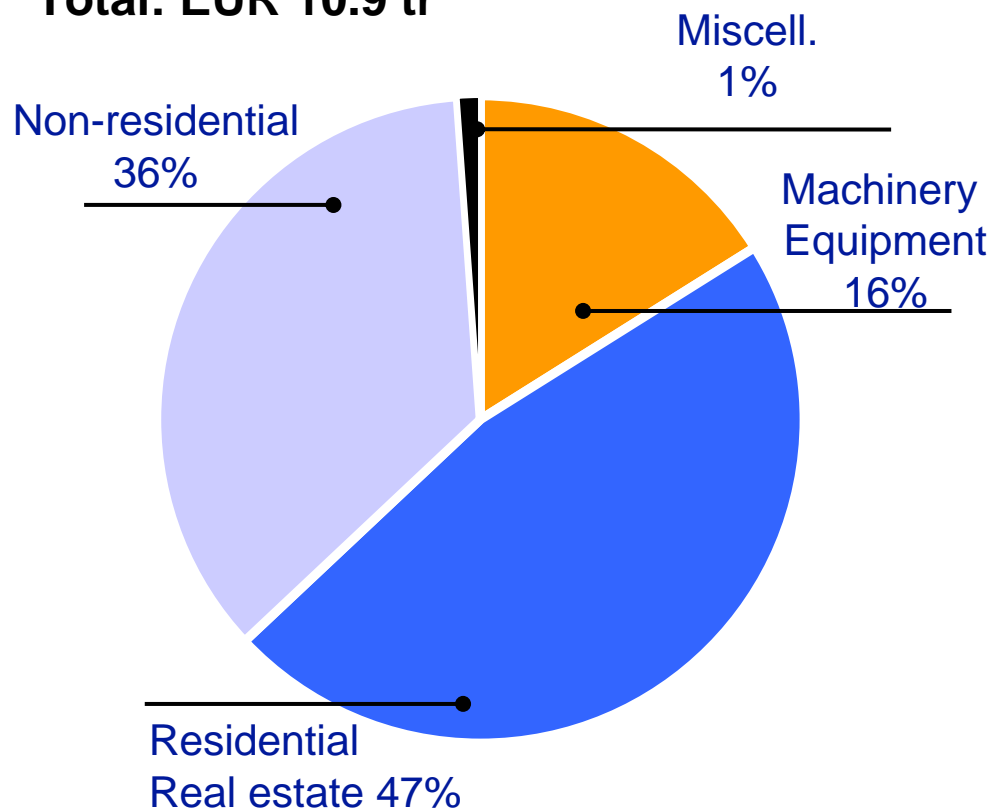
Concluding Remarks



Gross fixed assets in Germany

- 2005 -

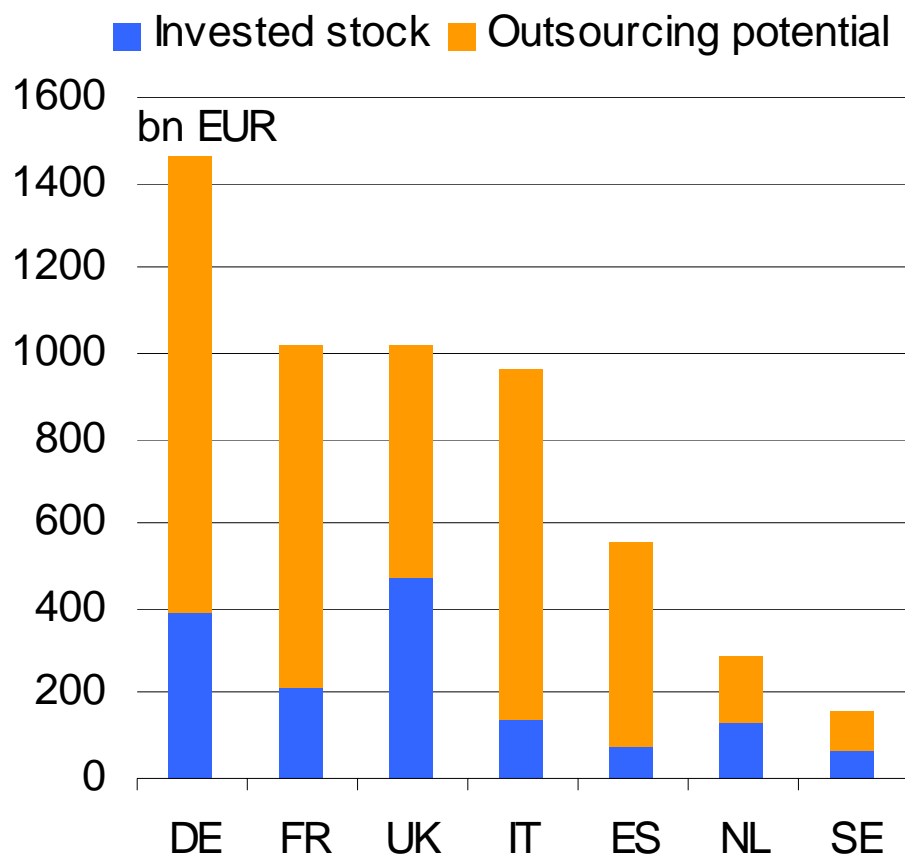
Total: EUR 10.9 tr



- Real estate assets account for more than 80% of all fixed assets in Germany – that is more than EUR 9 tr
- Roughly 40m dwellings are estimated at gross asset values of more than EUR 5 tr
- More than 40% of private households' assets are invested in residential real estate (EUR 3.2 tr)

Source: Fed. Stat. Office

Germany has the biggest commercial real estate sector - 2003 -



Source: DTZ

- Total estimated commercial real estate stock is the sum of invested stock and outsourcing potential
- Outsourcing potential is thus owner-occupied commercial real estate
 - DE: >70%
 - UK: ~50%
- The investment market in UK is much bigger than the German investment market

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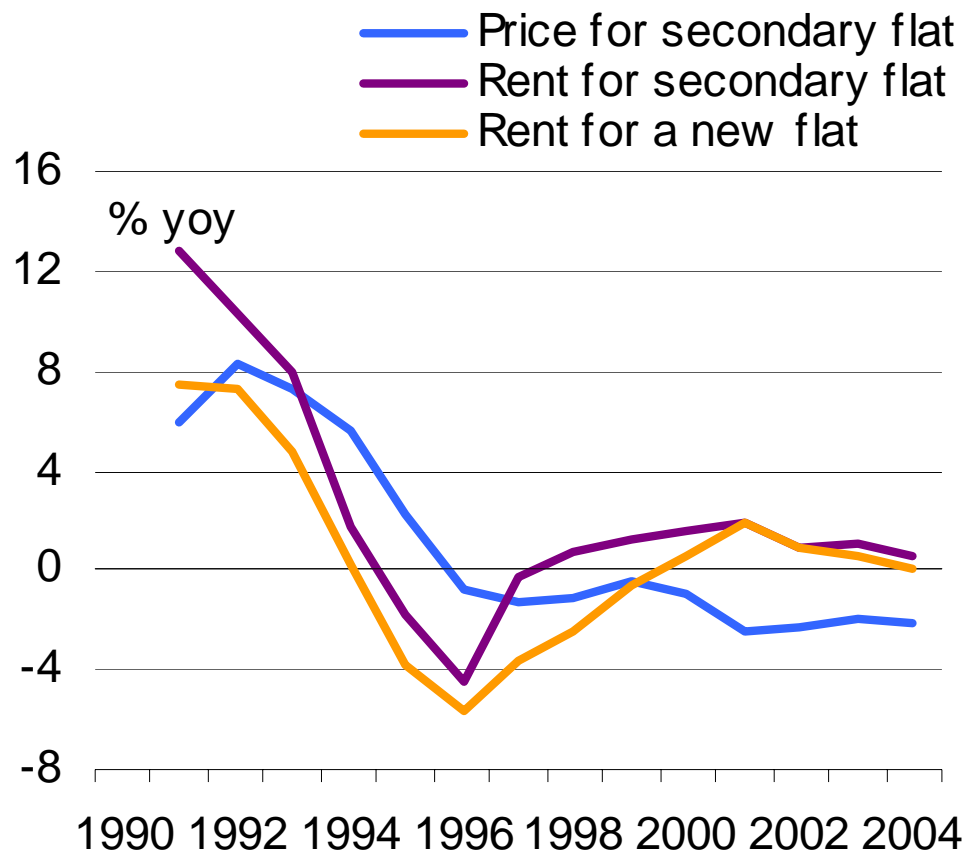
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Concluding Remarks



Housing Markets: Not very dynamic

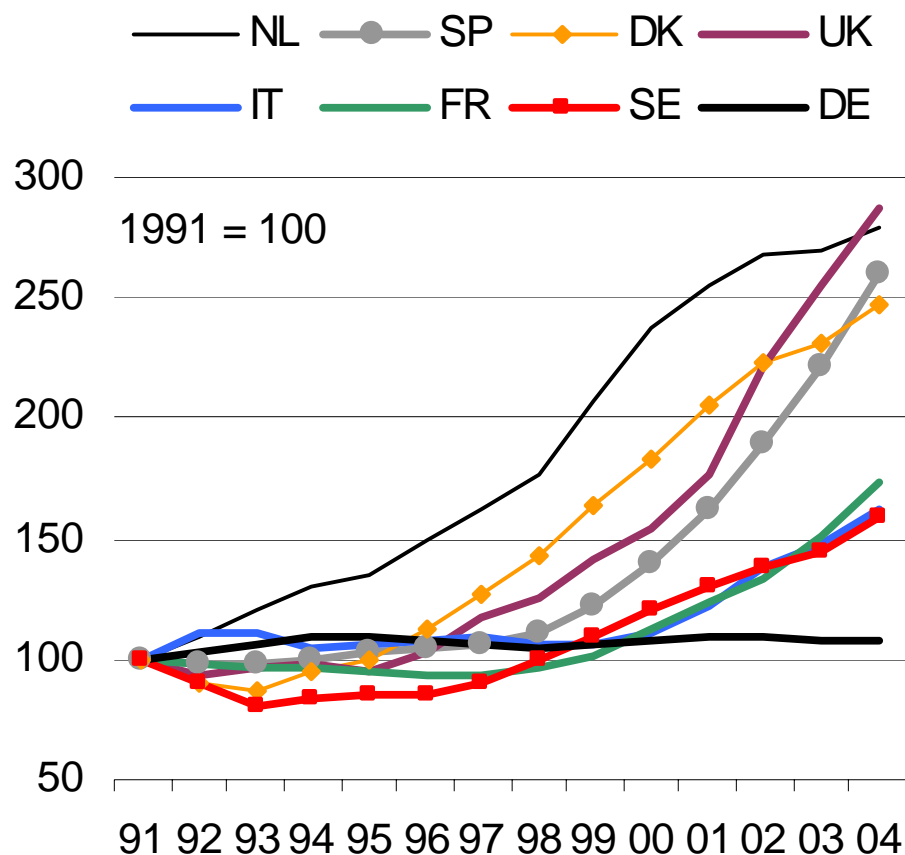


- Prices for owner-occupied flats have been falling for years
- Rents for new-builds stagnate, after strong declines in the second half of the 90s
- Rents for secondary flats are increasing only marginally – less than overall price inflation

Average of 50 to 100 German cities in East and West Germany

Sources: BulwienGesa, DB Research

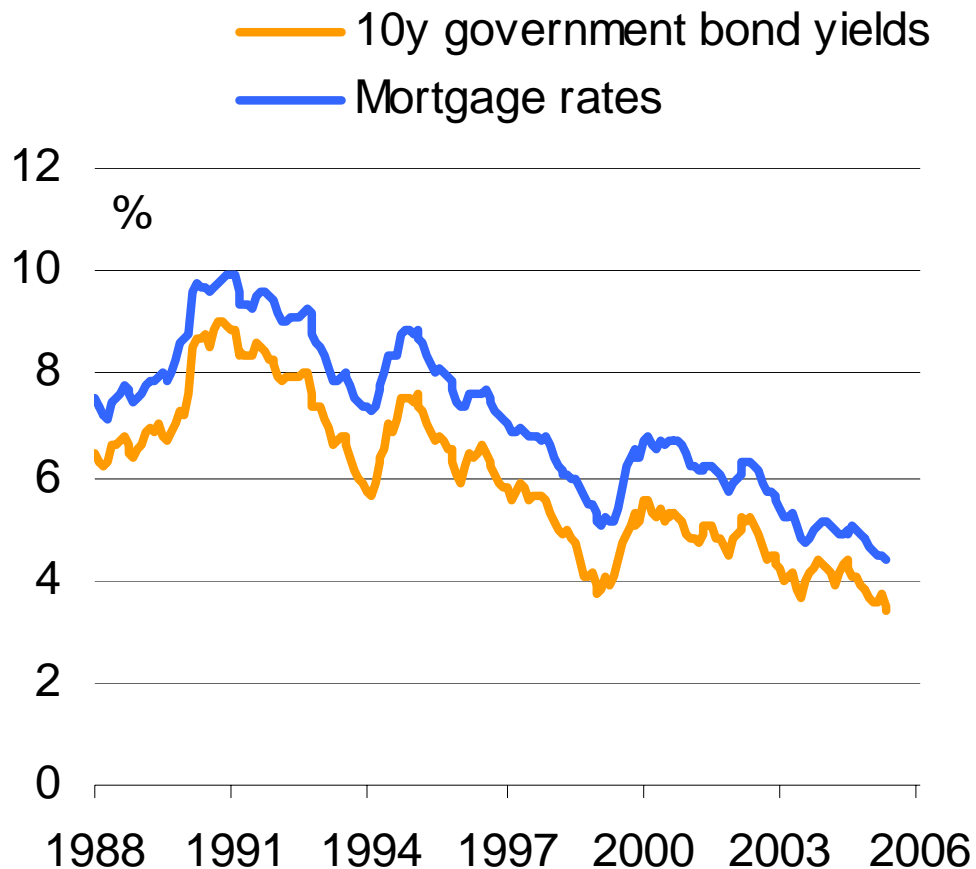
House prices in Europe: Germany is different



- While German house prices are not much above their level of 1991,...
- ... most European countries experienced strong house price growth in the last years
- That implies that the risk of strong price corrections has risen outside Germany
- Stable house prices in Germany might turn out as an asset in the near future

Sources: Nationwide, Nat. stat. offices, BulwienGesa, NVM

Longterm interest rates are still very low



- Longterm interest rates have still not turned upwards
- Facing the weak economic outlook for 2005 a strong rise is not very likely
- Low interest rates make real estate affordable

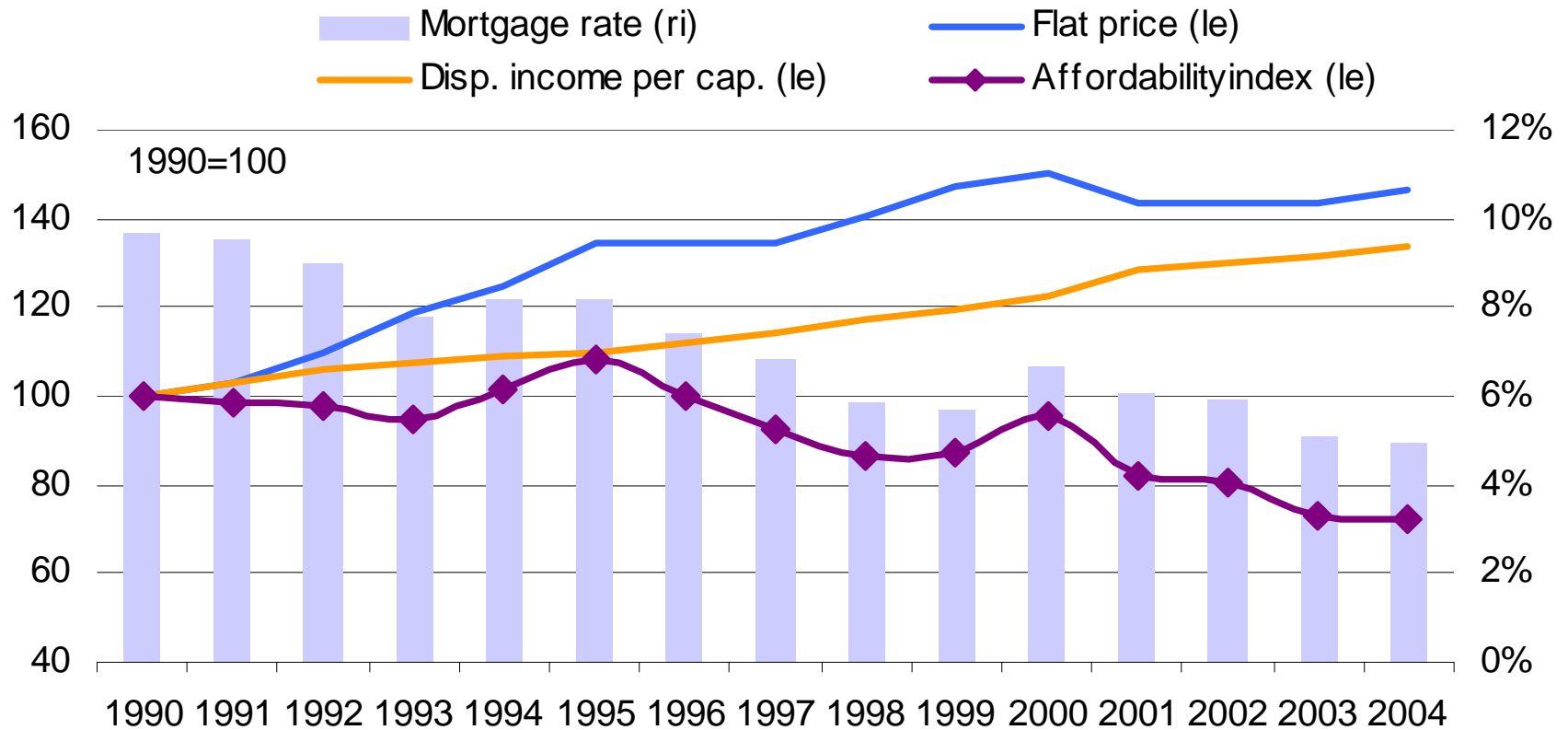
Sources: Bundesbank, EZB, Deutsche Bank

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Houses in Germany are relatively cheap

- Affordability index, example Frankfurt/M -



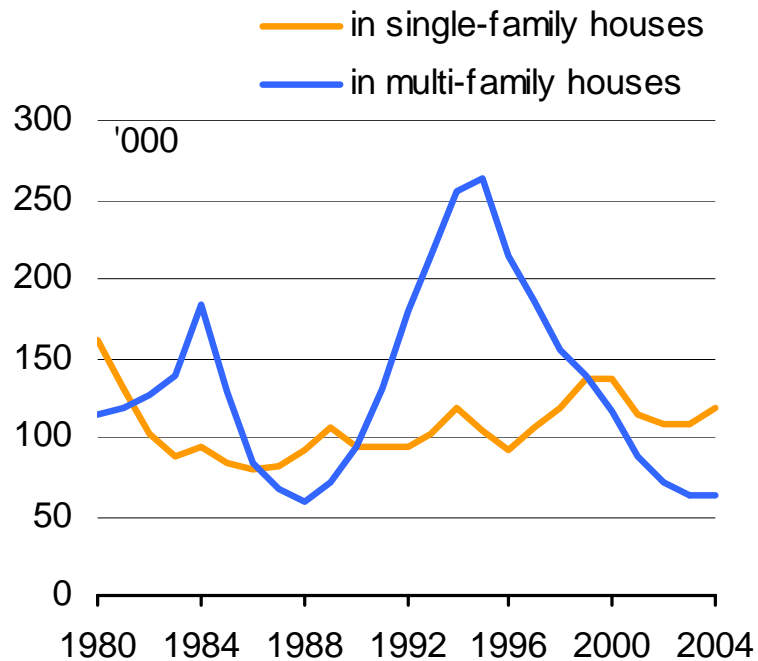
Sources: BulwienGesa, Bundesbank, OECD, DB Research

The affordability index is calculated as the average mortgage payments for an average sized flat (80 m²) and a mortgage with 25 yr maturity in relation to Frankfurt's disposable income per capita



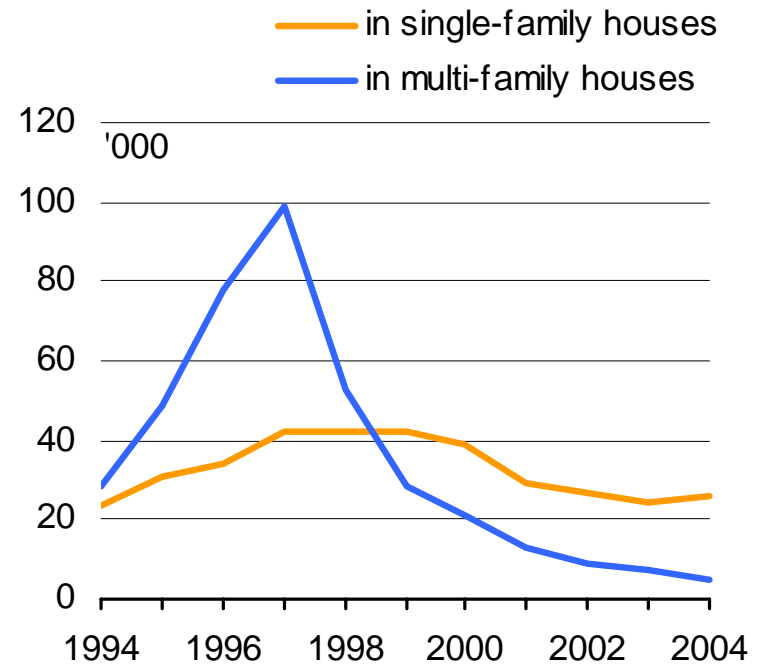
Housing completions below medium term requirements

West Germany



Source: Fed. Stat. Office

East Germany



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German residential portfolios have come into focus of foreign investors

- Foreign investors have increasingly been buying residential property portfolios: In 2004 foreign Private Equity investors bought about 300.000 German flats. We don't expect this enthusiasm for German portfolios to ease in the near future
- Prices today are not much above their level of the early 90s. This promises stable cash-flows
- As new-builds are close to historical minimum, and the number of households is still increasing, there is some upward potential for the medium term
- The low interest rates combined with the slight decreases in house prices imply that houses and especially flats are more affordable than in the mid-90s (however, this can be partly explained as normalization to the special situation of reunification and strong inward migration from the east in the early 90s)



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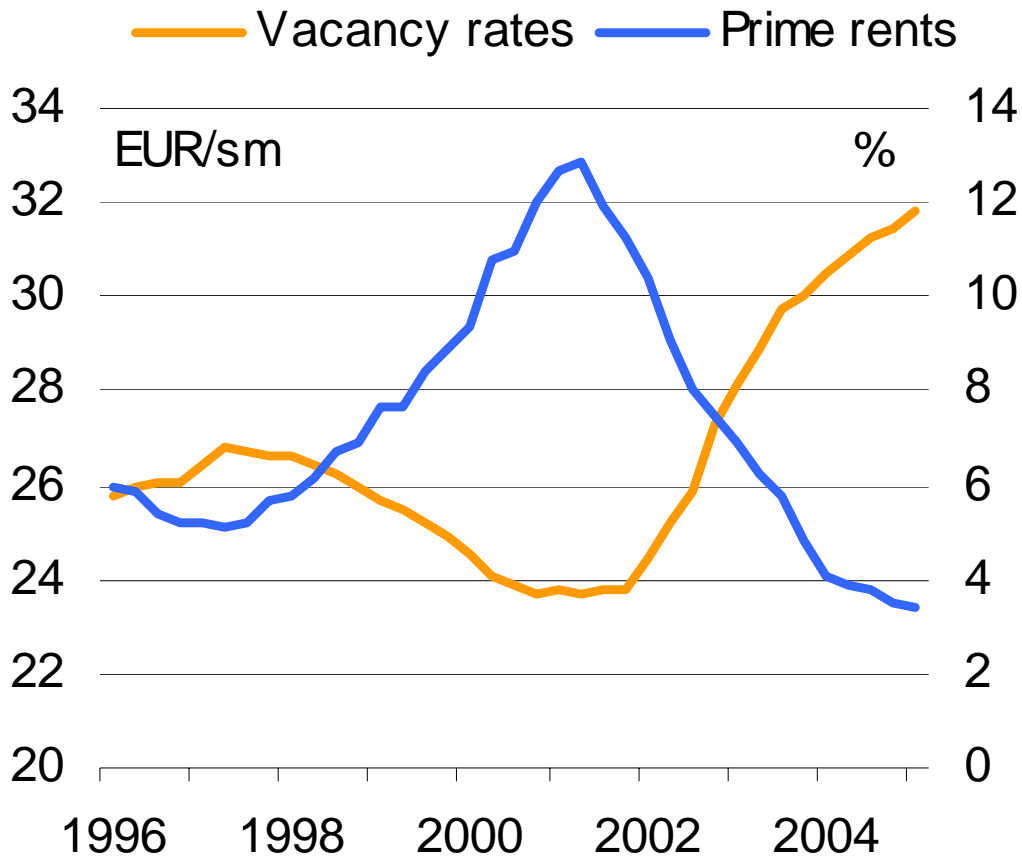
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More than one out of ten German offices stands vacant

- Weighted average for four major German office markets -



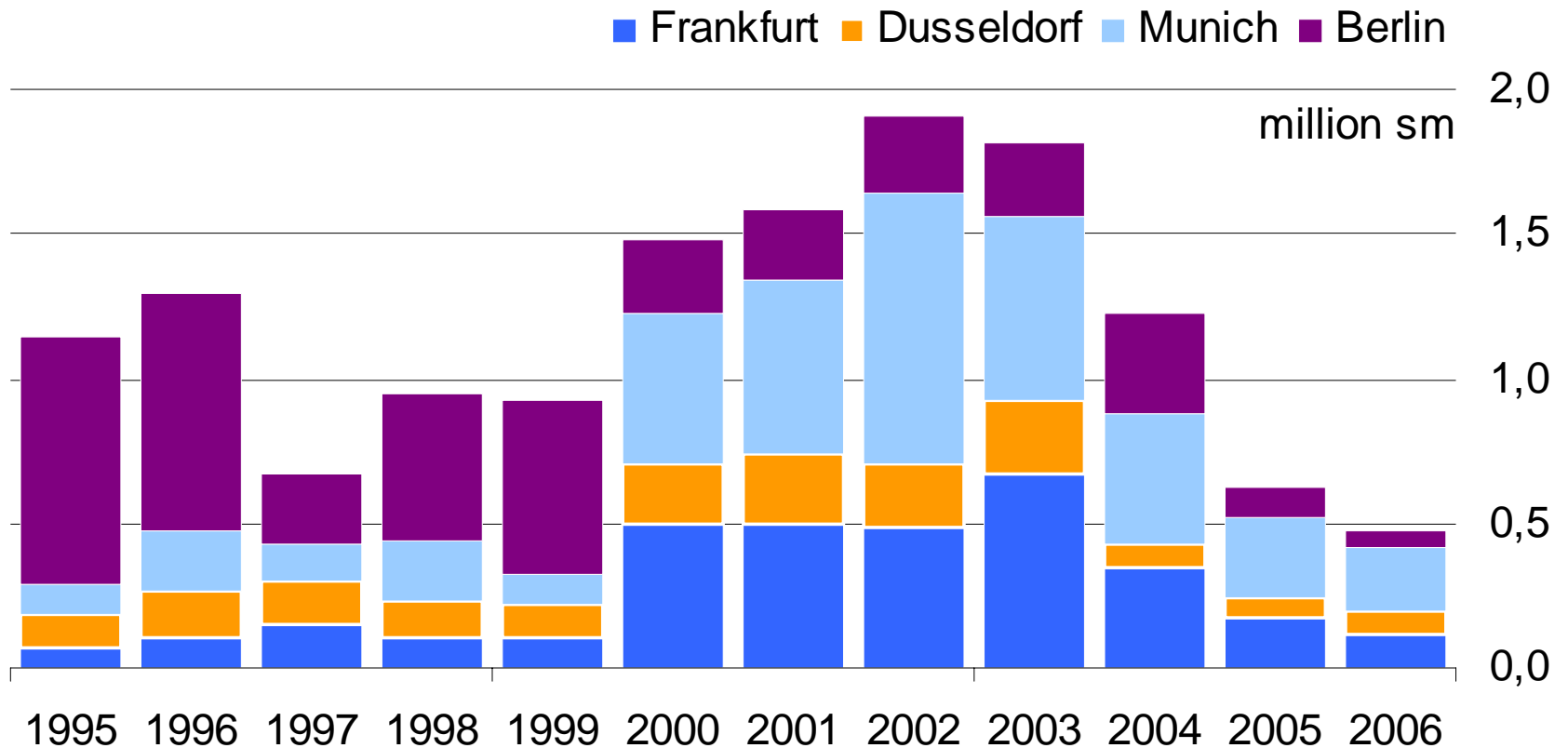
- During the new economy euphoria, office space became very scarce – especially in Munich (below 1%), Frankfurt (2.5%)
- This had led to strong increases of prime rents and had induced strong construction activity
- After the hype was over, the additional office space met weak office demand

Cities are Frankfurt/M, Berlin, Munich and Dusseldorf

Sources: CBRE, DB Real Estate

Supply pressure had to ease

- new office space in the major office markets -

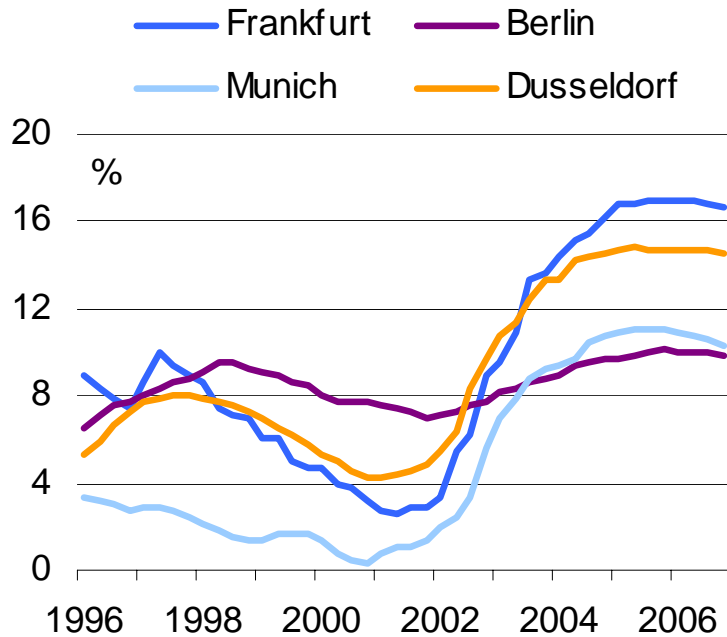


Source: DB Real Estate

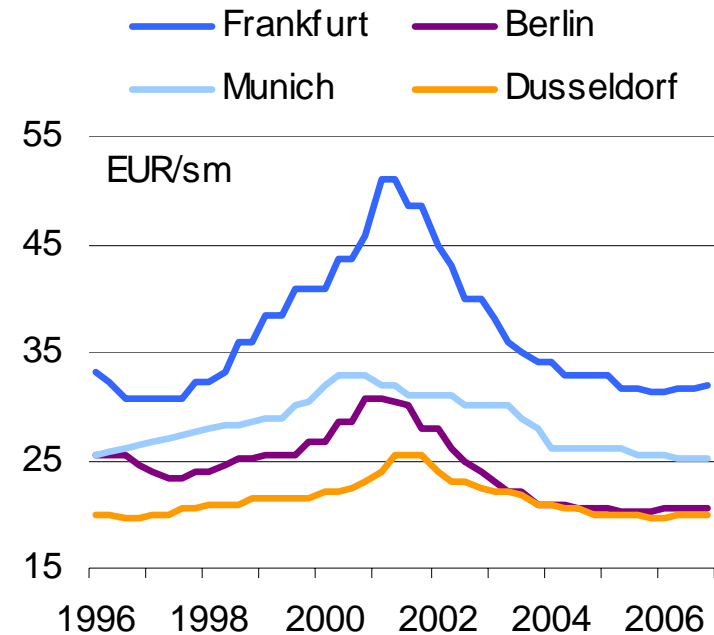


German office markets remain tenants' markets

Vacancy rates



Prime rents

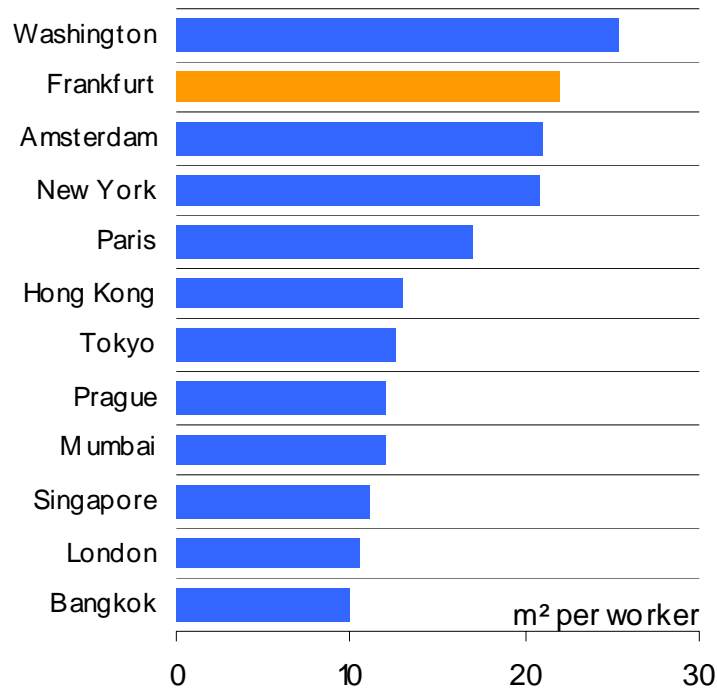


Sources: CB Richard Ellis, DB Real Estate, DB Research

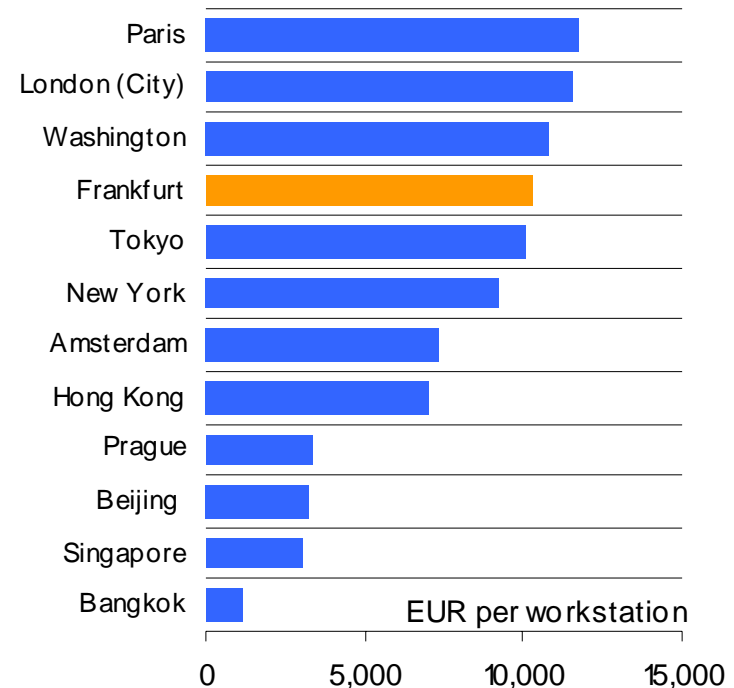


Rent levels in Germany are low yet overall occupancy costs are not

Space utilization per worker



Total occupancy costs per workstation



Source: DTZ



General outlook for office markets remains bleak, but that might offer opportunities

- ↓ The German economy will grow only by 1% in 2005, and 2006 does not promise any rally either
- ↓ Therefore, growth in office employment will be muted
- ↓ German offices can still be operated more efficiently (smart offices)

- ↑ The best time for an investment is always at the end of a recession
- ↑ Yields have started to rise, as German open-ended funds are taking international diversification more seriously and avoid German office markets
- ↑ If Germany finally manages to liberalize their labour markets, the high unemployment rate can be read as growth potential. In the UK, any further growth in office demand requires population growth (mainly migration)
- ↑ The strong rise in vacancy rates (and fall in rents) is limited to the economical centers. In smaller „B-cities“ vacancy levels are still low



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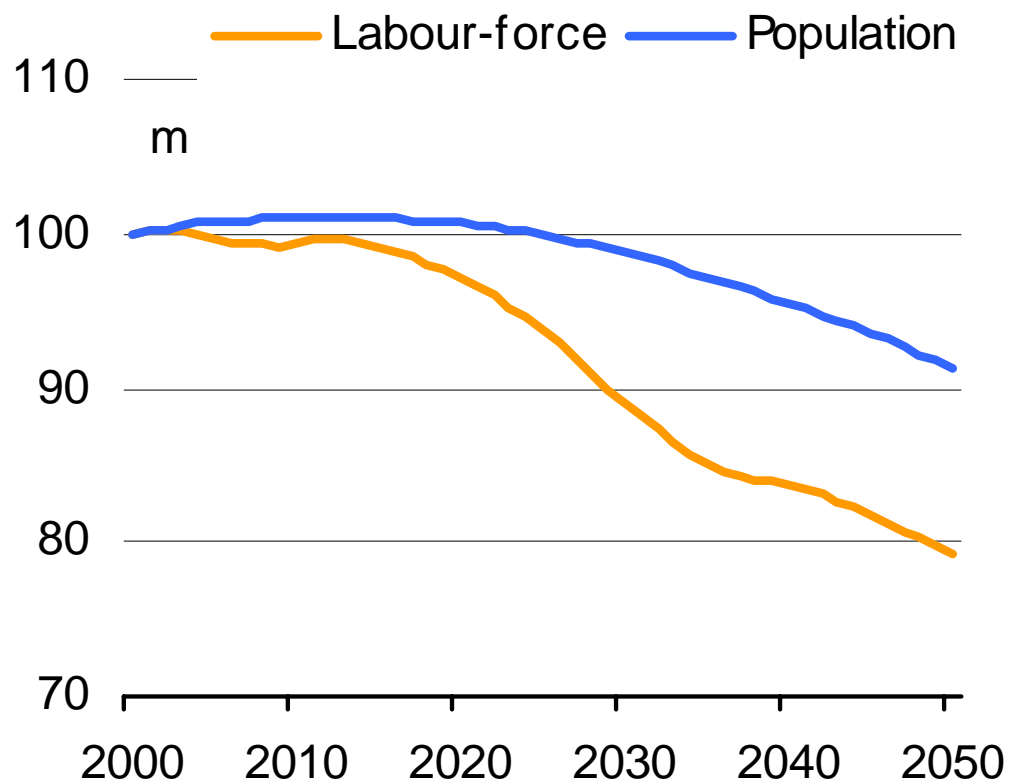
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Population Decline is on the Cards

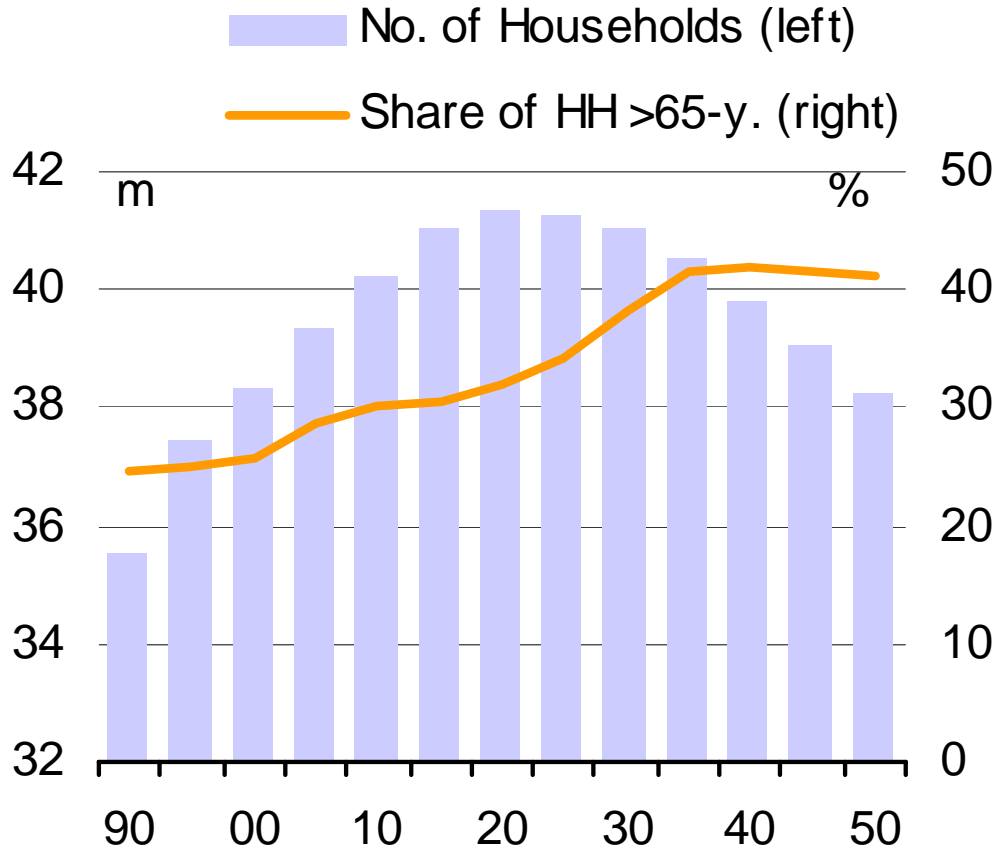


- According to forecasts of the Federal Statistical Office, the peak will be reached in 2012
- Then, an accelerated decline sets in
- In 2003 and 2004 the number of inhabitants shrank slightly, due to a sharp fall in inward migration
- The labour-force starts to shrink earlier and stronger – to keep working population constant, we have to work longer, start earlier and increase the share of women in the working population

Sources: Fed. Stat. Office (medium variant), DB Research



Number of Households will continuously rise

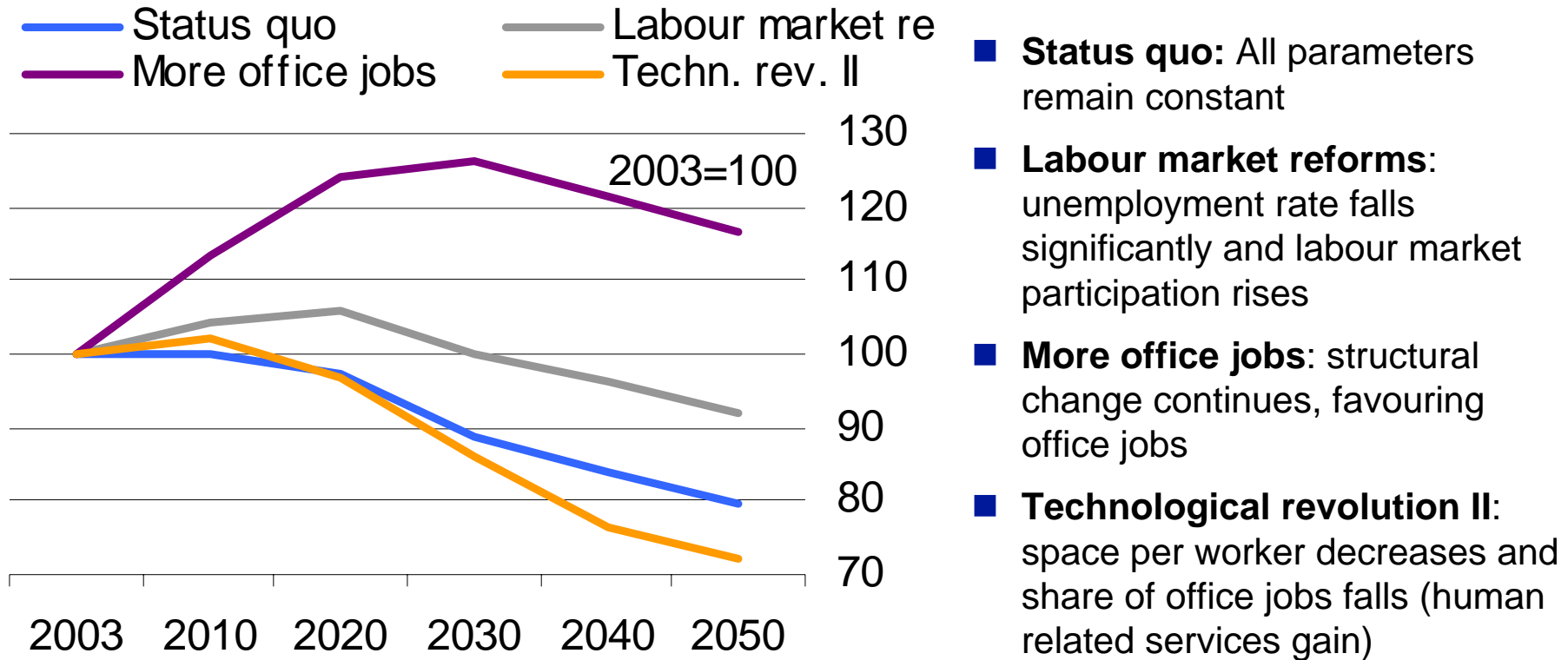


Sources: Fed. Stat. Office, DB Research

- Average household size is smaller in older households
- In the age cohort 35-45 the average household size is 2.7 persons, in the age cohort 75+, the average household size is 1.5 persons



Demand for office space might be affected stronger



Source: DB Research

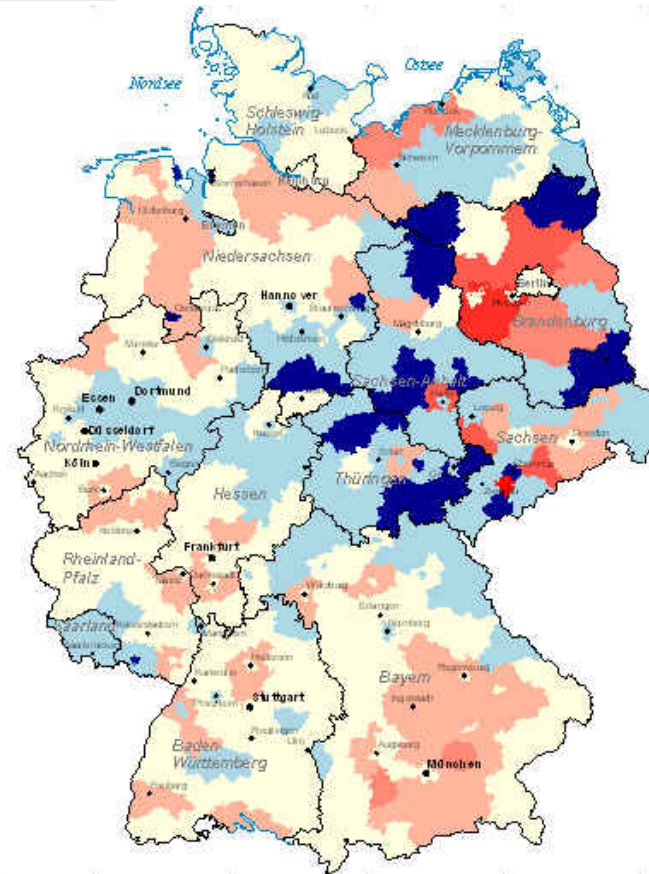
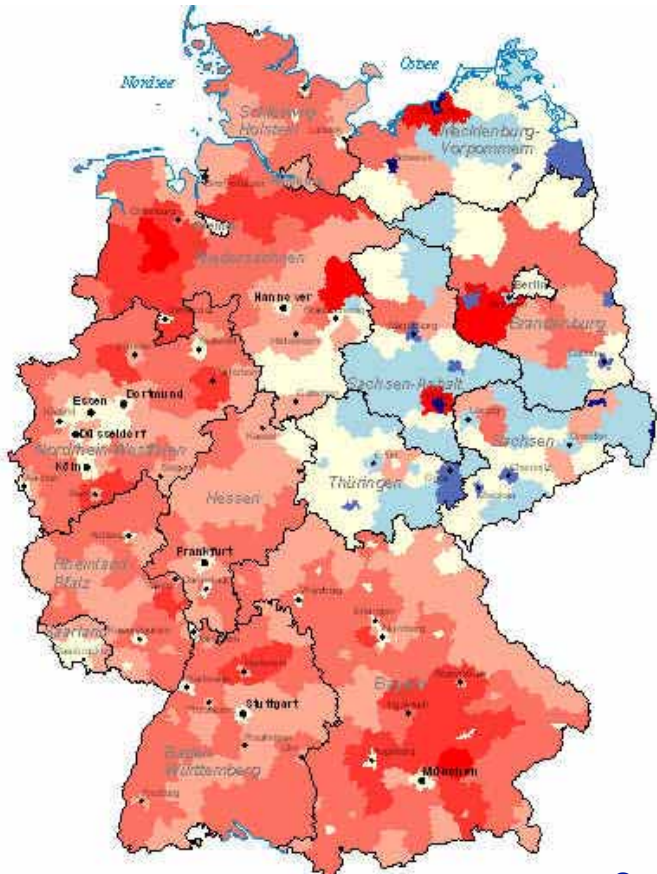


Regional Differences are aggravated

1990-2000 in %

Population growth

2000-2020 in %



Red = Growth
Blue = Shrinkage

Source: BBR

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Concluding remarks

- Germany's housing markets differ in many ways from other European markets:
 - Prices have been flat for most of the last ten years
 - Construction activity is close to the historical minimum
 - Owner occupation is the second lowest in Europe, and many Germans perceive real estate to be a secure investment
 - Private Equity funds have already discovered the merits of this stable asset class
- The main office markets are still far off their equilibria
 - Vacancy rates have reached record levels: In Frankfurt/M almost one out of five offices is unlet; in Dusseldorf it is one out of seven, in Munich and Berlin it is one out of ten offices
 - In the medium term this does not allow for strong rent increases
 - Many German investors are fleeing the market, this leads to rising yields
 - Not the worst moment to put German offices back on the agenda – also because the investment market is to become more liquid in the future