

Market report Germany offices

May 2013



Summary

Top six office markets at a glance

■ The top six German office markets saw a comparatively weak start into 2013. However, we expect them to reduce the almost 20% p.a. decrease in take-up recorded in Q1 13 during the remainder of the year. We predict that total take-up will amount to approx. 2.88m sq m in 2013, meaning a 5% decrease y-o-y.

■ Despite the decrease in take-up vacancy levels continued to reduce. Since mainly high-quality CBD offices are in demand and most of the vacant space is of secondary quality, one can observe a shortage in supply in many markets already.

■ The decline in vacancy, particularly in the prime segment, is also reflected in the development of rents. The prime rents are at an above-average level with some markets seeing longtime peaks. On average however, rents are stagnating.

■ Although prime rents are increasing and high-quality space is scarce, the development activity is still limited. Speculative developments in particular are rare. However, end investors and private equity players replace banks in many cases and provide equity for development schemes.

„In 2013 the market players are discussing supply shortages more often again as most of the vacant office space does not fulfill occupier requirements.”

Marcus Mornhart, Head of Office Agency Germany

Real economy and financial environment

German economy is proving highly resilient

Following a buoyant start to 2012, the German economy lost momentum throughout the year, which ended with a slight decline in gross domestic product (GDP) in the fourth quarter. Over the year as a whole, economic output rose by 0.7%, which was broadly in line with projections at the start of the year.

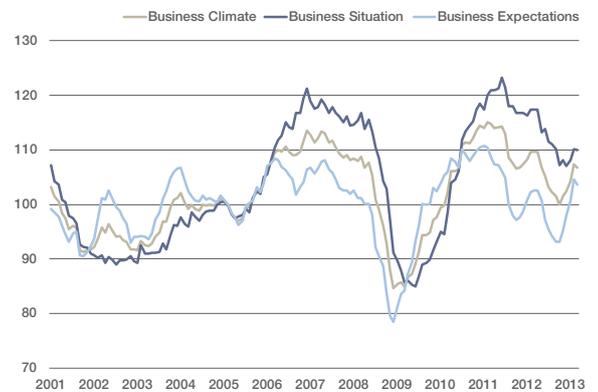
A closer look at the composition of this growth which, though below average was satisfactory in the prevailing conditions, allows certain conclusions to be drawn regarding the state of the German economy. The most disappointing aspect was investment, which declined by 1.7% overall, with all three components (investment in equipment, construction and inventory) showing negative trends. This clearly reflects continued uncertainty, which is primarily attributable to the eurozone crisis. Companies are acting very cautiously and are only making investments if they are confident for their profitability prospects. With various events in the past months creating a high degree of insecurity (including the bank bail-out in Spain, the looming fiscal cliff in the USA, elections in Italy and the crisis in Zyprus recently), a number of planned investments were postponed. However, while these factors continue to create negative sentiment at present, the status quo also suggests significant potential for recovery going forward. When this will materialise essentially depends upon further

developments in the global economy and particularly in the eurozone. Company expectations recorded by the Ifo Business Climate Index were raised in the final months of the year, indicating increasing confidence (Graph 1).

In addition, the negative GDP growth contributed by investment (-0.9 percentage points) was more than offset by the external contribution of +1.1 percentage points. As is normally the case, German foreign trade accounted for the largest proportion of economic growth last year. Despite the challenging economic environment, exports were up 3.7% on the previous year; significantly above the import growth rate of 1.8%. Thus, the German economy has proved that it can successfully market its products even when economic activity in key buying countries is below average. This, in turn, has had a stabilising effect on employment. Although the unemployment rate rose slightly towards the end of the year, the average of 6.8% across the year represented the lowest level since German unification. Consequently, the number of employees subject to social security insurance contribution increased steadily throughout the year to reach approximately 29m; the highest level since the start of the 1990s (Graph 2).

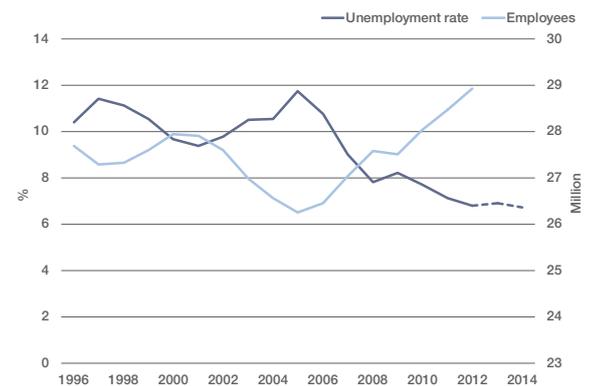
The positive growth in employment figures coupled with appreciable wage increases allowed consumer spending to rise year-on-year by 0.8% (2011: 1.7%), contributing 0.4 percentage

GRAPH 1 **Business climate** Tipping point seems to be reached



Source: cesifo

GRAPH 2 **Labour market** Once child of sorrow - today's poster child



Source: Bundesagentur für Arbeit, Focus Economics

TABLE 1 **Economic key figures at a glance***
2013 is probably going to be an "average year"

Indicator (y-o-y change)	2012	2013	2014	2015	Ø 08-12
Gross domestic product	+0.7	+0.7	+1.7	+1.8	+0.8
Private consumptions	+0.6	+0.8	+1.0	+1.2	+0.8
Industrial productions	-0.4	+0.2	+2.9	+2.0	+0.2
Consumer prices	+2.0	+1.8	+1.9	+2.0	+1.7
Exports	+3.7	+2.8	+5.3	+5.0	+3.0
Imports	+1.8	+3.4	+5.6	+5.4	+3.1

Source: Statistisches Bundesamt, Focus Economics / * from 2013 forecast values

GRAPH 3 **Consumer climate** Wage increases and job security foster consumer prospects



Source: GfK

points to GDP growth. The very high consumer confidence led the Consumer Climate Index to recently tip briefly over 6 points (Graph 3) and means that consumption is expected to continue to support economic growth over the coming year.

On the whole, if not impressive, the German economy showed very solid growth last year. This assessment is particularly validated if the situation in Germany is compared with that of other European nations. Only Estonia and Slovakia recorded higher economic growth than Germany in 2012. Indeed, a number of states are in recession, including the major economies of France and Italy. By any measure, the eurozone is particularly suffering. Economic output contracted in 2012 by 0.4%. The unemployment rate is over 11% and rising, and some nations are struggling with an almost insurmountable debt burden.

Financial markets remain in crisis mode

The high sovereign debt, both within and outside the eurozone, is a key determinant for the global financial markets. To ensure that debt burdens in nations such as Greece, and even Japan and the USA, remain sustainable, central banks have held interest rates at extremely low levels for several years. In the eurozone, the ECB cut its main refinancing rate to 0.5% in May this year from its previous record low of 0.75%. The central bank also implemented a range of additional measures, including the injection of liquidity, in order to stabilise the European financial and banking system. Although all of these measures are only temporarily effective, they are buying governments time to sustainably rehabilitate state finances and to lay solid foundations for the eurozone financial system. Some steps towards this objective have already been implemented. Many nations have passed extensive austerity packages and the European Union has established the European Banking Authority.

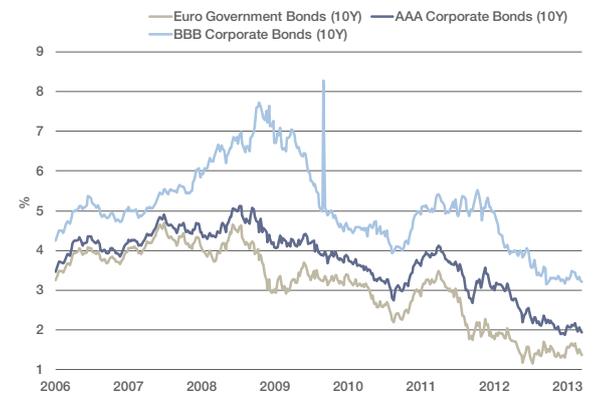
However, while many of these measures are highly controversial, it is also uncertain whether they can effectively combat the causes of the existing problems and how much time they require to do so. This uncertainty is also dominating the actions of players in the capital

markets, who remain highly risk averse in their strategies and are mainly investing their funds in investments deemed safe. These are primarily government bonds from those nations with moderate debt ratios, such as Germany, as well as companies with good credit ratings. Combined with the low interest rate environment, this approach is creating historically low yields on these securities (Graph 4). Indeed, in view of the current inflation rate of around 2%, real returns are actually zero or below.

The high risk aversion has also raised spreads between debt securities with creditworthy issuers and those with lower credit ratings to above-average levels. In the bond market, the difference between yields on AAA securities and those with a BBB rating is currently approx. 120 basis points. This is significantly lower than in the immediate aftermath of the Lehman insolvency (approx. 300bps), but still significantly above the previous normal level of 100bps. The relatively better performance of investments deemed safe compared with those of a higher risk can be observed across all asset classes and is a clearly identifiable phenomenon in the property markets.

GRAPH 4

Bond yields Secure bonds with a real yield around the zero line



Source: Thomson Reuters

Outlook

2013 a transitional year

A glance at the key indicators for the national economy suggests that 2013 is likely to be a decidedly "average" year for the German economy (Table 1). All projections are either in line with the average figures of 2008-12 or closely above or below these averages. Gross domestic product, for example, is expected to grow by 0.7% - almost precisely the average from the last five years. This also means that the current year will be very similar to the last. However, it is highly likely that there will be one key difference. While last year started with very high levels of economic activity that declined appreciably throughout the year, the picture in 2013 is likely to be reversed. The first half of the year, and particularly the first quarter, should be somewhat weak in view of the lack of foreign stimulus, exacerbated by companies' present reluctance to invest. However, the anticipated upturn in the emerging markets and the USA will provide impetus to the German export sector, which should translate into an increased growth rate in the second half of the year. If this is accompanied by a resumption in investment activity as companies increasingly come to terms with the Euro crisis (as this shows no imminent sign of ending!), then the German economy will be able to fully exploit its growth potential. This is reflected in the growth forecast of 1.7% pa from 2014. In this respect, 2013 can be regarded as a transitional year - provided that the Euro zone continues to consolidate and there are no further shocks.

Top six office markets at a glance

First quarter take-up a fifth down on last year

After a strong finish of 2012, German office markets showed a significant loss of momentum in the first quarter of 2013. Take-up in the six markets of Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg and Munich totalled just under 580,000 sq m in the first three months of the current year. This represents a decrease of almost 19% compared to the corresponding quarter last year and a decline of one third compared to the fourth quarter of 2012. However, in view of the slowing economy in Germany since last summer, combined with the continuing uncertainty in the eurozone, this decline in take-up was to be expected. This uncertainty was particularly reflected by the number of major lettings. Düsseldorf, Cologne and Munich each registered only a single transaction above 10,000 sq m. There were also relatively few lettings between 5,000 sq m and 10,000 sq m.

Berlin, Cologne and Frankfurt in decline – Düsseldorf, Hamburg and Munich grow

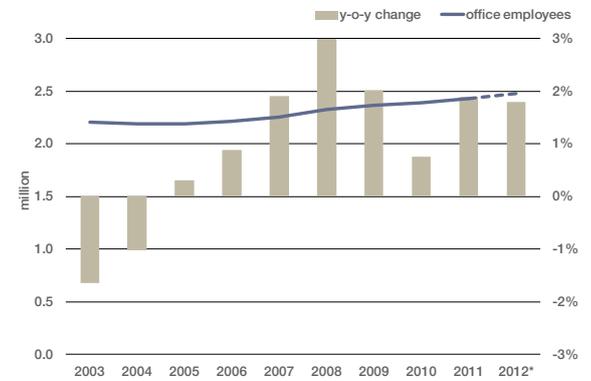
The greatest decline in take-up among the top six markets was seen in Frankfurt, where ongoing consolidation in the financial sector contributed to a 54% decline in office lettings compared to Q1 12. Double-digit declines in take-up were also seen in Berlin (-37%) and Cologne (-22%). Again, this was primarily attributable to a lower number of large lettings

compared to last year. However, with large requirements on the market in all three cities, this decline is expected to narrow significantly by the mid-point of the year or by the year end at the latest. The three markets with declines in take-up are also counter-balanced by a number of locations where take-up is growing. Düsseldorf (+5%), Hamburg (+16%) and Munich (+10%) all showed positive growth compared to the same quarter last year. This trend is supported not only by a healthy mix in terms of the economic sectors but also by expanding companies in all cities, who require new accommodation to accompany their growth.

Vacancy rate declines slightly further

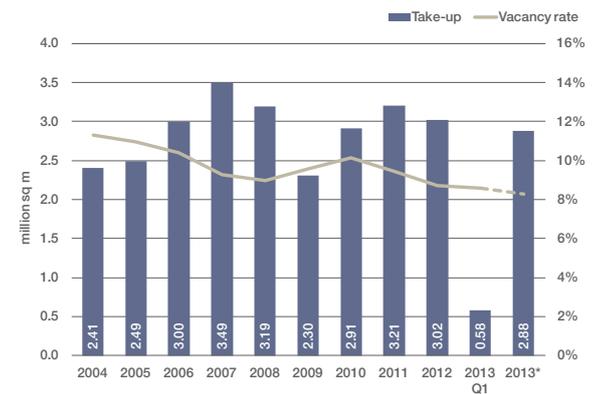
Despite the overall decline in take-up, the vacancy rate continued to fall – albeit only slightly. At the end of March, the average office vacancy rate across all locations stood at 8.6%, equating to 6.4m sq m. This compares to 8.7% at the end of last year and 9.3% at the end of the first quarter of 2012. In some market segments, there is even a discernible supply shortage. In central Frankfurt locations, for example, there is a lack of high-quality space below 1,000 sq m. The same applies in Munich, while Cologne is primarily lacking in centrally located accommodation in the mid-price segment. Therefore, while there may appear to be a varied offering for occupiers, there is actually a lack of suitable accommodation in many locations.

GRAPH 5 Office employment Growth in employment fosters take-up figures



Source: Bundesagentur für Arbeit, Savills / * forecast

GRAPH 6 Take-up and vacancy Decrease in take-up in Q1 due to absence of large deals



Source: Savills / * forecast

TABLE 2 Office market key figures Decline of vacancy rates continues in all markets, but at slower pace

	Take-up (sq m)		Vacancy rate (%)		Vacancy (m sq m)		Prime rent (€ per sq m/month)		Average rent (€ per sq m/month)	
	Q1 2013	y-o-y change	Q1 2013	y-o-y change	Q1 2013	y-o-y change	Q1 2013	y-o-y change	Q1 2013	y-o-y change
Berlin	139,400	-37.2%	5.5	-40bps	1.03	-6.4%	20.90	-2.3%	11.89	-0.8%
Düsseldorf	73,000	+4.7%	11.0	-30bps	0.83	-2.4%	26.00	+12.1%	14.25	+5.7%
Frankfurt	59,900	-53.9%	13.5	-180bps	1.60	-12.1%	37.50	+4.2%	18.00	-5.3%
Hamburg	103,000	+8.4%	7.4	-50bps	0.96	-8.6%	24.00	+1.7%	13.10	-7.9%
Cologne	47,000	-21.9%	7.8	-40bps	0.61	-3.2%	21.40	-0.5%	11.30	-0.9%
Munich	150,400	+10.0%	6.3	-110bps	1.40	-14.4%	32.10	+5.9%	15.04	+3.2%
Top six	572,700	-19.7%	8.6	-70bps	6.43	-9.3%	26.98	+3.8%	13.93	-1.3%

Source: Savills

(Speculative) development volumes remain very low

Despite declining take-up demand continues to exceed supply for a simple reason: The completion volume remains at a very low level. Around 940,000 sq m of office space is expected to be completed this year in the six markets included in the research. This is only slightly more than the figure for Frankfurt alone in 2003. While the expected completion volume is 40% higher than last year, it remains somewhat below the ten-year average. Moreover, in view of the situation in the financing markets, the low completion figures are not expected to change in the medium term. There remains no financing available for speculative projects and the pre-let requirement of 30% to 50% is too high, particularly for small developments. Potential occupiers of smaller areas from 500 sq m to 1,000 sq m normally only commence their search for accommodation 12 to 15 months before the expiry of their lease, which is too late for a letting in a building that has yet to be constructed. There are very few speculative developments in the German office markets. The only exception is Düsseldorf, where developers with funds from local family offices and international venture capitalists are acquiring speculative land and existing buildings. However, in this market too there is still a lack of high-quality office space in central locations. Refurbishments should also increase in view of the partial supply shortage, but for now there is relatively little activity. There are two main causes for this. Firstly, owner pricing expectations are high compared to what developers are prepared to pay. Secondly, many of the properties worth considering are in peripheral locations, where refurbishment no longer works out today because the achievable rents are too low.

Prime rents show upward trend though incentives remain the norm

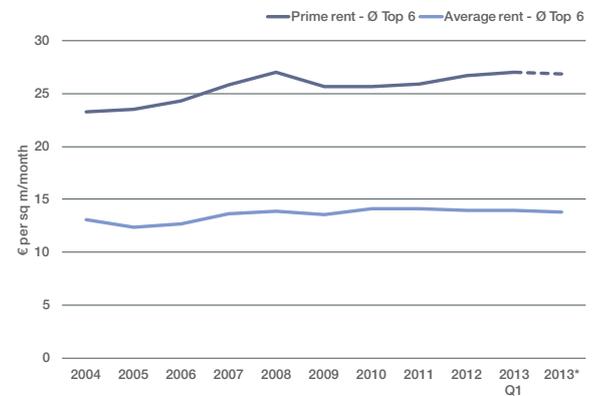
An unfavourable situation for occupiers is working to the advantage of landlords. Rents are continuing to increase, particularly for high-quality and/or centrally located office space in high demand. The average prime rent across the top six cities stood at €26.98 per sq m/month at the end of

the first quarter; 3.8% above last year's figure. There is likely to be continued moderate rental growth in the prime segment as there tends to be a surplus of demand for such accommodation. Regarding average rents, no increase is expected for this year at least. The vacancy rate is still high while demand is insufficient for non-prime properties. Furthermore, occupiers of secondary offices are significantly more price-sensitive. Incentives continue to be the norm even in the prime segment where rents continue to rise, and only show sporadic decline. These are normally between 5% to 10% of the nominal rent on a 5-year lease. This form of attracting tenants has seemingly now established itself in the market and is, to some extent, good etiquette.

More activity in the second half of the year

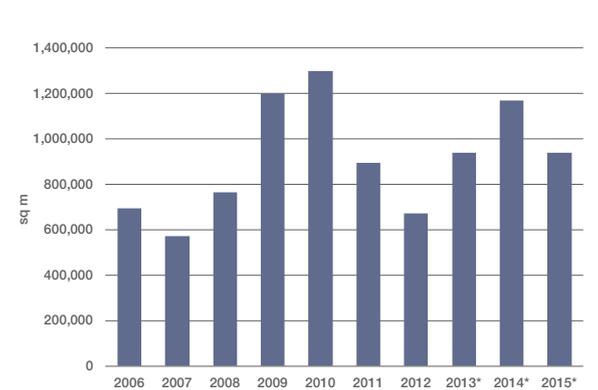
On the whole, the German office markets should remain largely stable in 2013. We expect the second half to be more active than the first half of the year driven by an increasing number of large lettings as the economic environment gradually improves. The significant decline in take-up observed in Q1 should therefore contract by the end of the year. Take-up is expected to total approximately 2.9m sq m, which would be exactly in line with the 10-year average and represent a decline of 5% compared to 2012. Against this background and in view of the low completion volume, the downward trend in the vacancy rate will continue, albeit at a slower rate.

GRAPH 7 **Rental levels** Prime rent with slight increase, average rent unchanged



Source: Savills / * forecast

GRAPH 8 **Development pipeline** Increase at low levels



Source: Savills / * forecast

TABLE 3 **Forecast top six markets** Largely stable office market figures

	31.12.2013	31.12.2012	y-o-y change
Take-up	2.88m sq m	3.02m sq m	-4.6%
Prime rent	€26.83 per sq m/month	€26.68 per sq m/month	+0.6%
Average rent	€13.78 per sq m/month	€13.94 per sq m/month	-1.1%
Vacancy rate	8.3%	8.7%	-40bps

Source: Savills / * forecast

Office market Berlin

Significant decline in take-up owing to a lack of large lettings

After a record year in 2012 with take-up of almost 835,000 sq m, the office market in the capital took a time-out in the first quarter of 2013. Take-up in the first three months of the current year totalled approximately 139,400 sq m. This represents a decrease of almost 37% compared with figures from the same period last year and is a good 20% short of the average Q1 take-up over the last five years. These relatively weak figures are primarily attributable to an absence of transactions above 5,000 sq m.

Public sector remains largest demand group – start-up community stimulates small-sized office segment

There are, however, a number of large lettings pending for later in the year, primarily from the public sector. The public sector remains the central pillar of the Berlin office market and the only sector to regularly undertake large lettings. Last year, when Zalando alone contributed some 70,000 sq m to the office take-up with a number of lettings, was therefore an exception rather than the rule. However, the example illustrates where growth in the Berlin economy and hence the office market could come from in future. The start-up community, particularly the IT sector, has been particularly active for a number of years. Moreover, Berlin is frequently referred to in the media as the 'Silicon Valley' of Europe. This has long been to the benefit of the office market, albeit almost exclusively in the form of lettings in the small office segment below 500 sq m. And while success stories such as Zalando and the resulting major lettings are certain to remain the rare exception in future, isolated successful start-ups can significantly stimulate the office market in the capital as the previous example shows.

Loft offices are rare and expensive

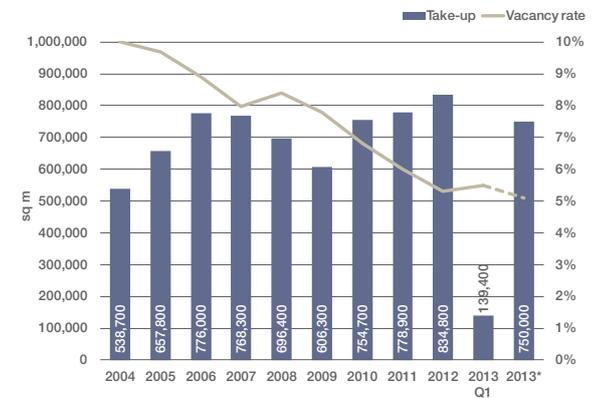
The above-average take-up in recent years combined with very low completion volumes has meant that the vacancy rate has now been in decline for more than five years. At the end of the first quarter of 2013, the vacancy rate stood at just 5.5%. In some market segments, there is

even scarcely any available space. In the small office segment, this is particularly true for loft offices in Mitte district, where demand significantly exceeds supply and rents of €16.00 to €18.00 per sq m/month are now the norm. In contrast, there is generally an adequate supply of space above 1,000 sq m. Only in the high-class segment there is a shortage of options for large occupiers. In this segment the supply is limited to existing properties at Potsdamer Platz or developments in new locations such as the central train station or Mediaspree. Companies searching for such accommodation must therefore potentially schedule a correspondingly long lead time of around three years as it may only be possible to fulfil the search criteria via a new development, meaning that a construction period of around two years must be added to the normal parameters (e.g. notice period of the existing lease).

No rental growth foreseeable despite further decline in vacancy rate

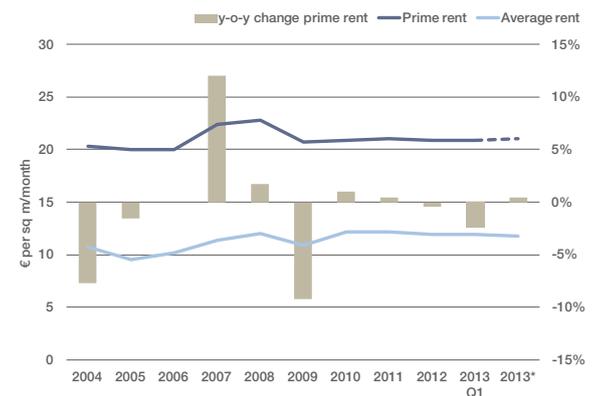
Despite the declining vacancy rate and supply shortages in some segments, rents in the first quarter remained largely unchanged. The prime rent remained at the previous quarter's level of €20.90 per sq m/month while the average rent stood at €11.89 per sq m/month (Q4 12: €11.96 per sq m/month). These figures are not expected to change significantly throughout the remainder of the year. Incentives in the prime segment also remained stable with three months rent-free on a five-year lease term consisting the norm. Conversely, the vacancy rate should continue its downward trend. On the one hand, we assume that take-up in the remaining three quarters of the year will be higher than in Q1, with a total take-up for 2013 of around 750,000 sq m. On the other hand, scarcely any space is coming to the market, with just 38,700 sq m of the 199,000 sq m projected for 2013 remaining unlet.

GRAPH 9 Take-up and vacancy Vacancy rate in decline



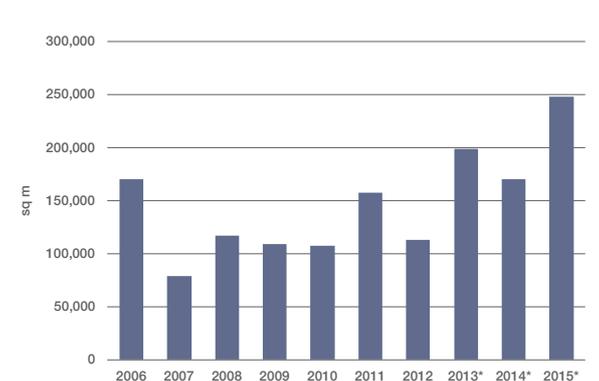
Source: Savills / * forecast

GRAPH 10 Rental levels Prime rent without noteworthy upward potential



Source: Savills / * forecast

GRAPH 11 Development pipeline Large developments to be finished in 2015



Source: Savills / * forecast

Office market Düsseldorf

Expansion-driven moves underpin take-up

Düsseldorf saw lively demand in the first three months of the year across all size categories, which translated into a significant number of completed lettings. The take-up of 73,000 sq m was almost 5% above the figure from the same quarter last year. Many of the deals, such as those involving Igedo and Mode IT Systems, arose since the companies no longer had sufficient space for expansion in their existing location to accommodate their (planned) employee growth and therefore needed to move to new offices.

Demand focused on high-quality space in good locations

Most companies focused their search on high-quality accommodation in central locations. Kennedydamm was the greatest beneficiary of this in the first quarter of 2013, representing the most active submarket by take-up with lettings of more than 15,000 sq m. In contrast, Medienhafen, another established office submarket with high-quality office stock, only managed take-up of approx. 1,500 sq m. However, this relatively weak performance (the location recorded take-up of 30,000 sq m in 2012) was not attributable to a lack of demand but rather, for the most part, to inadequate supply. There is currently a scarcity of vacant, larger, contiguous space, meaning that large occupiers are forced to divert their attention to other submarkets. This will not change significantly until at least the end of 2014 since no space is expected to be vacated before this time and projects such as Casa Stupenda will be completed in 2015 at the earliest. The situation is similar in the financial district, where high-quality space is also becoming scarce.

New developments achieve record prime rents

The strong demand for high-quality space combined with a shortage of supply in the same segment has sustained the high rental levels this year. The average achieved rent stood at €14.25 per sq m/month; around one euro above the 10-year average. The prime rent recently reached €26.00 per sq m/month; more than €3.50 per sq m/month above the ten-year

average. This extraordinary level, last reached in 2001, is primarily a result of a number of lettings in the Kö-Bogen and Dreischeidenhaus projects. Since both properties are now largely let, the prime rent will fall back again slightly next year at the latest.

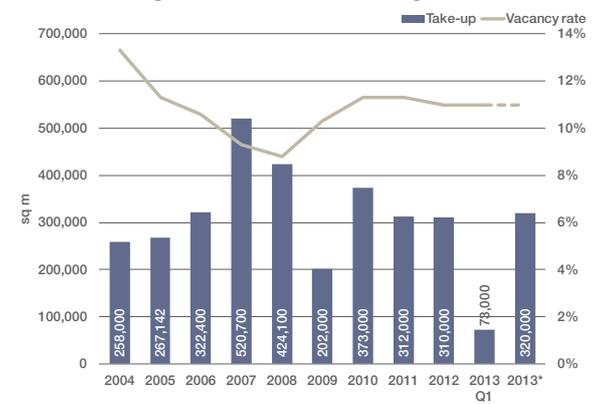
Increase in speculative development

The combination of high rents with a marked preference of companies for high-quality accommodation creates a favourable environment for developers. This is reflected in the increasing annual completion volumes to 2015 (2013: approx. 126,000 sq m; 2014: approx. 128,000 sq m; 2015: approx. 187,000 sq m). Düsseldorf is the only one of the top six markets where there is any noteworthy speculative development activity. The old Vodafone offices, for example, are being extensively refurbished while Hamburg-based Momeni Gruppe, who are currently renovating the Dreischeidenhaus, recently acquired Georg-Glock-Straße 3 on Kennedydamm, which they also plan to refurbish. Such undertakings are often financed by private funds from family offices or via international venture capitalists. Since developers are also primarily interested in the good locations, appropriate development sites are becoming increasingly scarce.

Moderate increase in take-up expected

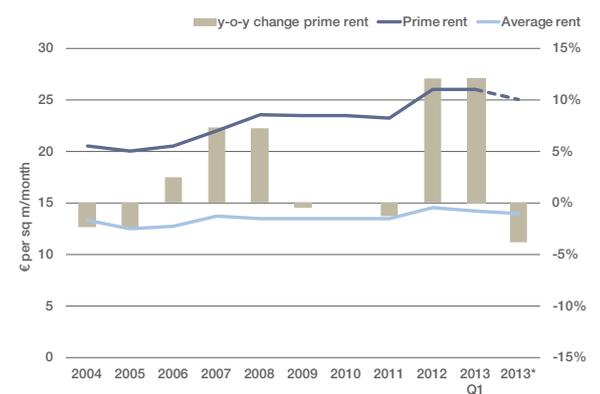
With demand expected to remain stable and a number of large requirements approaching completion, take-up in the forthcoming quarters is likely to exceed that of the first quarter, producing a projected annual take-up of around 320,000 sq m (2012: 310,000 sq m), which would be in line with the 10-year average. In these conditions, the vacancy rate will remain at its current level of 11.0%.

GRAPH 12 Take-up and vacancy Vacancy rate remains high for the time being



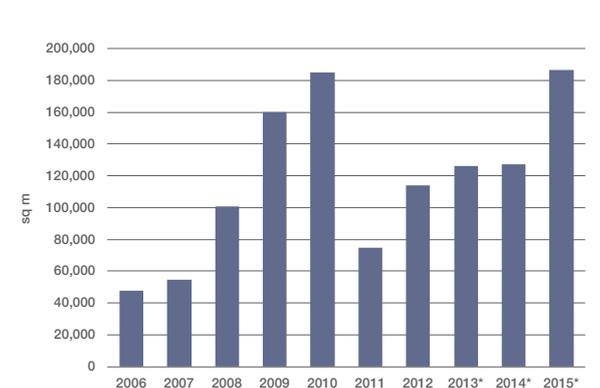
Source: Savills / * forecast

GRAPH 13 Rental levels Prime rent with double-digit increase



Source: Savills / * forecast

GRAPH 14 Development pipeline Significant increase in 2015



Source: Savills / * forecast

Office market Frankfurt

Unusually high demand, unusually low take-up

The Frankfurt office market was characterised by unusually high demand at the start of the year with requirements in all size categories. Despite this, take-up in the first quarter totalled just 59,900 sq m. This was not only 54% below last year's figure but also represented the weakest quarterly take-up for three years. Only the significantly smaller office market of Cologne registered a lower take-up level among the top six cities in the first quarter of 2013.

Consolidation in the financial sector continues

There are two principal reasons for such weak take-up despite brisk demand. One of these is the upheaval in the financial sector. The traditionally most important demand group for the Frankfurt office market is currently highly restrained. While consolidation-driven moves have generated very high take-up in recent years, there was just one letting above 1,000 sq m in the first quarter of 2013 to a private bank. The Bundesbank also extended its existing space at Skyper. The trend of consolidation should continue for the time being. Commerzbank subsidiary Hypothekenbank Frankfurt (formerly Eurohypo), for example, is to shed around 350 jobs by 2015, which should mathematically make almost 9,000 sq m of office space redundant. Overall, therefore, the financial sector is unlikely to provide any positive impetus to the office market for the foreseeable future. Law firms, a regular source of high take-up in previous years, have also been reticent in recent months, although there are currently a few requirements on the market.

No supply of most sought-after space

The second reason for the low take-up is that there is no appropriate supply for a large proportion of the demand. This is true for almost all size categories but particularly the size segment below 1,000 sq m, where modern, centrally located accommodation is scarce. This may initially come as a surprise in view of the sustained high vacancy rate of 13.5%, or approx. 1.6m sq m of vacant office space. However, a good third of this can be classified as structural vacancy, i.e. vacant space no longer

suitable for the market in its present condition. In addition, the vacant space is predominantly situated in secondary locations. These two factors combined mean that modern office space in central submarkets is relatively scarce. Since landlords prefer lettings to large occupiers and cannot let remaining vacant floors in small units owing to a lack of divisibility, this is all the more true of smaller office space.

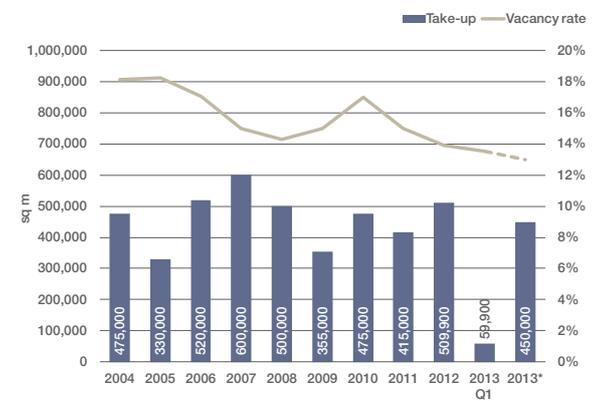
Speculative projects fail to materialise

These conditions are actually ideal for completing smaller office developments, yet these are scarce. Such projects often fail since, in view of the necessary long lead time for the tenant, no pre-let is feasible and, consequently, the financing falls through. Refurbishments of dated properties would also be sensible but are prevented in many cases by excessively high book values and the associated excessive sale price requirements of the current owners.

Tenants now accustomed to incentives

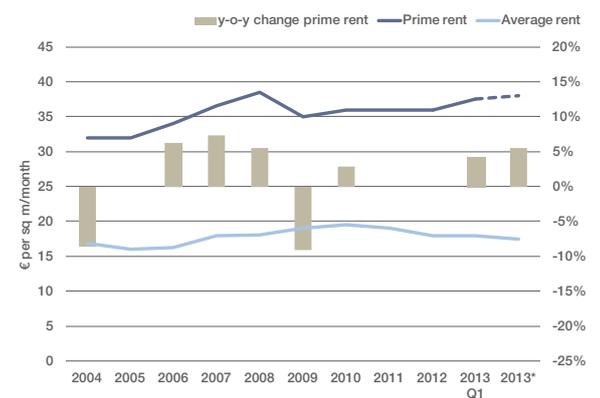
Despite the increasing shortage of high-quality space and moderate rise in nominal rents in the prime segment (the prime rent at the end of March stood at €37.50 per sq m/month; Q4 12: €36.00 per sq m/month), there was no change in incentives. These remained stable at 10% to 15% of the nominal rent on a 5-year lease. Such incentives are now deemed good etiquette from a tenant perspective, meaning that no noteworthy changes are expected here over the next three quarters despite the expected increase in take-up.

GRAPH 15 **Take-up and vacancy** Lowest quarterly turnover since Q1 10



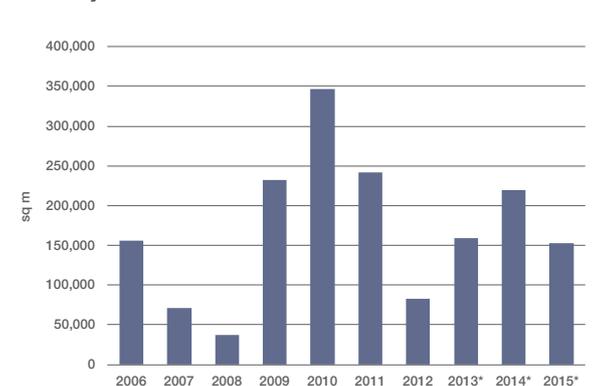
Source: Savills / * forecast

GRAPH 16 **Rental levels** Prime rent with significant increase for the first time since 2010



Source: Savills / * forecast

GRAPH 17 **Development pipeline** Development activity remains moderate



Source: Savills / * forecast

Office market Hamburg

Positive start to the year on the Elbe

After last year's office take-up in Hamburg of around 430,000 sq m fell just short of the 10-year average (approx. 450,000 sq m), this year's figure looks likely to exceed the benchmark. The 110,000 sq m transacted in the first three months of the current year represents an increase of almost 16% on the same quarter last year. The positive start to the year is attributable not least to the balanced demand across all size categories. The 5,000 sq m and above segment saw four completions, which was three more than in the same quarter last year and included a 14,000 sq m letting of new headquarters to Philips. There were also more completions in the smaller size segments than last year, with transactions distributed approximately evenly across the 1,000 sq m and above segment (total take-up of approx. 60,000 sq m) and the below 1,000 sq m segment (50,000 sq m).

Tenants are seeking high-quality space

City South was the most active submarket in the first quarter of 2013 accounting for almost 30% of overall take-up with several completions, the largest of which was a letting of 7,200 sq m to DB Schenker. The City submarket was the second most prolific with a solid 20% share of take-up followed by the airport, which accounted for almost 14% of take-up, primarily owing to the Philips deal. The larger lettings in particular were frequently driven by quality, i.e. companies want to improve their standard of accommodation while implementing modern workplace concepts in their new space. In some cases, this allows companies to reduce space compared with their previous accommodation despite expanding.

Supply shortages in the city centre

Demand for space is predominantly focused on modern offices, frequently in central locations. However, it is these locations that lack suitable supply. The city centre, for example, has scarcely any contiguous new-build office space above 2,000 sq m and there are even shortages in the below 300 sq m segment. On the other hand, there are market segments affected by falling demand. The old mercantile office

buildings in Hamburg are struggling to attract large lettings and many of these have high vacancy rates. Overall, however, the vacancy rate in the Hamburg market fell again slightly over the first three months of the current year to stand at 7.4% at the end of the first quarter (Q4 12: 7.5%).

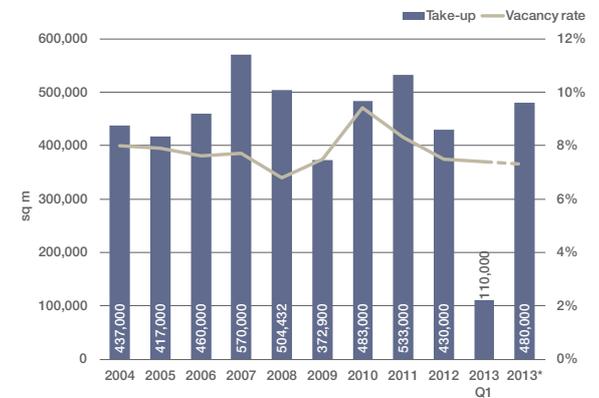
Nominal rents unchanged, incentives in decline

Despite the high take-up and surplus supply in some segments, nominal rental levels were largely unchanged. The average rent rose slightly to €13.10 per sq m/year (Q4 12: €13.00 per sq m/year), which is broadly in line with the 10-year average. The prime rent declined slightly in the first quarter, primarily owing to the low number of high-value lettings, to stand at €24.00 per sq m/year (Q4 12: €24.50 per sq m/year). However, the supply shortage in the prime segment was also evident in other ways. While the average rent-free period granted on a five-year lease has normally been five months in previous years, this has now largely decreased to three months.

Projected take-up for 2013: 480,000 sq m

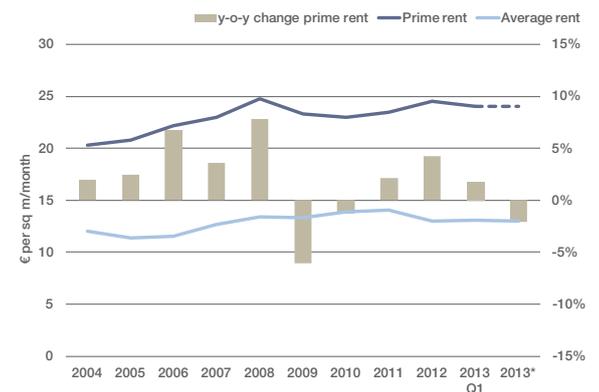
In view of the number of large requirements still active on the market (including some above 10,000 sq m) and the generally lively demand for space, we anticipate an annual take-up of around 480,000 sq m. At the same time, the completion volume will rise to 230,000 sq m (2012: 150,000 sq m). However, since around two thirds of this is pre-let, the vacancy rate is expected to decline slightly further. Against this background, we expect rents to remain stable.

GRAPH 18 **Take-up and vacancy** Increase in turnover for 2013 expected



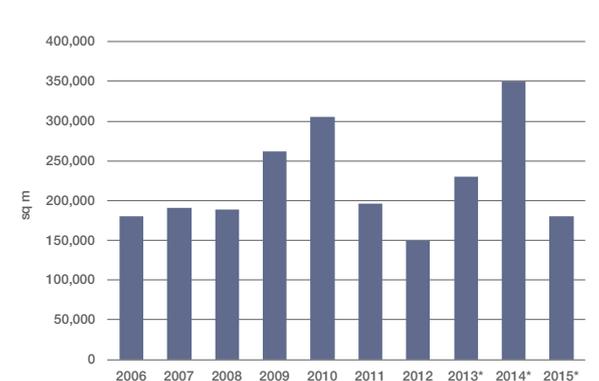
Source: Savills / * forecast

GRAPH 19 **Rental levels** Stable development seems most likely in the medium term



Source: Savills / * forecast

GRAPH 20 **Development pipeline** The trough in 2012 is followed by a significant increase



Source: Savills / * forecast

Office market Cologne

Reticence of large occupiers results in decreased take-up

The Cologne office market recorded a 22% decline in take-up in the first quarter of 2013 compared with the same period last year. Lettings totalled around 47,000 sq m of office space. There was healthy demand in the small office segment, but just two transactions above 5,000 sq m. One of them was the move of the University of Cologne into 10,700 sq m of purpose-built accommodation. There are a number of other requirements in this size category. However, companies are somewhat reticent and are procrastinating over leasing decisions.

Supply shortage in the mid-price segment

The lack of activity among large occupiers is not only attributable to the fact that these companies are not currently looking for new accommodation. The fact that modern space is scarce is also a factor. Unlike in most of the top six locations, however, occupiers in Cologne are tending to search in the mid-price segment, i.e. between around €13.00 to 16.00 per sq m/month. Such supply is available in principle, but is scarce in the sought-after central locations. Supply in these locations is primarily highly priced space, for which there is a lack of demand. Supply and demand are therefore of limited compatibility at present.

Lack of alternatives forces tenants to extend leases

Owing to the incompatibility of demand and supply, numerous tenants have extended their existing leases, to a certain extent through compulsion. However, such extensions normally have built-in flexibility via short lease terms. Nevertheless, the supply situation is unlikely to improve significantly in the medium-term. With its price-sensitive occupiers and tendency towards smaller units, the Cologne office market is not straightforward for developers. This is also reflected in the low completion figures. This year, some 74,000 sq m of new office space is expected to come onto the market (of which more than 80% is already let), followed by around 85,000 sq m next year and a currently projected 60,000 sq m in 2015. If this remains the case, the Cologne office

stock will grow by just 3% over the next three years – less any wastage of space. Only Munich has lower figures in this respect. Against this background, the vacancy rate (7.8% at the end of March) will also decline further over the coming years.

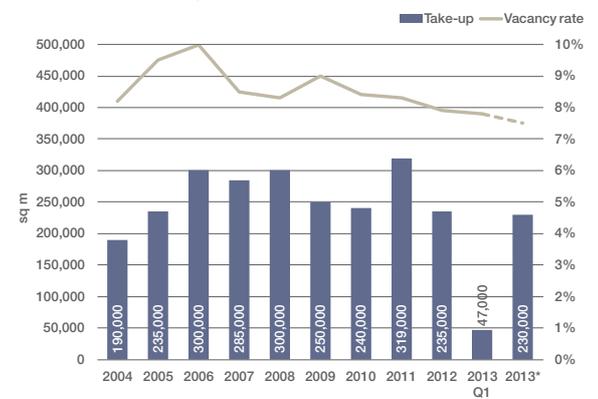
Tenants should commence their property search earlier

In view of the conditions outlined, the message to occupiers is that, when required, they should engage in leasing new premises at an early stage. To date, most companies are acting at short notice meaning that, by the time a decision to lease new space is taken, it is too late for a pre-let in a development and, consequently, developments are stalling. Particularly for larger occupiers seeking centrally located space in the mid-price segment, it would therefore be advisable to commence their search for suitable space significantly earlier than previously, as there would be significantly more options available to them.

Rents likely to remain unchanged for the remainder of the year

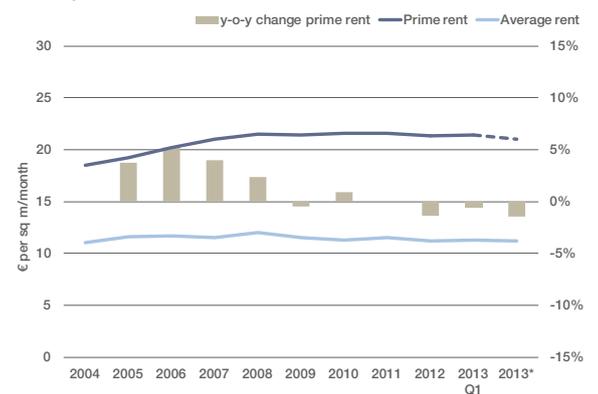
The marked price-consciousness of Cologne office occupiers is also reflected in rental levels. The average achieved rent at the end of March was €11.30 per sq m/month; the lowest of all top six markets. The prime rent stood at €21.40 per sq m/month. Both values should remain largely unchanged for the remainder of the year since take-up over the coming three quarters is only likely to slightly exceed that in the first quarter and, consequently, the vacancy rate will only show a marginal decline.

GRAPH 21 **Take-up and vacancy** Take-up levels to remain broadly stable



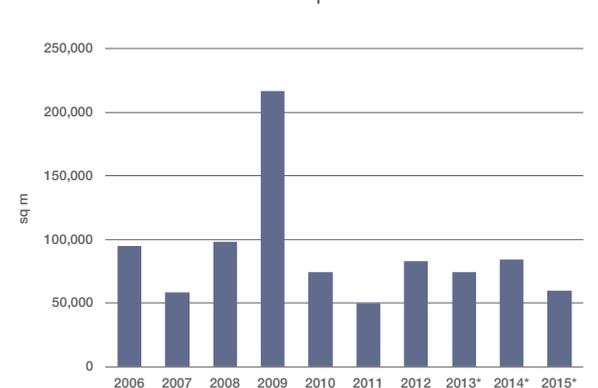
Source: Savills / * forecast

GRAPH 22 **Rental levels** Distinct price sensitivity hampers rent increases



Source: Savills / * forecast

GRAPH 23 **Development pipeline** Difficult environment for developers



Source: Savills / * forecast

Office market Munich

Lively demand in small-sized office segment drives take-up

While there were considerably fewer lettings of space over 1,000 sq m in the Munich office market in the first quarter (29 compared with 38 in the same period last year), last year's take-up was exceeded by 10%. Overall take-up totalled 150,400 sq m, with an average letting size of 640 sq m. Half of the completed leases were even for space below 350 sq m. This illustrates, on the one hand, the extent to which the Munich market is currently driven by the small-sized office segment and, on the other hand, how healthy demand for space is at present. As a few further deals are expected to complete over the remainder of the year (the State of Bavaria has a requirement for 12,000 sq m for its lottery administration, for example), this year's take-up is highly likely to exceed the 10-year average of almost 640,000 sq m. This projection is further supported by the fact that many companies cannot expand any further in their current buildings and therefore require new offices. This was already an important driver in the first quarter.

Focus on quality – modern space in the CBD is scarce

Since both large occupiers and smaller companies currently have a clear preference for high-quality space in central locations, new-build accommodation is scarce in the city centre across all size categories. Thus, in the 'Centre' submarket, there is just 110,000 sq m of office space vacant, of which only half is modern accommodation. Regarding the entire market area, the vacancy rate in the first three months of the current year has declined further and stood at 6.3% at the end of March (6.8% at the end of last year). Overall, the vacant office stock totalled almost 1.4m sq m.

Competition for good employees is driving companies into the city

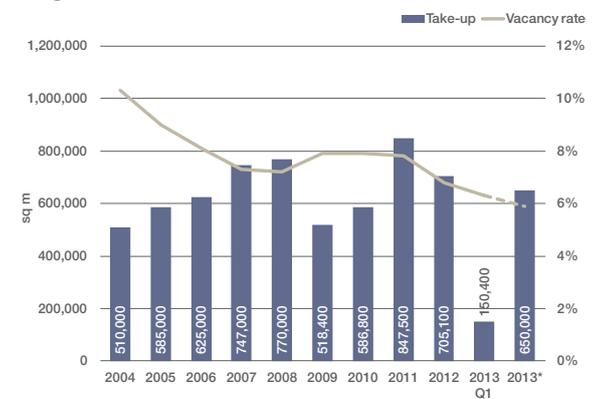
While central submarkets are sought-after by companies, the submarkets in the Munich hinterland are finding conditions more and more difficult. For large companies in particular, location is playing an increasingly important role in terms of recruiting new employees in order to prevail in an ever tougher "war for talent". Microsoft,

for example, currently based in Unterschleißheim, is currently looking at accommodation within the city boundaries. Nevertheless, the 'Region North' submarket, which includes Unterschleißheim, was the most active of the peripheral submarkets by take-up in the first quarter. This has also been the case in previous years and is the result of numerous relocations from airport-related companies.

Rising rents and longer lease terms signal stronger market

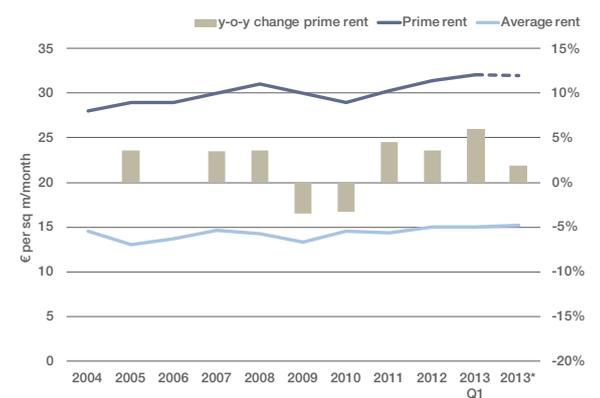
Occupiers' general focus on central and high-quality space is also reflected in rental growth. The prime rent in the first quarter rose to €32.10 per sq m/month (Q4 12: €31.40 per sq m/month); the highest figure since the end of 2001, while the average rent exceeded the €15 per sq m/month mark for the first time since 2003. A further indication of a more challenging market for tenants is longer lease terms. While three-year leases have been standard in previous years, five-year leases are now once again the norm. On pre-lets, which always have to be considered for large requirements in view of the lack of existing alternatives, leases of ten years are common. Overall, these are conditions that, in previous market cycles, have always fostered speculative development. However, owing to the difficult financing situation, this has not materialised thus far. However, with increasing numbers of equity investors available for developments, particularly local and national investors, this segment could be stimulated going forward.

GRAPH 24 **Take-up and vacancy** Vacancy rate is on target for 6%



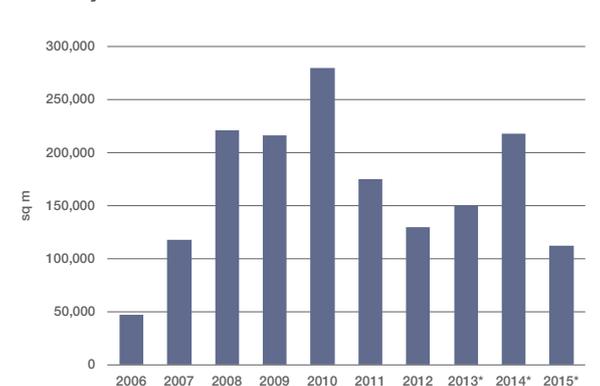
Source: Savills / * forecast

GRAPH 25 **Rental levels** Prime rent is likely to increase in 2013 too



Source: Savills / * forecast

GRAPH 26 **Development pipeline** Development activity with moderate increase



Source: Savills / * forecast

Savills Office Agency and Research

Please contact us for further information



Marcus Mornhart
Office Agency Germany
+49 (0) 69 273 000 70
mmornhart@savills.de



Christian Leska
Office Agency Berlin
+49 (0) 30 726 165 186
cleska@savills.de



Panajotis Aspiotis
Office Agency Düsseldorf
+49 (0) 211 22 962 220
paspiotis@savills.de



Marco Mallucci
Office Agency Frankfurt
+49 (0) 69 273 000 34
mmallucci@savills.de



Ken Hoppe
Office Agency Hamburg
+49 (0) 40 309 977 132
khoppe@savills.de



Simon Löseke
Office Agency Cologne
+49 (0) 221 933 313 32
sloeseke@savills.de



Nico Jungnickel
Office Agency München
+49 (0) 89 427 292 114
njungnickel@savills.de



Matthias Pink
Research Germany
+49 (0) 30 726 165 134
mpink@savills.de

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 500 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East. In Germany Savills is present with about 160 employees in the six most important property markets Berlin, Cologne, Dusseldorf, Frankfurt, Hamburg and Munich. A unique combination of sector knowledge and entrepreneurial flair give clients access to real estate expertise of the highest calibre. We are regarded as an innovative-thinking organisation backed up with excellent negotiating skills. Savills chooses to focus on a defined set of clients, therefore offering a premium service to organisations with whom we share a common goal.

This bulletin is for general informative purposes only. Whilst every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The bulletin is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research. © Savills May 2013