July 2022

MARKET IN MINUTES
Savills Research

Investment Market Germany

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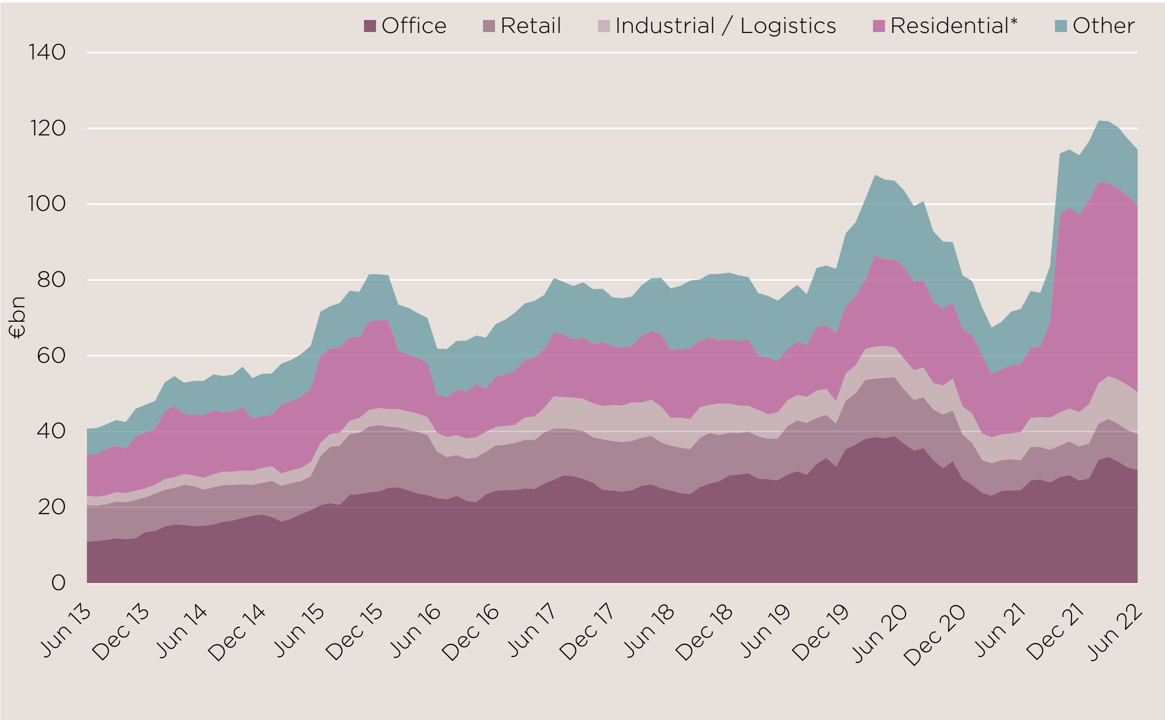
Graph 1: Transaction volume Germany (past 12 months rolling)



Source Savills / * only residential transactions with at least 50 units

The super cycle is over

The signs on the German real estate investment market had already changed noticeably by the end of the first quarter and the changed environment is now also clearly reflected in the figures. In the 2nd quarter, real estate was traded for about 11.1 billion euros. Of this, about 8.0 billion euros were accounted for by commercial properties and about 3.1 billion euros by residential properties. This was the weakest quarter in terms of turnover since the beginning of 2016. The rolling transaction volume for the last twelve months was €114.3bn, down 2.4% on the previous month (Fig. 1).

In our view, the exceptionally long upswing on the German investment market, which brought falling yields and rising or persistently high transaction volumes over the last twelve years, has thus come to an end. The current adjustment phase is the beginning of a new cycle. Although market participants have been expecting the turnaround in interest rates and thus a possible correction in the real estate markets for some time, they were surprised by the speed with which this transformation now took place. All market players are now dealing with a capital market environment that has changed completely within a few months. They have to adapt to this and this process is in full swing. As long as it continues, transaction activity will remain low. The temporarily lower competition offers opportunities for those investors who can and want to buy even in the current environment.
We expect many of the buyers who have pulled out at the moment to return to the market in the autumn. Provided the financial and economic environment remains stable until then, we expect a soft landing despite the current stutter. The investment pressure of many investors still seems high and in a world with higher inflation, real estate could even

Focus on selected figures

20 %
Private equity funds were responsible for approx. 20 % of the transaction volume in the first half of the year and were thus the second most active buyer group. On average over the last five years, their share was only about 5%.

- 78 %
The transaction volume of office properties was 78% lower in the second quarter than in the previous quarter. This is the highest decline of all types of use. In total, offices changed hands for about 2.2 billion euros in the second quarter. Such a low quarterly volume was last recorded in 2012.

Table 1: Transaction volume (€m)

	H1 2022	against H1 2021	Q1 2022	Q2 2022	Q2 vs Q1 2022
Commercial	28,303	17.4%	20,312	7,991	-60.7%
Residential*	7,533	-26.5%	4,447	3,085	-30.6%
Total	35,835	4.3%	24,759	11,076	-55.3%

Source Savills / * only residential transactions with at least 50 units become more attractive as an asset class. Moreover, the rental markets have been largely stable so far and in some segments, such as office and logistics, rental growth prospects have even improved recently.

Diverging price expectations lead to temporarily more illiquid market

In our view, the marked decline in transaction activity is largely due to the sharp divergence in price expectations on the buyer and seller side. Buyers' willingness to pay has fallen noticeably in some market segments, while sellers' asking prices have moved only slightly so far. Overall, 34% fewer transactions took place in Q2 than in the previous quarter (Fig. 2).

Initial yields rise, but chance of 'bargain' investments low

According to our observation, the gap between the purchase price expectations of sellers and buyers has widened further in the core segment than in the value-add segment due to the higher interest rate sensitivity. The former has therefore been particularly illiquid recently and determining market prices is hardly possible for many segments. The fact is: we are in the midst of a phase of price correction and because it is an interest-rate-induced correction, it is taking place in all market segments, albeit to varying degrees.

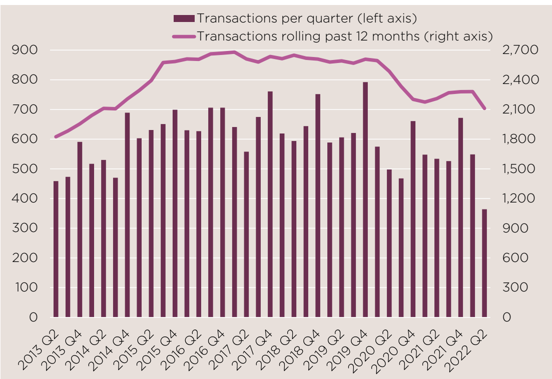
To reflect the exceptionally wide spread between asking and bidding prices in some segments, we show yield spreads there instead of point values for Q2 (Fig.3). The average prime yield for offices in the top 6 is 2.7% - 3.1% (Q1-22: 2.6%), with the lower end of this range reflecting the price expectations of sellers and the upper end those of buyers. For prime logistics properties, the range is narrower at 3.0% - 3.2% (Q1-22: 3.0%). In other segments, point yields can be quoted due to recent closings or closer price expectations in ongoing sales processes. In some cases, such as nursing homes and apartment buildings, these have remained stable compared to the previous quarter, in others they have already increased. The price expectations are also so far apart because most owners are not under pressure to sell despite the sharp rise in interest rates and prefer to cancel a sale rather than sell at a lower price. This shows that the entire cycle has been dominated by equity-rich investors. In addition, debt capital has become more expensive but is still available. This also distinguishes the current downturn from that during the financial crisis. We therefore assess the chance of 'bargain' purchases out of distressed situations as low. This does not apply to the project development segment, where the mixture of rising construction costs, higher interest rates and possibly lower exit factors may mean that some calculations no longer work out.

More movement expected in autumn

For the further development, much will depend on how quickly the price expectations of buyers and sellers converge. As long as the gap remains as wide as it is at present, the market will be comparatively illiquid and few transactions will take place. Although the number of transactions has stabilised in recent weeks, it will remain low in the coming months in view of fewer ongoing and newly started sales processes. Many of those investors who have temporarily withdrawn from the market intend to return in autumn, according to our observations. In this respect, we expect a quiet summer and significantly more activity again in the fourth quarter. In terms of total annual turnover, we expect under €50bn in commercial real estate (2021: €60.7bn) and up to €15bn in residential real estate (2021: €52.1bn).

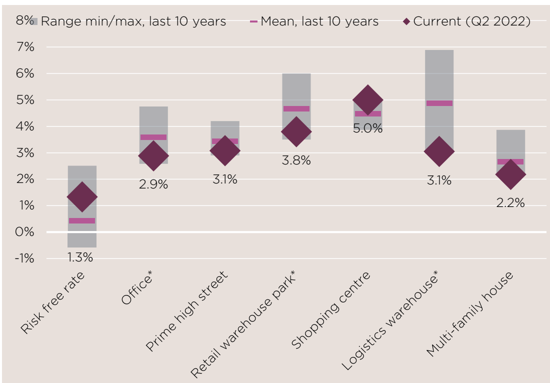
Download the charts and raw data here

Graph 2: Transactions*



Source Savills / * commercial and residential properties

Graph 3: Prime yields (Ø Top 6)



Source Focus Economics, Savills / risk free rate = 10Y government bunds; * Office: 2.7% - 3.1% / Retail warehouse park 3.6 % - 3.9 % / Logistics: 3.0% - 3.2% (yield range reflects the different purchase price expectations of vendors and buyers)

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