MARKET IN MINUTES
Savills Research

Germany Cross-sector - October 2022

Investment Market Germany

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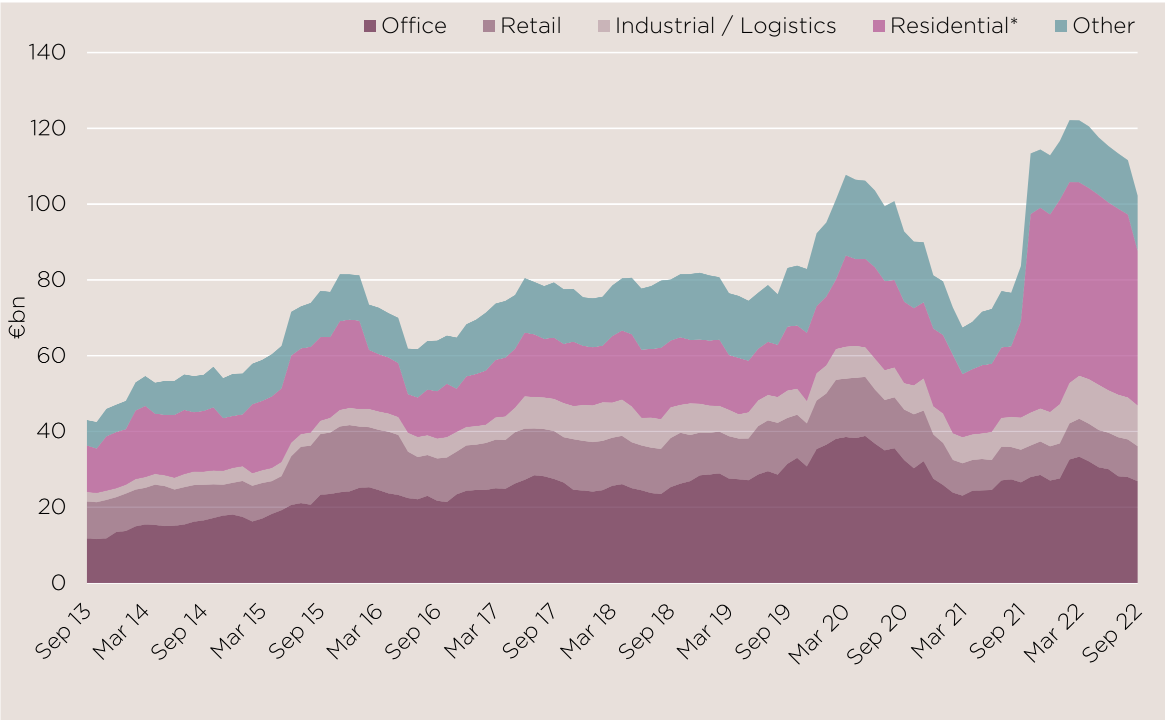
Graph 1: Transaction volume Germany (past 12 months rolling)



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

Turmoil with opportunities

Although the list of stress factors and risks has not become shorter, activity in the German real estate investment market has stabilised in the last three months, at least for commercial properties. At the same time, the short- to medium-term outlook has deteriorated, mainly due to the weak economy, and a prolonged transformation phase with high uncertainty and possibly further falling prices is emerging.

In Q3, commercial and residential properties traded for about €13.5bn. This is 14% more than in the previous quarter. Nevertheless, it was the second weakest quarter in terms of turnover since the beginning of 2016. Commercial property accounted for around €11.5bn and residential property for around €2.0bn. In the year to date, properties have changed hands for €50.3bn, 17.5% less than in the same period last year. The rolling transaction volume for the last twelve months was €102.2bn, down 8.4% on the previous month (Graph 1).

Investors are waiting due to high volatility on the financial markets

Falling interest rates and comparatively high economic growth have boosted the German real estate investment market for more than ten years. Now both parameters have changed direction, at least temporarily, and triggered an adjustment process in the real estate markets. This transformation is accompanied by exceptionally high volatility and uncertainty and many investors are therefore waiting. At the same time, many occupier markets - especially in the residential, office and logistics segments - look fundamentally perfectly healthy and are characterised more than ever by tight supply and the prospect of rising rents, at least in sub-segments. In our view, this environment

Focus on selected figures

-40%
The transaction volume in the 3rd quarter was about 40% below the quarterly average of the last five years. There were declines in all main types of use. The decline was smallest for retail properties at -10%.

72%
In the third quarter, 72% of the transaction volume was accounted for by buyers from Germany. In the two previous quarters, the shares were noticeably lower at 49% and 57% respectively. The five-year average volume share of domestic buyers was also lower at around 60%.

Table 1: Transaction volume (€m)

	Q3 2022	Q1 to Q3 2022	against Q1 to Q3 2021	last 12 months (Oct 2021 to Sep 2022)
Commercial	11,518	40,655	+1.9%	61,486
Residential*	1,957	9,617	-54.2%	40,743
Total	13,475	50,272	-17.5%	102,228

Source Savills / * only residential transactions with at least 50 units offers opportunities both for investors who can take a little more risk and for risk-averse investors who are willing and able to look beyond the current turmoil. The latter mainly include equity-rich investors, such as sovereign wealth funds, insurances or family offices.

Rising initial yields in all segments

It is also the high volatility on the financial markets that hinders and delays the formation of a new price level and thus also higher transaction activity (Graph 2). The strongly fluctuating interest rates also lead to strongly fluctuating results in the pricing models of investors. Naturally, buyers and sellers position themselves at the opposite end of this range, which was recently still so large in many cases that it could not be surpassed in price negotiations. We observe that some investors want to wait out the phase of high volatility and the associated pricing uncertainty and are passive until then. Interest rates fluctuate strongly, but the trend was for them to rise significantly in the third quarter. For example, the 10-year swap rate rose from 2.1% at the beginning of July to 3.1% most recently. In this environment, real estate yields also continued to rise. Prime yields rose between 20 and 40 basis points for most types of use (Graph 3). As in the previous quarter, we show ranges to reflect the high volatility and the still large gap in price expectations between buyers and vendors. Unlike in previous years, prime yields are now only realised on very few properties. Even small flaws often lead to significantly lower investor demand and a comparatively high price discount compared to the prime level. The price gap between core and core plus has widened.

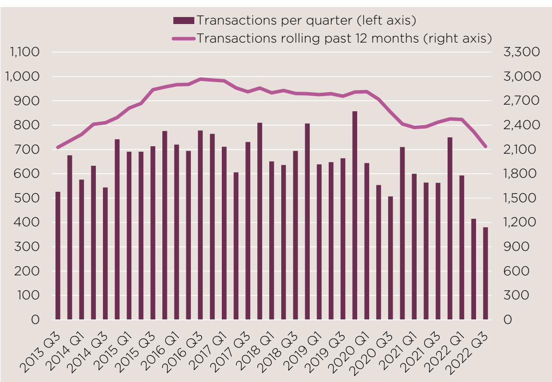
Equity-rich investors use adjustment phase for acquisitions

The increased price discrepancy between the prime segment and the rest of the market is primarily due to the fact that the cost of debt capital is higher than the prime yields in most segments. Due to the then negative leverage effect, investors using debt capital basically drop out as buyers in the top segment. At least equity buyers currently have an advantage. In the commercial property market, many of the investors with the highest purchase volume in the third quarter can be placed in this category, including a family office, a pension fund and a sovereign wealth fund. The residential market also offers opportunities for such investors. For example, the listed residential companies, which were responsible for 41% of the acquisition volume in the last five years, are now on the sell side. The de facto disappearance of this group of buyers increases the opportunities for other investors to obtain larger residential portfolios. For equity buyers, market timing plays only a subordinate role due to their mostly very long-term investment horizon, and an adjustment phase like the current one creates an opportunity for them to expand the property portfolio in Germany. For long-term investors, real estate also offers inflation protection and there are good reasons to assume that inflation will remain well above the level of the 2010s for a long time.

In the end, it could be the equity investors themselves who contribute significantly to the stabilisation of the price level and thus provide other investors with a firm foundation again. However, another prerequisite for the return of the currently wait-and-see investors would be a significantly less volatile financial market environment. There are no signs of this at present, and even then, it would still take some time before higher transaction volumes could be observed again. In this respect, we do not expect higher transaction volumes in the coming quarter or at the beginning of next year.

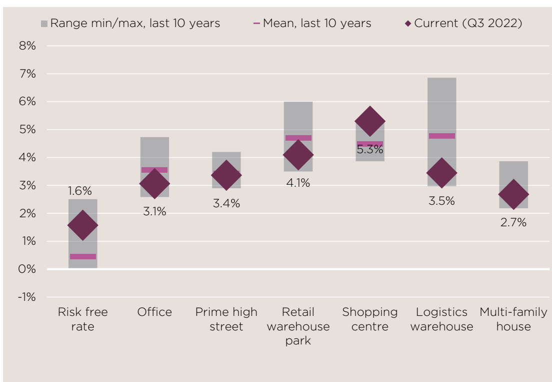
Download the charts and raw data here

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; Note: The yields shown for Q3-2022 reflect the midpoint of the spread of +/- 20 basis points we have observed between offered and demanded prices

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