MARKET IN MINUTES
Savills Research

Investment Market Germany

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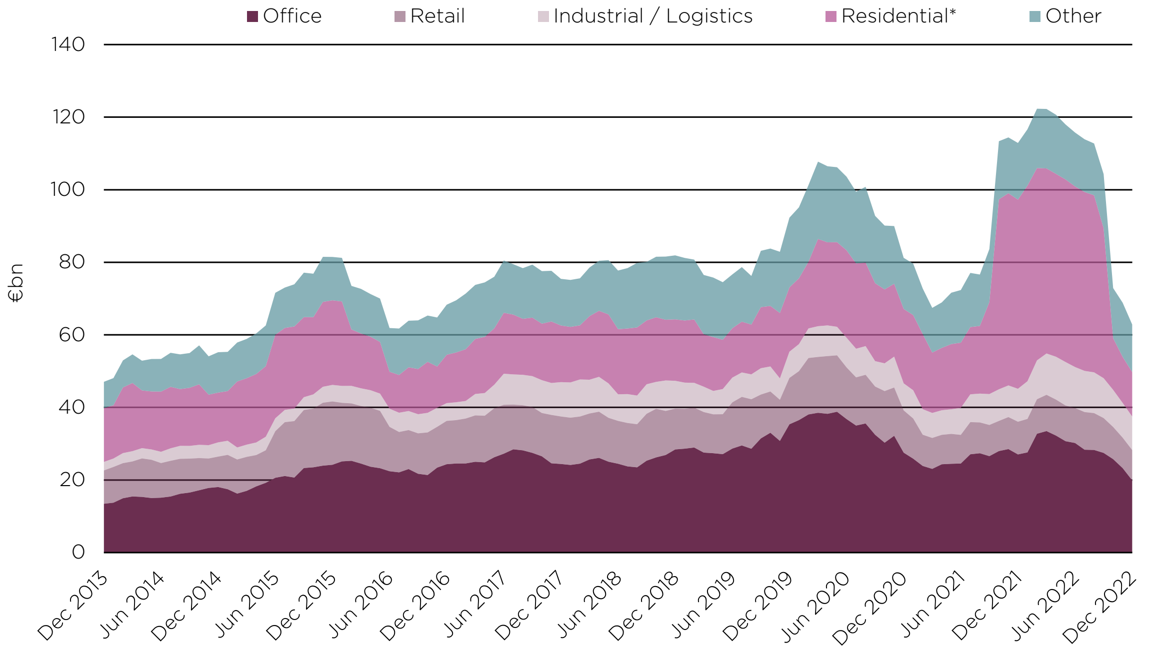
Graph 1: Transaction volume Germany (past 12 months rolling)



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

Turning Point 2022

The German Language Society has chosen "Zeitenwende", meaning turning point, as the word of the year 2022. This term also fits the German real estate investment market, because 2022 was a turning point in many respects. The starting point was the turnaround in interest rates, which was followed by a turnaround in volumes and yields. In total, properties were traded for around €62.9bn in Germany last year. Of this, about €50.6bn was for commercial property and about €12.3bn for residential property (Table 1). This was 44% below the previous year's figure. After initial uncertainty, there is now a growing realisation among market participants that the interest rate turnaround has not only changed the market environment in the short term, but that the return of interest rates could mean a paradigm shift for the real estate investment markets - at least compared to the last ten years.

Initial yields with renewed rise and still little transparency

While the turnaround in interest rates is likely to be largely complete, the price correction in the real estate markets is still in full swing. Prime yields rose across all segments in Q4, with nursing homes rising the least (+10bps) and supermarkets the most (+50bps) (Graph 3). We continue to observe a wide spread between the price expectations of buyers and sellers. The diverging price expectations continue to be a major reason why many buyers as well as sellers are acting very cautiously. This is reflected in the significantly reduced transaction volume (Graph 1) and the decline in the number of transactions (Graph 2). In view of the many aborted or stalled sales processes in recent months, owners are very concerned about burdening their own property with the stigma 'unsaleable'. Those who still want or need to sell

Focus on selected figures

€11bn
The year-end rally failed to materialise this year. With a transaction volume of around €11.0bn, the fourth quarter was the weakest in terms of volume in 2022. At the same time, it was the lowest volume in a final quarter since 2011.

17%
Investors from North America were responsible for around 17% of the transaction volume last year and were thus the most active foreign investors. On average over the previous five years, their share was only 9%.

Table 1: Transaction volume (€m)

	Dec 22	last 12 months (Jan 2022 to Dez 2022)	against last year (Jan 2021 to Dec 2021)	against last month (Dec 2021 to Nov 2022)
Commercial	2,974	50,610	-16.7%	-9.9%
Residential*	794	12,249	-76.5%	-3.5%
Total	3,768	62,859	-44.3%	-8.7%

Source Savills / * only residential transactions with at least 50 units often do so off-market by selectively approaching a small circle of potential investors.

Equity-strong investors with increased purchase volume

The reluctance of many investors opens up opportunities for those who are less affected by the turnaround in interest rates and/or who did not win in the intensive bidding war of previous years. These include, above all, buyers with a strong equity base. Private investors (incl. family offices) and sovereign wealth funds are among the few investor types whose net purchase volume (purchases minus sales) of commercial real estate was above the respective five-year average last year. Both groups invested more than €800m on balance. The market environment is also becoming more attractive for investors with an affinity for risk, especially in the value-add segment. Because most institutional core investors are no longer willing to compromise in the current environment, they are only buying properties that are free of flaws. This makes the playing field for value-add investors larger again and, due to the restraint of many investors in the current environment, there are fewer players competing for the properties. The fact that the volume of new construction is likely to fall in the next few years due to higher interest rates and construction costs also suits value-add investors.

Offices with highest transaction volume, industrial properties defend third place

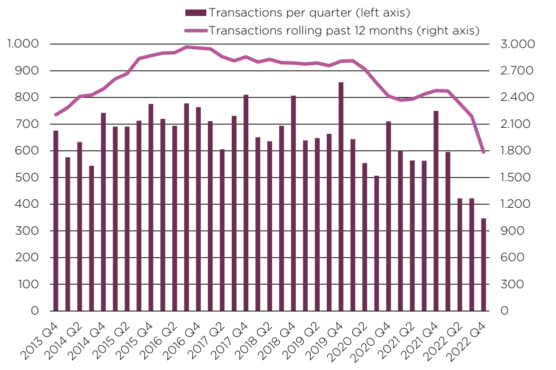
The general downturn on the investment market has affected practically all types of use. Only mixed-use properties (+9%) and industrial properties (+2%) recorded slight increases in transaction volumes compared to 2021. Despite a drop in volume of more than a quarter, office property was by far the strongest type of use in terms of transaction volumes (€19.9bn), followed by residential property (€12.3bn), which recorded a drop in volume of 77%. Industrial properties (€9.3bn) defended the third place they had captured last year, ahead of retail properties (€8.3bn). The largest decline in volume was recorded by development sites (-43%) – a sign that developers are particularly hard hit by the changed market conditions. In the project development segment we consequently also expect an increasing number of forced sales.

Selling pressure increases and ensures more supply - demand remains lower than before the interest rate turnaround

For other landlords, too, the steep rise in interest rates is likely to lead sooner or later to increasing pressure or at least incentive to sell. Overall, however, we consider the financing situation of landlords to be comfortable and therefore expect only a few distress sales apart from the project development segment. Nevertheless, there are other reasons that speak for an increasing number of sales. For example, the devaluation of shares and bonds may have led some investors to believe that the real estate quota in the portfolio is now too high. This could trigger sales. Liquidity bottlenecks in open-ended funds due to cash outflows could also make sales necessary. Against this background, we expect more supply in both the commercial and residential property markets in the future. Demand will also rise again, but not to the level of the years before the interest rate turnaround. A significant increase in transaction activity is not to be expected before spring - until then, yields are also likely to rise. For the year as a whole, we expect transaction volume in commercial real estate to be below €50bn. In residential real estate, the transaction volume is likely to be in the lower double-digit billion range.

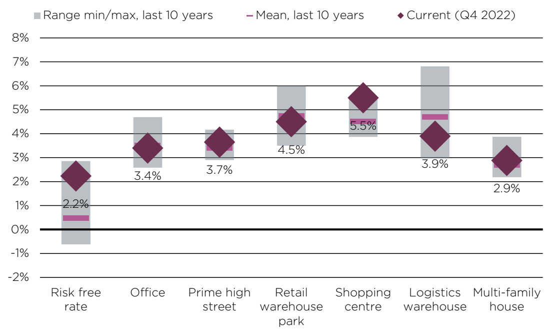
Download the charts and raw data here

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 Q4-2022 reflect the midpoint of the spread of +/- 20 basis points (yield range reflects the different purchase price expectations of vendors and buyers)

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