German Residential Market Overview

Germany | 2016
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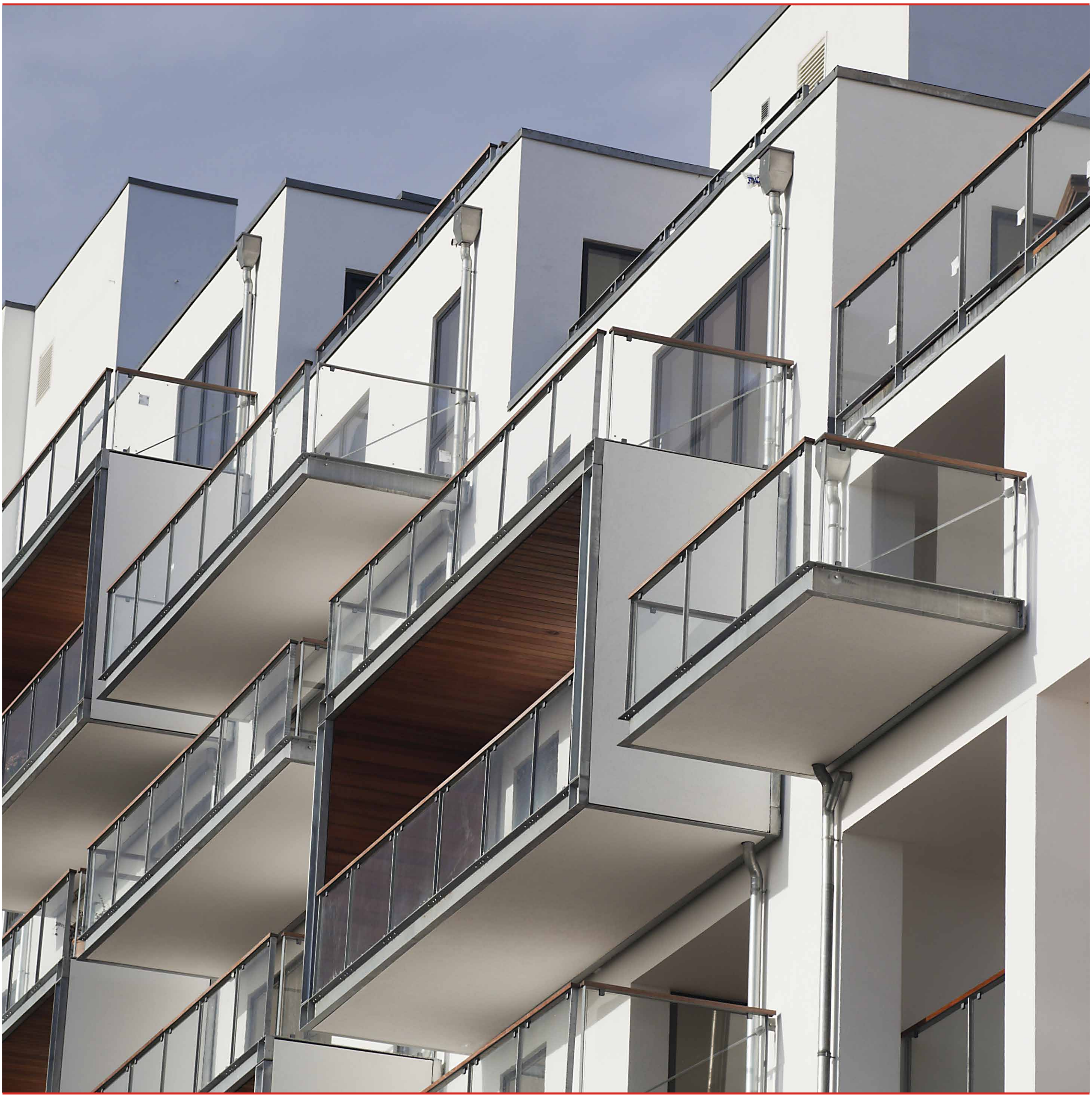


Socio-economic trends

Positive outline conditions for the housing markets

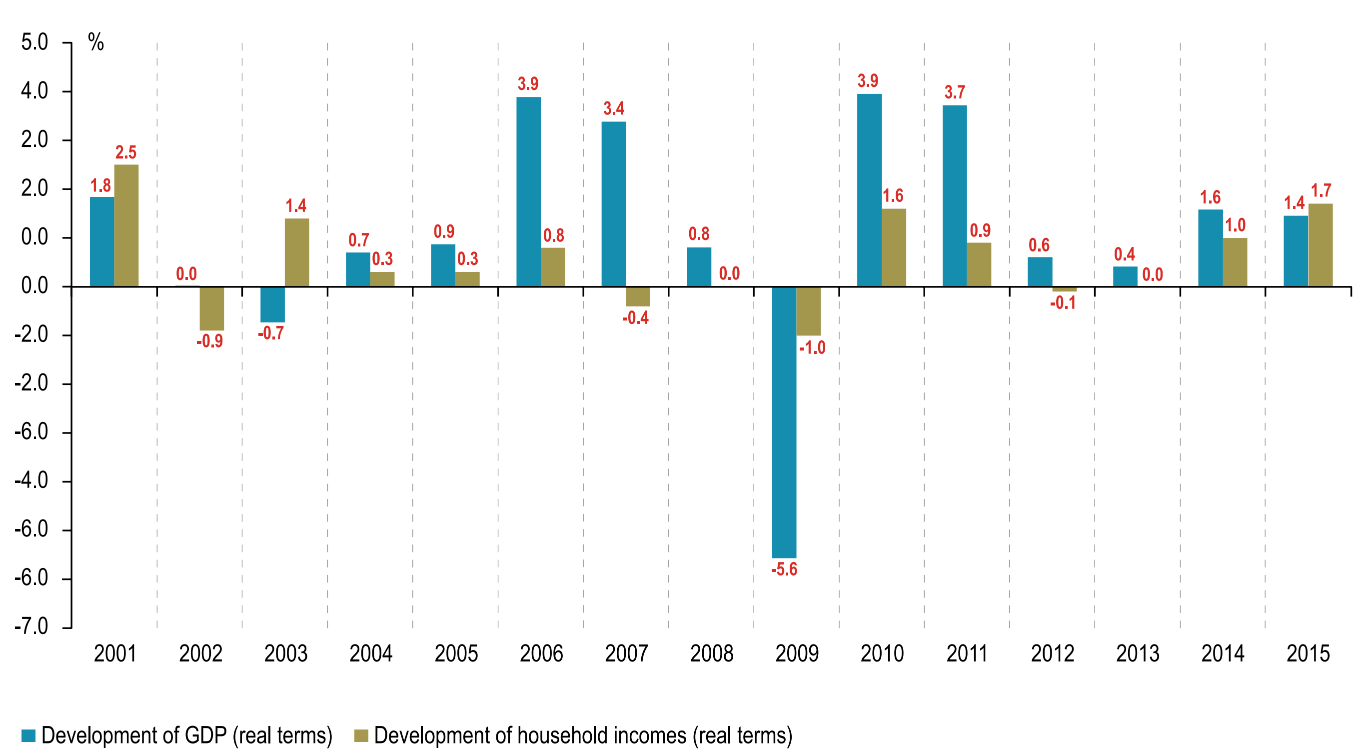
Since the global economic collapse in 2008 and 2009, Germany's economy has been growing at a rate of between 0.4% (2013) and 3.9% (2010) every year. Even in times of economic upswing during the 1990s, earnings increased only slightly, but since 2010 households have seen an average of 0.9% growth in their earnings every year after adjustment for inflation.

Alongside the rise in disposable income (2010-15: 5.1%), unemployment has fallen, reaching 6.4%, its lowest level since reunification in 2015. At the same time, the number of employees rose sharply in 2015 compared to the year before, to reach an all-time high of 43.5 million (+1.3% compared to 2014). Fundamental economic data in Germany has never been so good for households over the last 20 years and this is strengthening demand on the housing markets, in both the rental and owner-occupier home segments.

Demand boosted by record immigration

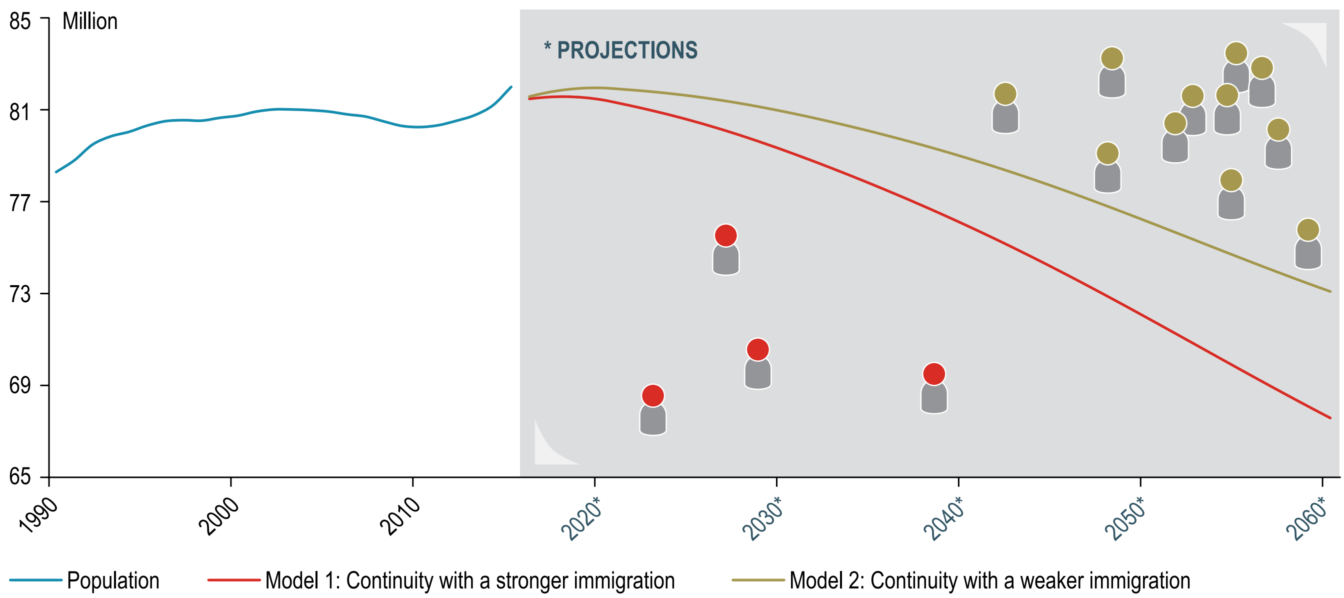
Natural population trends in Germany have been negative since 1972. This means that the number of births has been insufficient to keep population numbers healthy and that population growth over the last 40 years has been driven by immigration from abroad. The

Comparison of the development of GDP and household income



Source: Federal Statistical Office, Regional Accounts VGRdL, JLL

Population development and projections for Germany



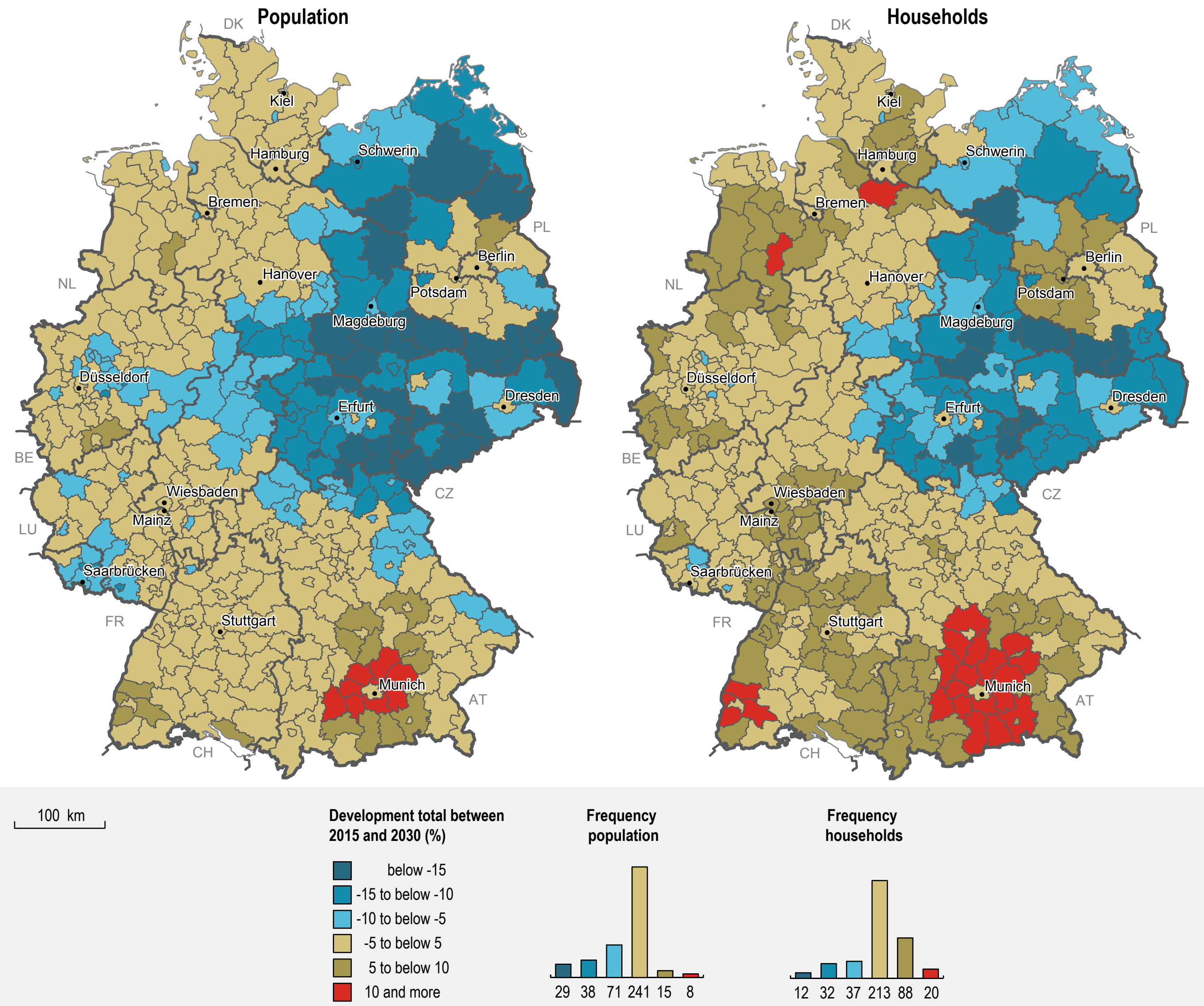
Source: Federal Statistical Office, JLL

volume of immigration is determined by the attractiveness of the local labour market and political outline conditions, as well as by economic and social conditions in the countries of origin. Whilst the population figure reduced slightly between 2002 and 2010 in response to the weak economic trends and comparatively high unemployment in Germany, it has been rising again since 2011. Currently, the population is growing as a result of immigration, and predominantly economic migration into Germany from within Europe. Net migration reached its highest level since reunification of around 1.1 million in 2015. However, the population forecast published by the Federal Statistical Office suggests a rise of only 500,000. If the high levels of immigration continue, this figure should fall to around 200,000 per annum by 2021. However, the actual level of future immigration, as the most important factor for determining population growth, is difficult to forecast as it depends on political and economic outline conditions.

More important than the rising population figure for demand in the housing markets is the number of households, which grew by 1.4% to 40.8 million in 2015. Even in years when the population declined, the number of households in Germany continued to rise. This trend, which is due to the increasing number of single-person households, is expected to continue. According to estimates by the Federal Institute for Research on Building, Urban Affairs and Spatial Development (BBSR), the number of households is expected to grow until 2025, adding to the demand in the housing market.

Nonetheless, population and household growth is not equally distributed across the country, but is concentrated on the economically wealthy conurbations.

Regional population projections



Data source: BBSR-Bevölkerungs- und Haushaltsprognose 2035
Geometrical source: BKG, Kreise, 31.12.2013

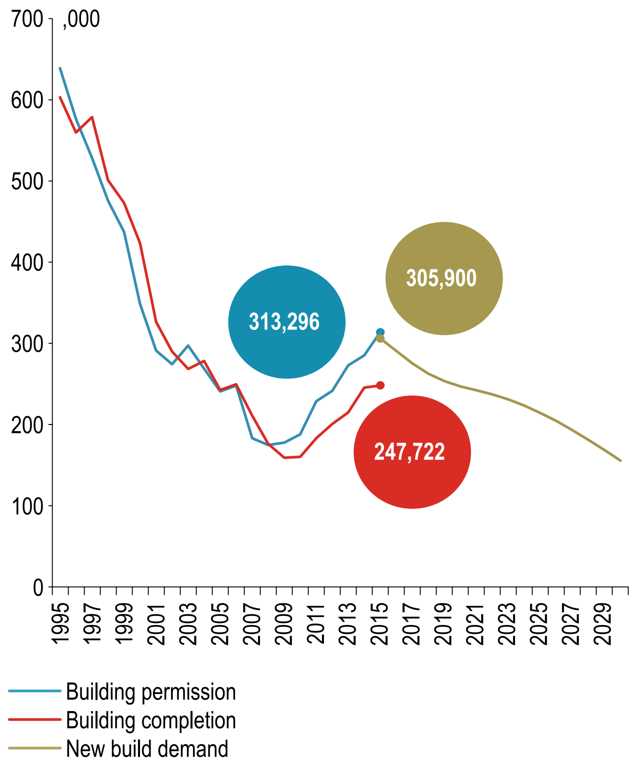
Editing: J. Nielsen

Housing market supply

Stagnating completion volumes in 2015

Until recently, restrained economic trends, stagnating earnings and intermittent falls in population numbers have led to weakened demand for new homes and therefore to a low level of construction activity. Only after outline conditions improved in 2009 has there been an increase in the number of building permits granted and, since 2011, an increase in the volume of construction activity. Around 248,000 new homes were completed in Germany in 2014, with almost half of these consisting of single and two family dwellings. The BBSR anticipate a requirement for around 306,000 new homes per annum for 2015 and therefore current construction activity continues to lag behind estimated demand, despite the distinct increase in the number of building permits granted. However, this forecast does not consider the current significantly higher level of immigration. Regionally, there is a very different demand pattern. Whilst according to the BSSR a number of regions in eastern Germany are not expected to see an increased requirement for new homes from 2024, wealthy conurbations will continue to observe strong demand, albeit at lower levels of new construction than are currently being reported.

Construction activity and demand for new construction

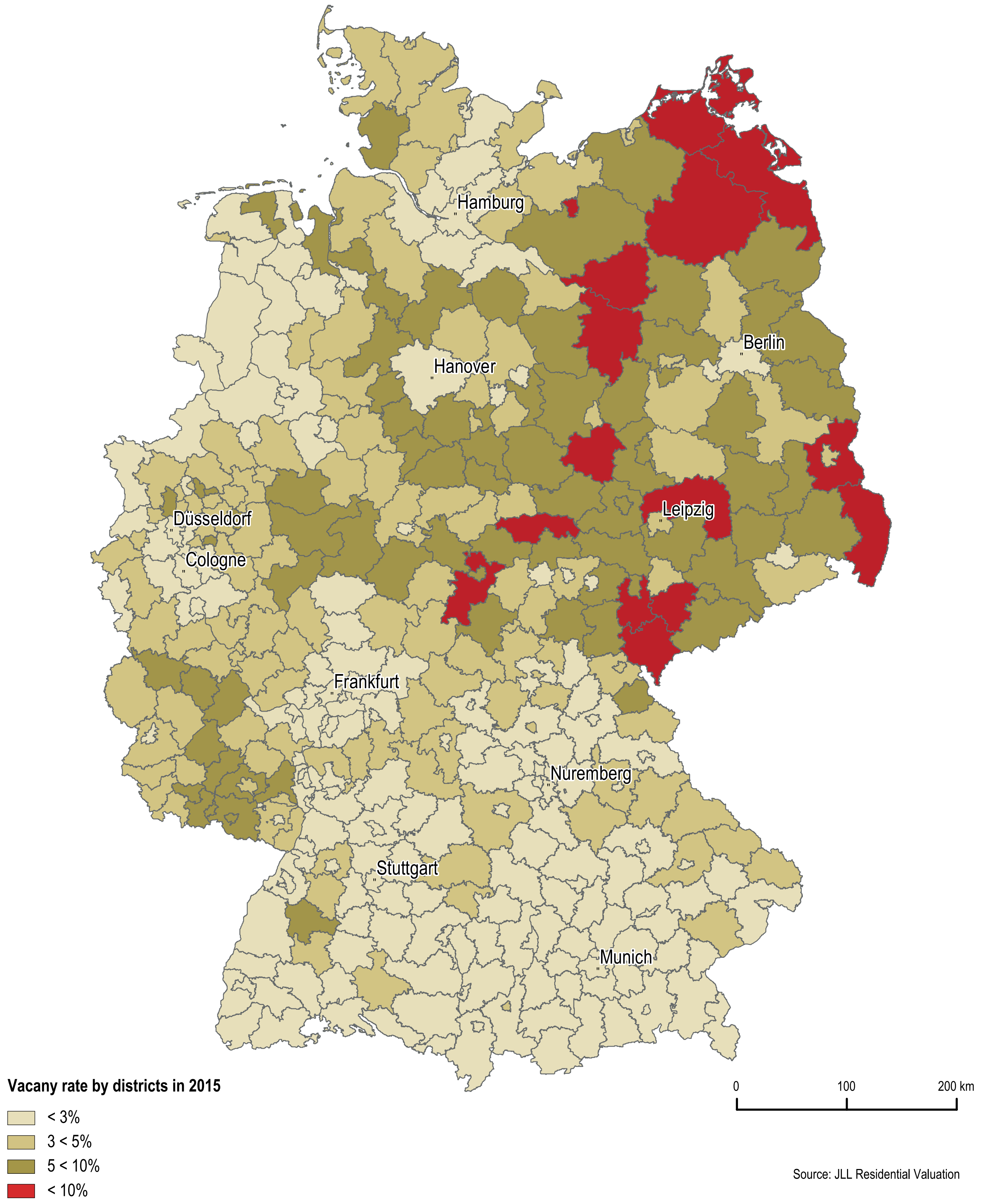


Source: Federal Statistical Office, Federal Institute for Research on Building, Urban Affairs and Spatial Development

Vacancy mainly falling

The variable development of the housing markets in Germany is also reflected in vacancy rates. The lowest vacancy rates are found in wealthy major cities and their surrounding areas, and in the economically robust regions in the south and northwest of the country which are experiencing high levels of demand in their housing markets. There is also often no marketable vacant accommodation in these locations. Conversely, high vacancy rates of >10% are being observed in a number of rural regions in eastern Germany, which have also seen demand fall. However, vacancies are also above-average in structurally weak administrative districts in the west of the country. The gap in vacancy rates between the regions is expected to increase, opening up scope for the revitalisation programmes to reduce vacancy rates.

Vacancy rate

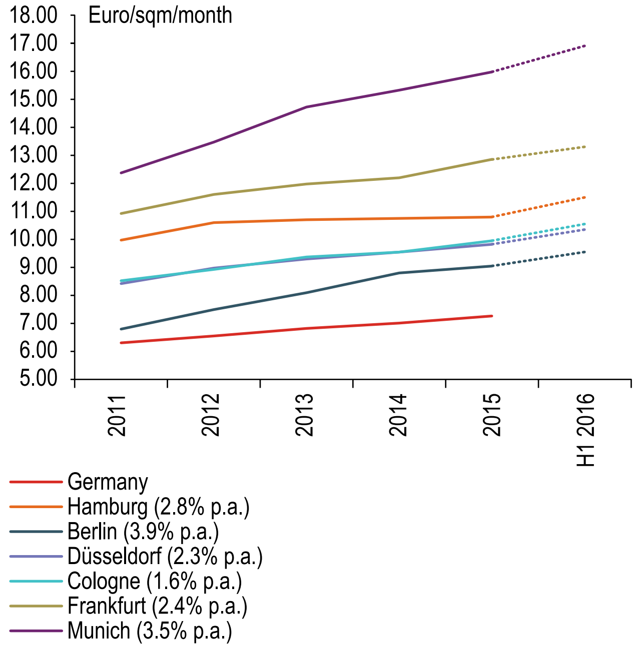


Rental housing market and condominium market

Stronger rent rises

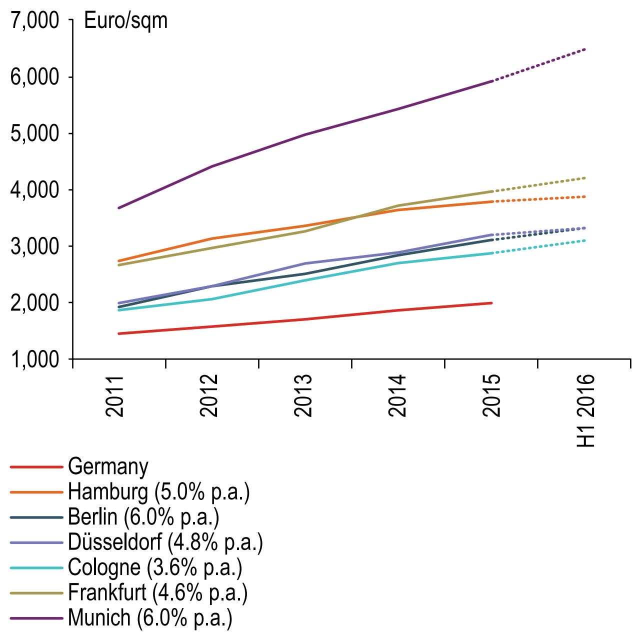
There was a period of falling and stagnating rents at the beginning of the new millennium, but they have been increasing in Germany since 2008, initially at a moderate pace of 1%, although annual rises of up to 4% have also been seen since 2011. This trend has been even stronger in many major cities. On the one hand, the rise started much earlier here and on the other, the trends have often been more dynamic than for Germany as a whole. Whilst the annual growth rate in Germany has been around 1.7%, since 2004 it reached 3.9% in Berlin and 3.5% in Munich. This greater momentum in these cities is due to a significant strengthening of demand, insufficient construction activity and an improvement of outline economic conditions.

Comparison of the development of rents in selected major cities and Germany as a whole



Source: IDN Immodaten, JLL

Comparison of changes in condominium prices in selected big cities and Germany as a whole



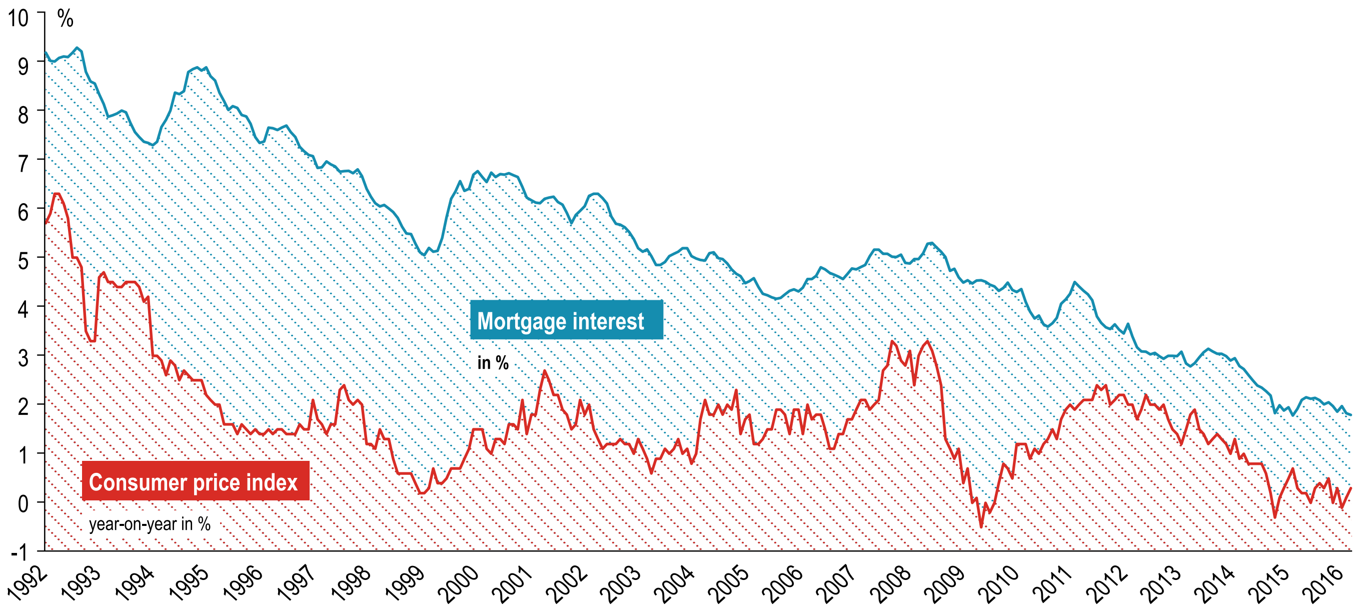
Source: IDN Immodaten, JLL

Dynamic price growth in the condominium apartment segment

The trend of rising prices for condominium apartments in Germany took hold in 2009. Since then, prices in this segment have often risen at twice the rate of housing in the rental markets. Similar to the rental markets, there is greater momentum being observed in major cities than in Germany as a whole. For instance, particularly high price rises have been reported in Berlin and Munich (both with 6.0% p.a.). This dynamic trend in prices for condominium apartments can be attributed to the favourable financing on offer, the lack of alternative forms of investment for private purchasers and, particularly in the major cities, to the low supply.

Investment market

Mortgage rates and inflation of consumer prices



Source: German Federal Bank, Federal Statistical Office

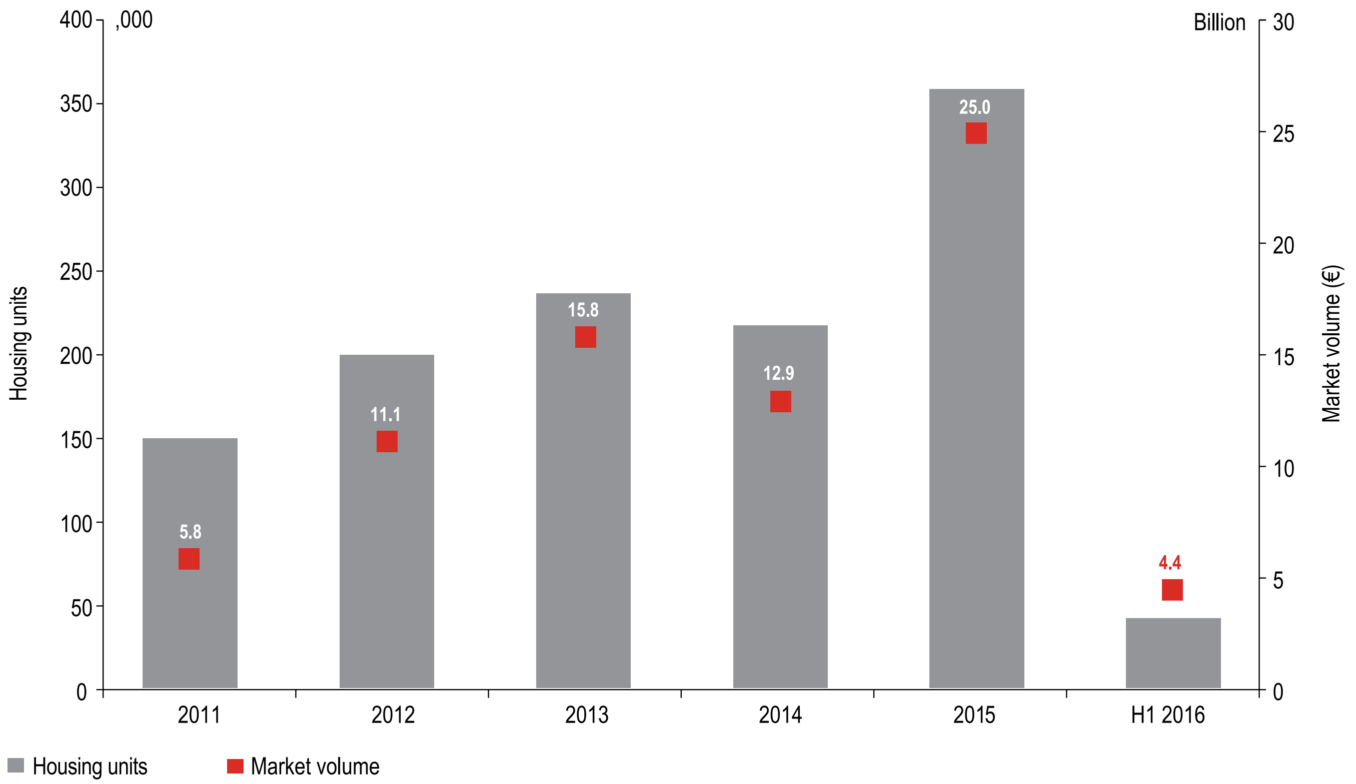
Favourable financing conditions

The sustained, record low mortgage interest rates which lie below 2% in real terms after adjustment for inflation mean that the financing of residential investments is inexpensive for both institutional and private investors. Since mid-2011, mortgage interest rates based on 10-year fixed terms have fallen from over 4% to around 2%. It is anticipated that they have now reached their lowest level. Over the last few years, major property owners such as listed housing companies have exploited the attractive interest rates on offer to undertake extensive refurbishment programmes, thereby improving their profit levels. Even the granting of loans is currently commonplace amongst investors looking to raise capital, thanks to lower returns on comparable forms of investment.

Lack of supply on the transaction market - high demand

After reaching transaction volumes of almost €20 billion for residential property portfolios in the mid-2000s, the market crashed to below €3 billion in 2009, during the years following the financial crisis. It has recovered since then, reaching its highest transaction volume of €25 billion in 2015. In the first half of 2016, the volume fell back to €4.4 billion, making this one of the weakest half-years of the past five years. This is due mainly to the lack of large-scale deals which have been driving up sales over the past few years. Nevertheless, demand from institutional investors for residential property is unwavering. This is evident from the rising number of forward deals and acquisitions of development projects being concluded. Around one quarter, or €1.2 billion, was traded in this segment in the first six months of the current year. Micro apartment buildings and student residences are an emerging segment, accounting for more than €300 million of investment. Berlin is and remains the destination for residential investments in Germany. One quarter of the total transaction volume, or more than €1 billion, has been invested in the federal capital, followed by Hamburg (€320 million) and Leipzig (€280 million).

Residential investment market by housing units and market volume



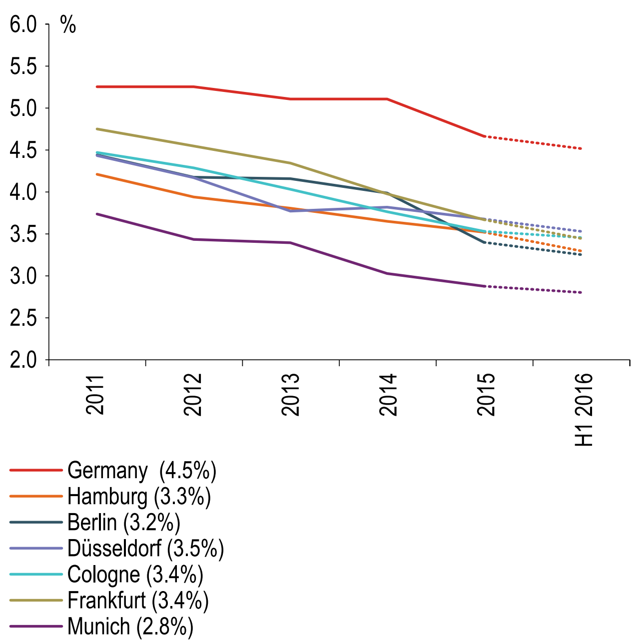
Source: JLL

Outlook

Yields continue to fall

Yields in the transaction markets for residential property have been falling since 2009 and are now considerably lower than the levels noted in the years preceding the financial crisis. There has been a noticeable increase in the appeal of investments in German residential property to investors from the domestic and international markets. Nonetheless, there is an increasing lack of supply and therefore prices have risen sharply, causing investors to shift their focus towards secondary locations and buildings of poorer quality. As a result, the net initial yields for Germany illustrated below have fallen less sharply than would have been expected by the market. However, in major cities which are popular with investors, yields have seen considerable falls, and in some locations are approaching record low levels.

Net initial yields (Values for H1 2016 in brackets)



Source: JLL

Sustained positive conditions in the German housing market

Demand for residential property is expected to remain high for the foreseeable future. For private investors, this is due to increasing earnings and favourable financing conditions. From an institutional perspective, demand is not only fuelled by the favourable financing on offer, it is also enhanced by the attractiveness of a stable cash flow in a safe haven such as Germany. Moreover, demand is driven by a growing population, mainly in the country's economically wealthy conurbations, but is constrained by the continued low level of construction activity. Although the volume of construction is currently increasing, this is unlikely to satisfy demand over the medium-term, particularly in the growth markets. At the same time, regions which are reporting decline in their populations are also seeing vacancy rates increase. Rents and purchase prices for condominiums as well as investment properties continue to spiral upwards, whereby the level of growth is highest in economically strong regions. Demand in the transaction market for residential portfolios can no longer be satisfied and therefore all investment markets are observing falling yields. Net initial yields of less than 3% are regularly achieved in the top cities.

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