Real Estate House View

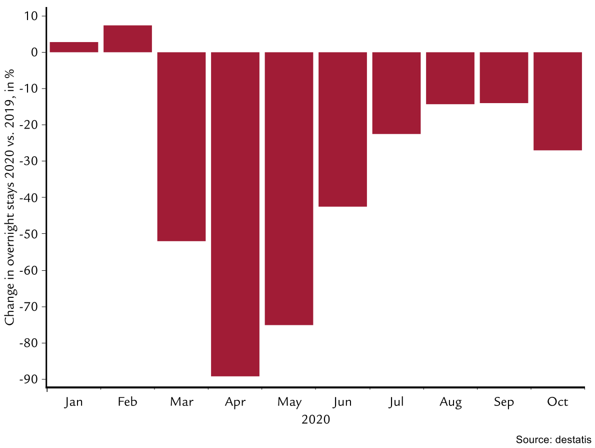
Germany

First half of 2021

Key takeaways

- **Long-term trends still rule the markets:** the COVID-19 crisis has accelerated ongoing fundamental trends in the real estate sector. Should prolonged economic restrictions remain in place, these changes will take place even more quickly and intensively.
- **Residential markets unimpressed?** Rents continued to rise unabated in 2020 and are expected to increase further, although regulations are dampening this trend locally.
- **Daily goods a bright spot for retail:** the repeated closure of shops continues to put pressure on high street rents. Goods for daily needs continue to sail with a tailwind and offer potential for rent increases.
- **Industrial and logistics remains mixed:** e-commerce is boosting demand for logistics properties, while the manufacturing sector remains subdued but can look forward to an improved economic climate.
- **Ongoing cautious optimism for offices:** demand is expected to remain subdued in the coming months but without a slump in sentiment thanks to the prospect of an economic recovery.
- **Central banks remain investors' best friends:** strong investor demand will continue in the coming years with a focus on residential, healthcare and logistics. Yields for core assets remain low and may fall slightly further.

Chart in focus



Overnight stays plummeted massively during the lockdowns in 2020 and failed to match the previous year's level even in the summer months despite a preference for domestic holidays. For the hotel market, the long-term driver of increasing tourism should return once the crisis is over. In addition, there is likely to be a catch-up effect. However, for business travel a noticeable decline can be expected in the medium to long term, which could have an impact above all on the occupancy rates and solvency of hotels in those cities that are less attractive for tourists.

At the start of the new year, the German authorities implemented more restrictive containment measures to fight the second pandemic wave. Experience from the Q4 2020 suggests that the economic impact of such measures is substantially less damaging than anticipated, as global supply chains in the manufacturing sectors remain open and Asian demand for German goods has improved substantially. The start of the vaccination campaign means the end of the tunnel is now in sight. As 2021 is an important election year in Germany, the ruling coalition government has launched major incentives to maintain its current generous fiscal policy stance. Net new debt issuance in 2021 is expected to exceed last year's volume. Annual inflation is expected to rise significantly above 2% in the second half of 2021 as the return of VAT to its old level and CO_2 pricing both mean a significant temporary boost to the consumer price index.

Residential first!

The residential sector not only remained stable and liquid in 2020 but also increased its investment share and became the preferred sector of investors. The flight of investors to residential is explained by an intact letting market with low defaults where rents remained stable or grew. Going forward we need to differentiate between rental trends for new buildings, where growth of around 2% is expected, and old buildings subject to regulation restrictions. Alongside the advantage of more affordable rents and purchase prices, suburban areas are gaining attractiveness as people increasingly work from home. This could take some pressure off rents in the major cities.

Transition year for offices?

The office market in 2020 was torn between a spike in investor demand for "super core" products in the summer, the subsequent normalisation in the autumn and standstills by insecure tenants during the lockdowns. As of Q4 2020, the market is characterised by a wait-and-see attitude due to the economic uncertainty triggered by the second lockdown and its unknown duration. This situation will continue for some time in 2021 and dampen the letting market. Contracts are likely to be signed or renewed for very short periods in order to postpone longer-term decisions until 2022. The issue of space requirements due to increased (or less?) working from home should gain importance. All in all, after slight decreases in 2020, we expect largely stable prime rents in 2021 followed by upside potential thereafter in the wake of the expected economic recovery. However, due to the significant impact of incentives, effective rental performance will be lower. Nevertheless, we anticipate stable to marginally decreasing prime yields, as office still remains a major category for investors focusing on core properties and solvent tenants.

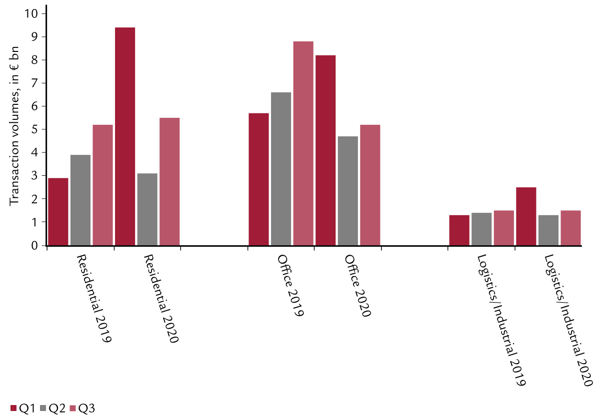
Food as a must-have in retail

Retail in 2020 was increasingly split between the well-performing fast-moving consumer goods segment, which saw sales increases above 5% y-o-y, and the remaining segments including non-food retail that was already struggling prior to COVID-19, especially the mid-priced fashion sector. Due to the lockdowns and consumer restraint, a significant decline in rents for high street areas was observed in 2020 – including the top seven markets – and is forecast to continue in 2021, above all as not all landlords seem sufficiently to have anticipated the situation. Moreover, a shift is taking place towards shorter rent periods. Challenges in the letting market are reflected in the investment market, where prime yields went up in 2020 and are expected to continue doing so in 2021. Retail parks with a strong food anchor are likely to prove stable in 2021 and generate higher rents.

Logistics – a perennial issue

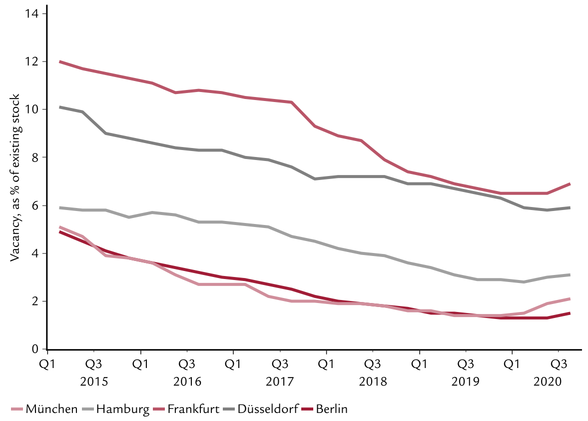
While the large-volume logistics segment has proven resilient during the crisis, it needs to be broken down: demand from e-commerce retailers increased, but that of manufacturers and their logistics service providers suffered. Driven by the needs of e-commerce, demand for modern space remains high. We accordingly expect moderate rent increases for 2021 and thereafter, with the overall economy expected to pick up speed. In the segment for small-scale logistics space, demand for urban logistics is fuelling further rent growth. Industrial space will feel the impact of the economic downturn for some time. For 2021, we expect rents to remain stable. The healthy occupier market is attracting more and more investors. We thus anticipate some yield compression in the medium term.

Chart 1: Transaction volumes over time



Source: CBRE

Chart 2: Top 7 office vacancies



Source: RIWIS

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