PRESS RELEASE

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New DZ HYP report

"The German Real Estate Market 2020/2021"

- » **Continued high demand on the housing market**
- » **Office properties perform solidly**
- » **New concepts for lively inner-city districts**

Approximately one year after the outbreak of the coronavirus pandemic, the German real estate market – and especially the residential asset class – continues to perform solidly overall. The commercial housing market is still experiencing surplus demand and moderate rent increases, whilst space take-up on the office property market declined during the year. However, due to low vacancy rates and modest new construction activity in the past, increasing investor reticence for office space has not had an impact on the rental development so far. Numerous retailers were forced to close their shops in 2020, which resulted in a broad-based decline in prime rents and rising vacancies in inner cities. These are the results of the latest research report published by DZ HYP, covering developments on the commercial real estate markets of Germany's top locations: Hamburg, Berlin, Dusseldorf, Cologne, Frankfurt, Stuttgart and Munich.

Dr Georg Reutter, Chairman of the Management Board of DZ HYP, explains: "Despite the subdued macroeconomic environment, investors are still displaying considerable interest in German real estate. However, we are seeing a shift in demand. Whilst office properties were highly sought after before the coronavirus pandemic hit the country, investor focus moved to retail properties for local supply and to logistics properties during the course of the year. Residential real estate remains the most stable asset class. Not only are financing terms favourable, but the importance of having one's own four walls seems to be growing once more in the light of lockdowns, contact restrictions and working from home. That explains why demand continued to increase during the crisis."

Details of the report results:

Residential rents in major cities are spread across a wide range

The coronavirus pandemic has not affected housing demand, with unchanged strong demand facing a shortage in supply in major cities. This development has in fact characterised the housing market during the whole of the past decade, albeit with a slightly decreasing rental price dynamic since 2017. In 2020, first-occupancy and existing rents in prime locations gained 3 per cent, whilst they had risen by more than 8 per cent in 2017. This trend is carried by slower population growth in big cities, the already high level of rents, and a notable increase in the number of multi-storey apartment buildings. Ten year ago, around 50,000 apartments were being completed each year – that number has since tripled. Berlin has even been able to quintuple the number of apartments built in the past ten years. As regards first-occupancy rents, the price dispersion of the analysed locations amounts to approximately €7 per square metre. As at the end of the third quarter of 2020, one square metre in rented flats cost €13.30 in Dusseldorf, and €20 per square metre in Munich. For existing apartments, Berlin is the most economic prime location, with €10.70 per square metre, and Munich is once again the most expensive city, at €17.70 per square metre. The rental price development is expected to lose further momentum in 2021. However, for stagnating or falling rents to materialise, economic burdens would have to become significantly higher than hitherto assumed.

Coronavirus pandemic indirectly impacts housing market

The digitalisation megatrend received an unexpected boost in 2020. Flexible work patterns are likely to persist, and influence housing demand. For people who regularly work from home, a separate study is a definite advantage. In smallish city apartments, however, this is hard to achieve – a situation which city outskirts could benefit from. Longer commutes are less of an issue if they do not have to be made often. The scope of a potential impact on the outskirts, however, is hard to predict.

Office space vacancy rates remain at a low level

Prior to the economic slump in the spring of 2020, office markets were reporting a dynamic development, which was down to the ongoing lack of available space. With vacancy rates of below 2 per cent in many cities, there were hardly any offices available at the beginning of 2020. Considering the uncertainty regarding further economic development and the question as to the long-term importance of flexible working, office markets in major cities have proved robust throughout the year. All in all, office space take-up was down from the approx. 2.7 million square metres seen in the first nine months of 2019, to approximately 1.7 million square metres in the same period of 2020. At the same time, stable vacancy rates and prime rents indicate the unwavering attraction of offices. Vacancies ranged between 1.5 per cent in Berlin to 6.9 per cent in Frankfurt. As at the end of September 2020, an average of around 3 per cent of available space was vacant in the top seven locations. The only time that vacancies were lower was at the beginning of the 1990s and at the turn of the millennium. Prime rents for office space were able to hold onto their high levels during the course of the year, with an increase of €1 per square metre recorded at five out of seven top locations. The lowest average prime rent at the end of the third quarter of 2020 was achieved in Cologne, at €23.50 per square metre, whilst Frankfurt was the most expensive location, at €41 per square metre. Demand for office space should weaken in 2021, and have a dampening effect upon rental development. But considering the low initial level, vacant space will remain manageable, thus making significant drops in rents unlikely.

Accelerated structural change in the retail sector

Changing consumer behaviour reduces the need for retail space in city centres – marking a structural change which was already in full swing before the pandemic hit, and which has now been accelerated. In 2017, prime rents reached a record high of an average €300 per square metre in the top locations; they have been stagnating at this level ever since. Initially there were no noticeable rent declines in major cities, as there were in secondary locations, with the increasing e-commerce burden offset by high customer traffic, mostly above-average purchasing power, and long-term tourism potential. When lockdown occurred in the spring, and the subsequent economic recession began to bite, 2020 became the first year in which prime rents fell in most top locations. Only Dusseldorf (€285 per square metre) and Munich (€345 per square metre) reported stagnating prices as at the end of the third quarter. In the medium term, prime rents are expected to continue their modest decline. All in all however, major cities are going to retain their status as attractive shopping destinations after the recession.

Centrally-located, mixed-use districts: an opportunity for cities

The structural industry change and the crisis many retailers are facing can also be an opportunity for inner-city locations: they are easily reachable, have a broad gastronomic and cultural offering, and offer diverse shopping opportunities. The mixture of quality of stay on the one hand, and a central location on the other, makes inner cities attractive for various alternative uses, such as apartments, hotels, fitness centres, leisure facilities, and city logistics. The latter especially and increasingly requires central space due to dynamic e-commerce growth. If respective investments are made in alternative uses, the future of inner cities could lie in heterogeneous mixed-use districts, rather than in pure shopping streets.

DZ HYP regularly analyses developments on the real estate markets in its target business areas. The current report "The German Real Estate Market 2020/2021" is available for download from our website (https://dzhyp.de/en/); alternatively, we can send you a copy upon request. The charts are also available upon request.

About DZ HYP AG

DZ HYP is a leading provider of real estate finance in Germany as well as a centre of competence for public-sector clients within the Cooperative Financial Network. DZ HYP services its clients and business partners with a comprehensive range of products and services from its three business divisions: Corporate Clients, Retail Customers, and Public Sector. The Bank's nationwide presence comprises two Head Offices (Hamburg and Munster), plus Regional Centres in Germany's main cities and Regional Offices across Germany. Please visit www.dzhyp.de for more information.

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