

Real Estate House View

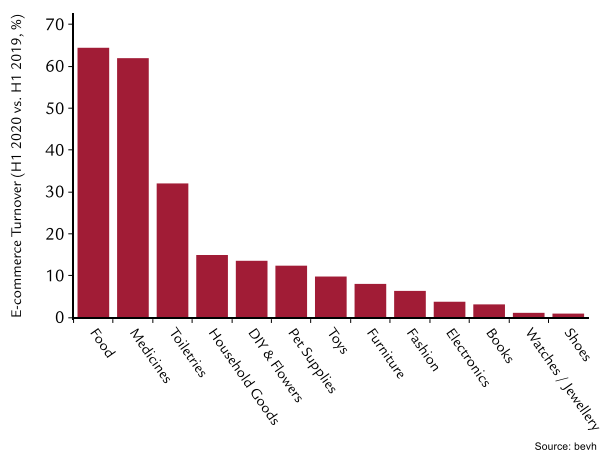
Germany

Second half-year 2020

Key takeaways

- **Sectors supplying basic goods show resilience:** all real estate sectors that support the supply of essential goods to society and the economy, such as housing, food shopping or goods fulfilment through logistics, have demonstrated their resilience during the crisis.
- **Residential rents continue to rise:** investors in the sector have not been significantly impacted by the coronavirus crisis. Rents have continued to grow. Rising unemployment may cause future defaults to rise.
- **Strong divergence in retail:** the differences between the already weak store-based sales in city centres and shopping malls and the stronger performance of stores supplying essential goods have become more pronounced. City centre retail is unlikely to recover, with the exception of the most sought-after prime locations.
- **Lack of supply supports the office sector:** low supply has maintained performance in the sector, but demand is difficult to estimate. Rents are likely to come under pressure and more incentives will be necessary to attract occupiers.
- **Property investments remain in demand:** we expect transaction volumes to increase in the second half of the year in light of a lack of investment alternatives in a low interest rate environment.
- **Prices remain high:** yields for prime properties quickly returned to pre-crisis levels after the lockdown and are expected to compress slightly in the medium term, most notably in the residential and logistics sectors.

Chart in focus



E-commerce was one of the beneficiaries of the lockdown, as additional consumer groups used the supply channel and customers purchased products previously rarely ordered online, such as food. However, in the first weeks of the lockdown, only retailers providing essential goods or daily use items benefited. Turnover for products, which are typically bought online like fashion, shoes and electronics saw a large decline. Sales did improve after the first few weeks of lockdown. Overall in the first half of 2020, e-commerce sales expanded by +9.2% with particularly strong growth in daily use consumer goods.

German authorities have dealt successfully with COVID-19 so far, enabling the economy to return to pre-crisis levels more quickly than other large European economies. Incoming survey results and high frequency data revealed that economic activity gathered momentum alongside the gradual re-opening of the domestic economy in May. Mobility data showed a return to normal activity in the domestic economy. The dependency of the Germany economy on global trade will result in manufacturing activity recovering at a slow pace while global supply chains remain interrupted. Mid-2020, previously seen problems in the German car industry re-emerged, weighing on the short-term recovery of the economy. While the worst of the COVID-19 depression seems to have passed, it is important to understand that its lasting after effects in the form of rising unemployment and corporate bankruptcies will become visible over time.

Office markets in a good position

Office take-up in the top 7 German cities decreased by around -35% in the first half of 2020, compared to the same period last year, underlining the lack of activity in the occupational market during the lockdown. Enquiries have subsequently resumed. The office markets were in better fundamental condition entering the corona crisis compared to previous crises. This was evident from very low vacancy rates, high demand and moderate but increasing completions. Given the economic uncertainty, demand is likely to remain constrained in the short term. We expect some downward pressure on rents in 2020 with headline rents to remain stable due to an increased use of incentives. A delay in completions is likely to soften the impact of an increase in vacancy rates. Prime rents are likely to continue to increase in the mid-term in the major markets.

Accelerated change in retail

The coronavirus crisis highlighted the polarisation already seen in the retail sector and accelerated structural changes by a number of years. As a result of the lockdown and the restrained return of consumers to city centres, a significant decline in rents for high street areas is expected in 2020 even in the top 7 markets. The high revenue losses of most retailers require sustainable solutions for occupiers and landlords; insolvencies

have already occurred. In 2021, rents are forecast to recover in prime locations as international retail chains will support demand. Retail parks with a strong anchor for daily consumer goods have proven to be stable. We continue to believe that food and low-priced non-food items will prove resistant to e-commerce and expect retail parks to experience rental growth.

Residential as a bulwark

Residential demand remained stable in the lockdown period, even though letting activity declined. Asking and contracted rents continued to increase. Unpaid rents, requests for reductions in rent and postponements were low in the first few months of H1 2020. As unemployment rises, we expect the situation to worsen somewhat. In the medium term, we believe that rents will rise moderately in line with inflation.

Does industrial and logistics win?

The industrial & logistics sector has demonstrated its resilience during the crisis, although take-up declined in the first half of the year. Large-scale warehouses absorbed demand from e-commerce operators which was partially offset by a poor performing manufacturing sector. Demand for modern space remains robust. Rents are expected to remain flat this year and rise moderately thereafter. Within the small-scale logistics segment, demand for urban logistics supported limited upward rent movements. Demand for industrial space is expected to remain depressed in the short term to medium term. Rental growth is unlikely to emerge in 2020 but for the years ahead.

There is still no alternative

Following an exceptionally good first quarter, which saw transaction volumes of EUR 28 billion, investments subsequently declined. This resulted in a y-o-y drop of -10% to approximately EUR 35 billion in the first half of 2020. Investor demand remains high during a sustained low-interest-rate environment. Transaction activity is expected to be intense in the second half of the year. Core property continues to see prices consistent with pre-crisis levels and this is not likely to change in the foreseeable future.

Chart 1: Retail prime rents (index)

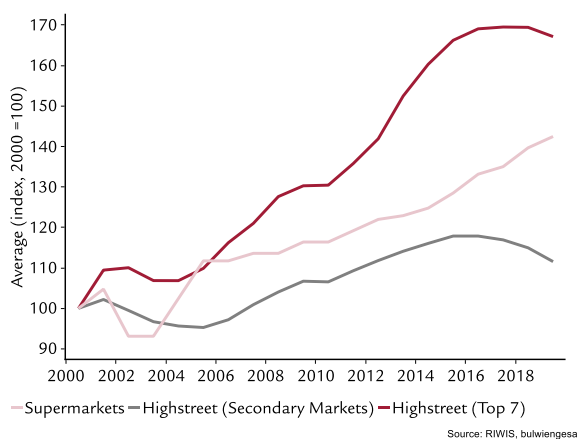
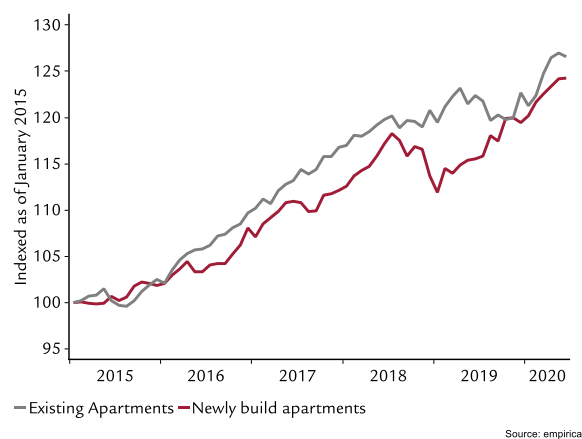


Chart 2: Residential average asking rents Top 7



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