

Real Estate House View

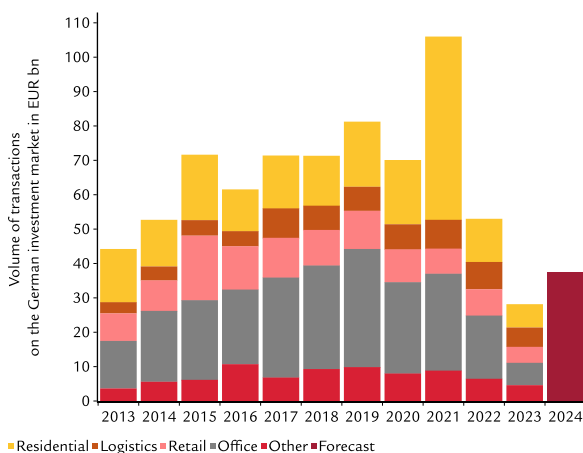
Germany

Second half-year 2024

Key takeaways

- **Signs of recovery:** A recovery of the real estate investment market has been long anticipated. The market is now finally displaying the longed-for signs of recovery with falling key interest rates and stabilising financing costs. Consequently, transaction volumes in 2024 are expected to surpass last year's lull.
- **Nothing changed I:** Logistics and residential sectors remain very popular among investors thanks to their strong fundamentals. Offices are still viewed critically, as are some retail segments. Prime yields are set to follow German government bonds, albeit with a delay, and reach their peak in 2024.
- **Nothing changed II:** There has also been no change in rental expectations: rental growth remains evident across fundamentally strong sectors/segments such as logistics and residential, as well as some retail segments (namely retail warehousing, supermarkets, and convenience stores), and premium offices, driven by sustained occupier demand.
- **Everything different:** While total returns (income returns plus capital value growth) were largely driven by capital value growth in the years prior to 2022, they are now driven by income returns. The good news is that active asset managers can (partially) control income growth themselves.

Chart in focus



Source: RCA / Swiss Life Asset Managers

The German real estate investment market displayed tentative signs of recovery in the first half of 2024: a number of brokers have reported a (slight) increase in transaction volume compared to the first half of 2023. As the German real estate investment market (-74%) has come under significantly more pressure compared with the rest of Europe (-60%) since 2021, it can also expect the greatest recovery potential (2024: +33% vs. 2023). However, liquidity inflows are unlikely to be evenly distributed as the market continues to polarise, with subdued interest in secondary offices and strong demand for modern residential and logistics properties, owing to structural changes and the focus on ESG.

The economy is recovering only slowly. A rise in real wages again for the first time since 2021 is supporting household consumption. According to recent surveys, consumers appear confident that their personal financial situation will continue to improve over the next twelve months. However, the critical industrial sector has so far only recovered sluggishly from the fall in orders in recent years. Companies remain challenged, forecasting a further deterioration in international competitiveness particularly with the US and China, owing to impacts from higher energy prices. The EU's recently announced new customs duties on electric vehicles from China are also unlikely to bring the German industrial sector any relief. The significant normalisation of monetary policy that is emerging will boost investment activity, with momentum expected particularly for the construction industry.

Logistics: the time is ripe

67% of European investors canvassed in an INREV survey said they preferred the Germany-industrial/logistics country-sector combination in 2024. This mixture is among the top favourites, alongside UK-industrial/logistics and Germany-residential. Preference for German industrial and logistics can be attributed to two factors. First, due to the strong market fundamentals driving tenant demand for modern space, of which there is insufficient supply. Occupiers looking to protect their supply chains and reduce dependence on foreign imports are doing so by re-shoring production and increasing inventories. The second factor relates to pricing, as the sector is already offering entry opportunities, with prime yields appearing to have peaked and moving sideways into 2024 (Q1 2024 \emptyset Top 5: 4.4%, +0 bp vs. Q4 2023).

Retail: light and darkness

Bricks-and-mortar retail remains challenged. Although real wages are rising, two thirds of retailers canvassed in an HDE survey are reporting falling footfall at their bricks-and-mortar outlets. Consumer restraint can, among other things, be attributed to insufficient accessibility of town and city centres, given the interplay between city transformations of mobility (e.g. car-free cities) and unreliable or infrequent public transport. The picture for convenience retail is more positive. In view of the very high density (the nearest

supermarket or discounter is no more than one kilometre away for 74% of people in Germany), these are not only highly accessible, but they have also defied competition from e-commerce. Online food delivery services are even in some cases now withdrawing from Germany. An increase in rents in real terms is therefore expected in this segment, as with retail warehouses.

Offices: not disappearing (completely)

While offices have long ceased to be the investor's darling, much data still speaks in favour of the sector. The economic downturn is approaching its end, and the German economy should grow again from 2025. Office employment is also increasing, at least in the top seven cities, albeit cautiously (2024 – 28: \emptyset +1.1% p.a. vs. 2014–23: \emptyset +1.7% p.a.). Thirdly, companies are enforcing their employees to return to the office, at least for fixed days on-site. Consequently, while according to the ifo Institute, demand for office space in the top seven cities is set to decline by around 12% by 2030, we expect modern space in well-connected and amenity-rich locations meeting new requirements will continue to enjoy strong occupier demand, offering scope for rent increases. Real rent increases are also expected in the long term, particularly in Berlin and Munich.

Residential: the deficit is growing

The massive drop in supply completions is exacerbating the already fraught housing situation in Germany. A combination of construction freezes and fewer projects in the pipeline meant just 1.7 million m² new supply was delivered in the cities covered by RIWIS over the first half of 2024, down from an annualised average of 6.4 million m² over the last three years. Experts are also critical of misguided support programmes that are increasing build costs due to excessive efficiency standards which put upwards pressure on new builds' rents, so much so that even companies focusing on social housing have almost stopped building. While the Federal Government has promised to improve and cut back regulations for housing construction, until this happens the excess demand will prevail – to the joy of investors.

Chart 1: Logistics prime rent top 5

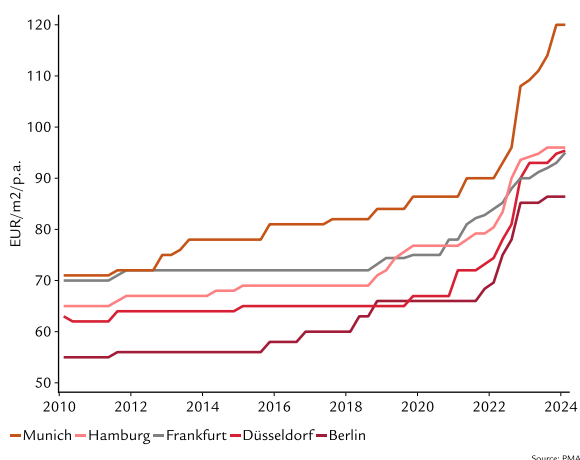
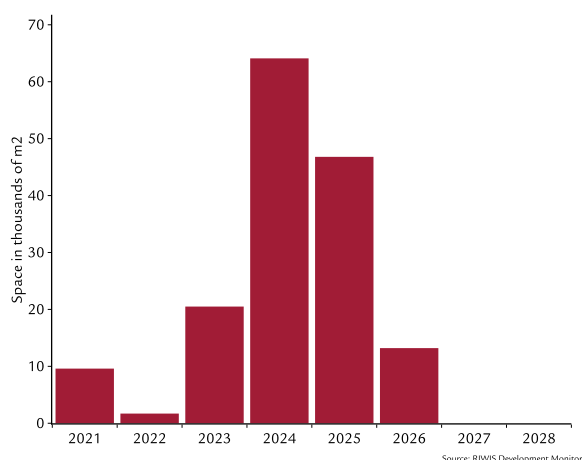


Chart 2: Housing construction freezes of the top 125 towns and cities



Authors

Swiss Life Asset Managers, Germany

Andri Eglitis

Head Research

andri.eglitis@swisslife-am.com

Gudrun Rolle

Research Analyst Real Estate

gudrun.rolle@swisslife-am.com

Swiss Life Asset Managers

Francesca Boucard

Head Real Estate Research & Strategy

francesca.boucard@swisslife-am.com

Marc Brüttsch

Chief Economist

marc.bruetsch@swisslife-am.com

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