SKJERVENGROUP

SKJERVEN GROUP - *Monthly Newsletter* BERLIN - JANUARY 12, ISSUE #13/2021

Quo vadis Real Estate Market Germany 2021?

In previous years, the outlook for the coming year was always relatively straightforward. It was less a question of whether the markets would go up, but rather how much they would grow. With COVID-19, that has changed abruptly. Almost nothing is the same as before. Consequently, the World Uncertainty Index has soared to unprecedented heights and reached record levels.

The pandemic has led to a sharp divergence in the space requirements of the various types of use of real estate. Interim rentals of logistics space on the one hand and rent defaults on the retail market on the other are prime examples of this.

Upswing from the middle of the year

In an analysis, the researchers of Savills assume that the sharp divergence in demand for space is likely to have disappeared by the middle of 2021. At the same time, the real estate consultant assumes that the demand structure on the real estate markets will still be fundamentally different from that at the beginning of 2020. Some uses will have a substantially higher, others a substantially lower demand for space than before the crisis. The demand for logistics space is an example of the one case, while the demand for retail space is an example of the other. Both have been diverging for years because of expanding online retail. COVID-19 is now acting as a catalyst here.

CONTINUE TO P. 02

Offices: Decline in demand likely

Savills forecasts that office occupancy will be relevantly lower than before the crisis, i.e. companies will give up space while the number of employees remains unchanged. This would apply above all to the large users and accordingly in the larger space segment. This would structurally reduce the demand for office space. The question currently being asked is whether COVID-19 has not just interrupted the trend of rising demand for office space, but ended it.

Germany as a real estate location wins the crisis

If there were any doubts before the COVID-19 crisis that interest rates would remain low in the coming years, they have probably disappeared. Around 80% of all bonds outstanding worldwide are yielding less than 1% - a quarter even less than 0%. It seems unlikely that this will change significantly in the course of the 2020s.

Against this background, further increases in real estate ratios in the portfolios of institutional investors and consequently sustained high investment pressure are to be expected. This is particularly true for Germany. The country has coped comparatively well with the pandemic so far and this has consolidated its status as a safe investment haven.

Due to the further increase in risk aversion, it is likely to benefit from this even more in the future than it already has. The fact that prime yields in the lowest-risk real estate segments have not risen despite the deepest recession in Germany's post-war history reflects continued very high capital pressure in the core segment.

CONTINUE TO P. 03

Residential real estate coming through the crisis well

In any case, the investment universe for risk-averse investors has shrunk, at least temporarily. Large parts of the hotel and retail real estate market have lost their core status in the eyes of many investors, and they have become more selective in the case of office properties. **Demand is therefore likely to focus all the more strongly on those properties that continue to deliver stable cash flows during the crisis and promise the same for the period after the pandemic. These primarily include logistics and residential properties, food retail properties, offices if they have long leases with the public sector or similarly creditworthy users, as well as niches such as data centers and other infrastructure-related properties.** In all of the above segments, Savills therefore expects prices to continue to rise and transaction volumes to increase again post-pandemic at the latest.

CONTINUE TO P. 04

Berlin's residential real estate market on hold:

Players waiting for decision on rent cap (Mietendeckel)

At present, it is noticeable that the players on the Berlin residential investment market are acting cautiously. The watchword is wait and see. This year, the German Federal Constitutional Court will decide whether the Berlin rent cap (Mietendeckel) is unconstitutional.

Since November 23, 2020, the second stage of the rent cap must be implemented. This obliges Berlin landlords to reduce excessive rents. A rent is considered excessive if it is more than 20% above the rent ceilings set by the Senate in the respective building age class.

Members of the Bundestag from the two German parties, FDP and CDU, have filed a lawsuit with the Federal Constitutional Court to stop the rent cap: The judges in Karlsruhe will deal until summer 2021 with the question of whether the state of Berlin is allowed to enact such laws at all or whether the legislative competence lies solely with the federal government. A much-noted expert opinion by Hans-Jürgen Papier, former president of the Federal Constitutional Court, concludes that the law is unconstitutional. An opinion that is widely held among legal experts.

The fact is that despite the rent cap and the recent Corona pandemic, we have not yet seen a collapse in prices for Berlin residential real estate. Those who still invest now could benefit as early as this summer if the rent cap is indeed declared unconstitutional. But even if that doesn't happen, investors have acquired a tangible asset that stabilizes the overall portfolio in times of crisis.

CONTINUE TO P. 05

Federal Statistical Office reports further increase in housing prices in Germany

In the third quarter of 2020, prices for residential real estate in Germany exceeded the figures for the same quarter of the previous year by an average of 7.8%, according to the German Federal Statistical Office. Compared with the second quarter of 2020, prices for apartments and for detached and semi-detached houses climbed by 2.9% in the third quarter. Thus, residential real estate continued to become significantly more expensive despite the ongoing Corona crisis, both in the city and in the countryside.

There is no end in sight to this price trend. Despite the crisis, German tenants are increasingly moving into their own four walls. At least, that is what a representative survey conducted by the opinion research institute Yougov on behalf of Commerzbank revealed. Every third person wants to buy a property, and among younger people (18 to 54 years old) it is even more than 40%, says the survey of 3,000 Germans of legal age from November 2020, which has now been evaluated.

For many, the desire for home ownership can also come true thanks to further state subsidies. At the beginning of the year, the housing construction premium increased and the so-called Baukindergeld (support of 12,000 Euro per child), which was supposed to expire at the end of 2020, was extended until March 2021. Not only will there be higher subsidies for housing construction in the future, but the income limits will also rise, meaning that more people will be able to benefit from the subsidy.

These developments will ensure that housing prices in Germany will continue to rise in the future. This will apply in particular to attractive metropolitan regions such as Berlin.

CONTINUE TO P. 06

Solid construction activity gives confidence for 2021

The two major associations of the German construction industry are confident about the new year. With a 2% increase in gross value added, the sector has supported the overall economy, which fell by 5.8% in Germany in 2020. This was achieved entirely without state aid. Construction companies have only benefited indirectly from financial assistance provided by the federal and state governments to local authorities, which mostly put the capital into construction projects.

The main reason for confidence is residential construction, which will continue to support the industry in 2021. The driving forces continue to be low interest rates and high demand. This was indicated by building permits and new orders, which were at almost an all-time high. Here, additions rose by 9% in the fall. Prior to this, there was still a small dip in the second quarter of 2020. The associations expect residential construction to survive the second lockdown unscathed and slide well into the new year. Sales are then expected to rise to EUR 52.6 billion (+3%).

Civil engineering is also a bright spot. It is mainly driven by investments in pipeline and railroad construction. According to the Federal Statistical Office, civil engineering is one of the construction sectors in Germany with the highest investment in property, plant and equipment, indicating good business and high capacity utilization.

CONTINUE TO P. 07

The main construction industry employed around 880,000 people in 2020, 10,000 more than in 2019, and companies plan to hire 5,000 people this year. With 41,000 apprentices, as many young people are completing training in the industry as last almost twenty years ago. Future topics such as digitalization, prefabrication, broadband expansion and energy-efficient refurbishment of private and public buildings offer good opportunities for the industry, according to the two construction industry associations.

Deutsche Bank Study:

International Investors See German Residential Real Estate as Alternative to Bonds

Global investment pressure continues to rise. Due to the ongoing low-interest phase, investors around the world are looking for attractive investment opportunities beyond bonds.

CONTINUE TO P. 08

In a recent study, DB Research concludes that due to the once again intensified global shortage of worthwhile low-risk capital investments in the Corona crisis, many international investors are looking at the German housing market as an alternative to the bond markets.

Despite the pandemic, rents continued to rise in 2020. Reletting rents in the 126 cities on which DB Research's analysis based on data of bulwiengesa increased by around 2% year-on-year. They thus rose much more strongly than the consumer price index and rental inflation (0.5% and 1.4%). The researchers call this increase in re-letting rents remarkable. Because even in Berlin the rents would have registered a plus of nearly 2% despite rent cap (Mietendeckel).

The purchase prices for existing properties increased by almost 6% in 2020, so that the average rental yield was around 4.3% per year. In metropolitan areas, the rental yield is around 3.2%. DB Research registers particularly high rental yields averaging 5% in the 25 eastern German cities (west 4.1%).

As long as the spread between rental yields and yields on low-risk bonds remains as high as it is at present, the German residential real estate market will remain an attractive alternative for international investors for a long time to come. After all, it is not only the higher yields that are convincing: in times of crisis, real estate as a tangible asset is a highly sought-after investment.