The market for real estate investments

Significantly less appetite for investments

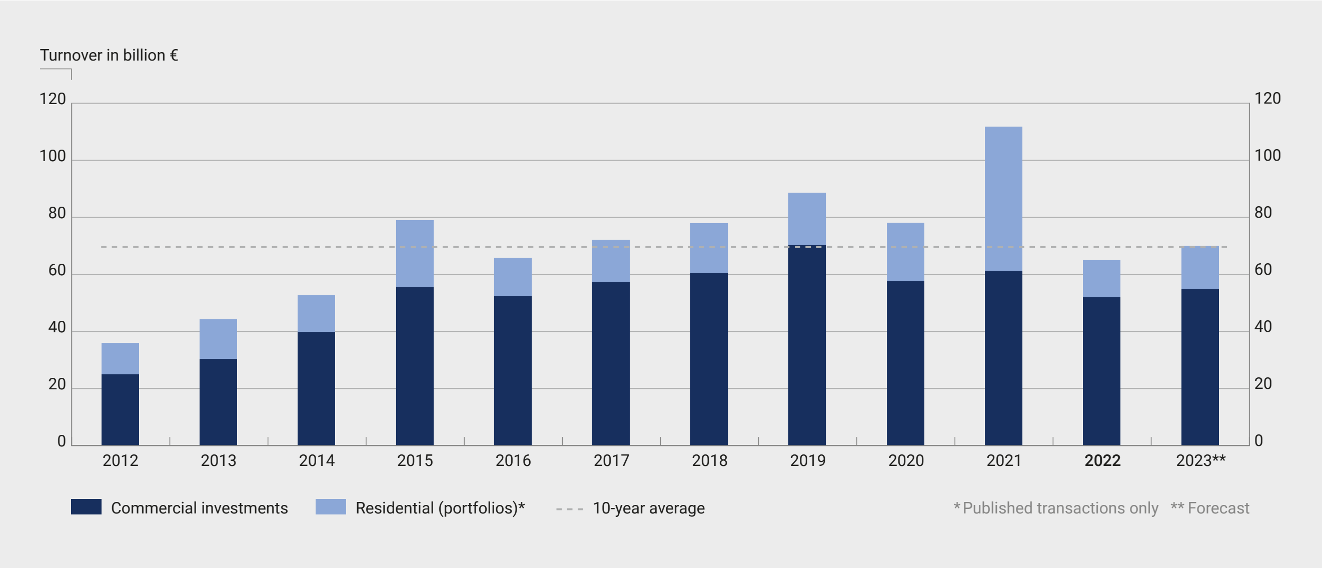
Against the backdrop of the current economic situation, activities on the real estate investment markets in 2022 were, as expected, less dynamic than in the previous year. A total of € 64.9 billion was invested in commercial and residential properties over the course of the year. The market for residential investments in particular lost momentum after its record performance in the previous year:

- The investment market recorded an overall result of € 64.9 billion, 42 % less than in the previous year (€ 111.8 billion) and 8 % less than the most recent ten-year average.
- Commercial investments remained the largest group with about € 52 billion, approximately 15.3 % less than in the previous year. The current ten-year average was exceeded by 2 %.
- The transaction volume on the residential investment market, € 12.9 billion, was about 74 % lower than in the previous year (€ 50.4 billion). The ten-year average fell short by approx. 34 %.

Offices remained the strongest segment in 2022, accounting for 42 % of the commercial investment volume, followed by the group of *Other Investments*, including hotels and nursing homes among others. They accounted for 22 % of total commercial real estate investment. The logistics segment saw a further increase with 19 % or investments of € 9.9 billion being made in this segment. The weakest segment was *Retail Investments* with a share of 17 %.

Following the record in 2021, turnover volume fell in 2022 as expected, but by somewhat more than had been forecast. Overall, the framework conditions were mixed. The interest rate market has been seeing increases since 2021 with interest rates climbing to 3.4 % in November 2022, almost triple of what they had been the year before. Across the entire year, interest rates averaged at 2.2 %. On top of that, we saw prices for energy and raw materials rise considerably, with an additional negative impact on investments. A relaxation of the market situation is expected for the second half of 2023 at the earliest, yet the above-average results of the previous five years will still remain well out of range and we expect a result below the ten-year average.

The German Real Estate Market: transaction volumes of commercial and residential investments



Source: own calculations/records © DIP, Aengevelt Research

Real estate investment: turnover in Germany split by asset class

Type of asset class	Rank	Billion €		Difference to the previous year		Share	
		2022	2021	Billion €	%	**2022**	2021
Office	1	21.73	30.1	−8.37	−27.8 %	42 %	49 %
Logistics (incl. light industrial)	2	9.85	9.5	0.35	3.7 %	19 %	15 %
Retail incl. commercial buildings	3	8.87	8.3	0.57	6.9 %	17 %	14 %
Others	./.	11.58	13.5	−1.92	−14.2 %	22 %	22 %
Commercial buildings	./.	**52.03**	61.4	−9.37	−15.3 %	100 %	100 %
Residential portfolios	./.	12.90	50.4	−37.5	−74.4 %		
Total of real estate investments	./.	64.93	111.8	−46.87	−42 %		

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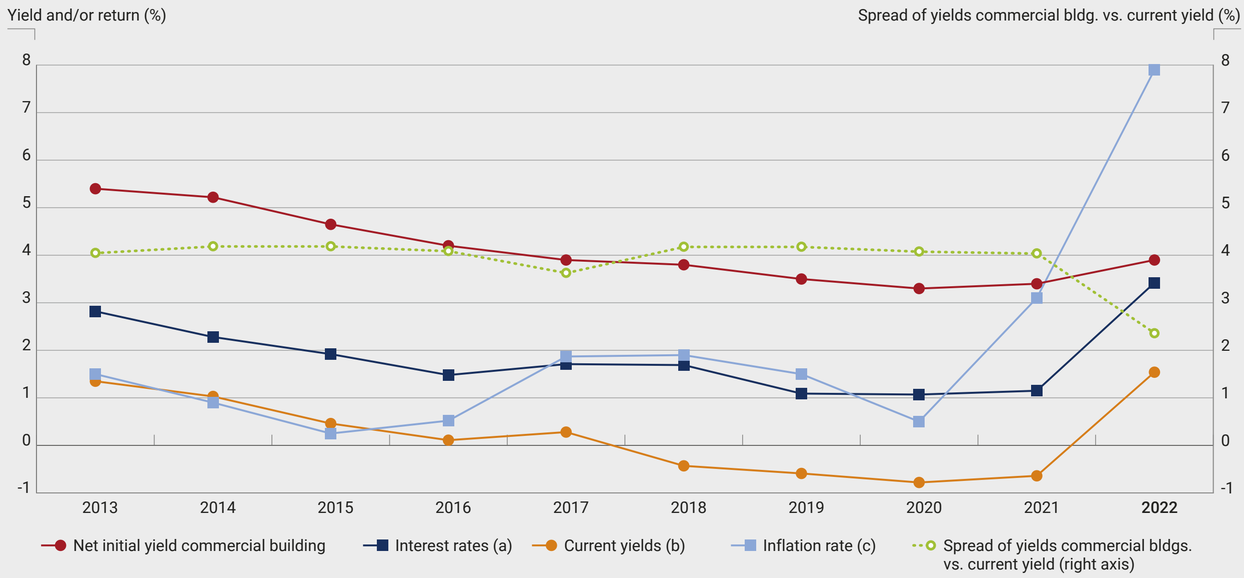
The spread between commercial buildings and running yields had largely amounted to more than four percentage points in past years – yet it currently is 2.4 percentage points. The marked increase in the running yields of domestic bearer bonds is a major factor in this development. The average figure for the year 2022 as a whole was 1.5 %, but was −0.6 % in the previous year. As in the previous year, the spread between logistics and commercial properties fell moderately by 10 basis points to 0.8 %, compared to 3 % ten years ago.

Investment environment: yields (commercial buildings, securities) interest, inflation



(a) Loans for residential bldgs., 5 to 10 years, as of Sept. of each year, private, new loan
(b) Current yields of domestic bearer bonds, total of averages
(c) Consumer price index (total) for Germany

Source: Deutsche Bundesbank (German Federal Bank), own data Aengevelt Research © DIP, Aengevelt Research

Commercial investments in the “Big Seven”

The transaction volume in the “Big Seven” amounted to € 27.5 billion in 2022, about 22 % less than in the previous year. The share in overall commercial investments in Germany accounted for by the “Big Seven” fell by 5 percentage points to 53 % (2021: 58 %) year-on-year.

As in the previous year, most of the investment into the “Big Seven” went to Berlin with € 9 billion. This result was 19.3 % lower than in the year before. Recording a transaction volume of € 4.7 billion, a 51.6 % improvement year-on-year, Hamburg ranks second. With this result, Hamburg saw the by far biggest improvement among the “Big Seven” when compared to the previous year. Frankfurt ranks a close third with almost € 4.7 billion, which is 26.2 % less than in the previous year. Munich was not able to repeat its good performance of the previous year, either, and ended the year with 45.6 % less or a result of about € 3.9 billion. Düsseldorf, on the other hand, was able to significantly improve its performance, attracting approx. € 3 billion, 29.3 % more than in 2021. A particularly marked decline was recorded in Cologne, where the difference amounted to 65.8 %. Stuttgart is once again the seventh of the “Big Seven”, recording a result of € 1.15 billion of investments or 39.6 % less than in the previous year.

Hamburg could achieve the by far biggest improvement among the “Big Seven” when compared to the previous year.

DIP is expecting a slight increase in commercial investments in the “Big Seven” in 2023, with prices likely to level off on a lower level. Yields are expected to continue to rise, at least for the time just beyond the first half of the year. It is likely that developments on the investment market will gain momentum again once the phase of buyers and sellers establishing price levels has progressed sufficiently and more appropriate pricing has been achieved. There are capital reserves available as a result of the limited investment activity of the previous year. Experience suggests that these reserves will also flow into real estate investments again once the economic development in 2023 has been assessed. However, it is unlikely that the very good sales results of previous years, which were driven by price levels, will be repeated again in the immediate future.

Commercial real estate investments: turnover in the “Big Seven”

Location	Rank	Billion €		Difference to the previous year	
		2022	2021	Billion €	%
Berlin	1	8.96	11.1	−2.14	−19.3 %
Hamburg	2	4.70	3.1	1.60	51.6 %
Frankfurt a. M.	3	4.65	6.3	−1.65	−26.2 %
Munich	4	3.86	7.1	−3.24	−45.6 %
Düsseldorf	5	2.98	2.3	0.68	29.3 %
Cologne	6	1.23	3.6	−2.37	−65.8 %
Stuttgart	7	1.15	1.9	−0.75	−39.6 %
Real estate investments “Big Seven”		27.52	35.4	−7.88	−22 %
“Big Seven” share in commercial investments		53 %	58 %		−5%

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Returns rising

Contrary to forecasts from last year, German DIP members saw returns rise, on average by between 30 and 60 basis points from 2021 to 2022, depending on asset classes:

- Top returns for top commercial properties amounted to about 3.8 % (2021: 3.4 %), while returns for pure office buildings are, on average, 60 basis points higher at 4.1 % (2021: 3.5 %).
- Returns for self-service shops and specialist retailers rose slightly, but these properties remain attractive with average top returns of 5.6 % (2021: 5.3 %).
- Top returns for logistics properties also rose in the course of 2022 to approx. 4.6 % (2021: 4.3%).

The picture of top returns or top factors differs as follows for the different cities of the DIP association: Munich has been the traditional leader in regard to prices, followed by the remaining “Big Seven”. Across all asset classes and locations, the previous trend of falling returns has come to a halt and changed to a noticeable upward movement.

Residential investments

2022 was not able to repeat the record volume of the previous year, which had been relying heavily on the acquisition of Deutsche Wohnen by Vonovia. The transaction volume of € 12.9 billion was about 74 % lower than in the previous year that closed with € 50.4 million. This means that the year 2022 ended with the lowest sales volume since 2012. The steep rise of interest rates, an economic development slackening off and high inflation meant that the traditional end-of-year rally did not materialise: Only about € 1.88 billion were invested in the fourth quarter.

In 2022, residential investments were not able to repeat the record volume of the previous year.

The top returns for residential investments on the DIP markets (new buildings and existing buildings after extensive refurbishment) amounted to 3.6 %, an increase by 60 basis points year-on-year, with 3.0 % having been recorded in the past year. The change in financing conditions and high

Top returns and top multipliers at DIP locations

Location	Commercial buildings		Residential		Self-service/specialized retailers		Offices	
	Return	Multiplier	Return	Multiplier	Return	Multiplier	Return	Multiplier
Berlin	3.7 %	27	3.7 %	27	5.9 %	17	3.7 %	27
Bremen	4.3 %	23	4.0 %	25	5.9 %	17	4.5 %	22
Dresden	3.8 %	26	3.4 %	29	6.3 %	16	5.0 %	20
Düsseldorf	3.3 %	30	3.6 %	28	5.0 %	20	3.6 %	28
Essen	4.5 %	22	4.3 %	23	5.9 %	17	4.3 %	23
Frankfurt a. M.	3.0 %	33	3.6 %	28	4.5 %	22	3.1 %	32
Freiburg	4.0 %	25	2.9 %	35	5.3 %	19	3.8 %	26
Hamburg	3.6 %	28	3.6 %	28	4.8 %	21	3.3 %	30
Hanover	4.2 %	24	4.0 %	25	5.3 %	19	4.3 %	23
Karlsruhe	4.0 %	25	3.3 %	30	8.3 %	12	5.9 %	17
Cologne	3.7 %	27	3.4 %	29	5.0 %	20	3.8 %	26
Leipzig	4.1 %	24.5	3.8 %	26	5.3 %	19	4.2 %	24
Magdeburg	4.5 %	22	3.8 %	26	6.3 %	16	4.5 %	22
Munich	2.9 %	35	2.2 %	45	3.8 %	26	3.1 %	32
Nuremberg	4.3 %	23	3.8 %	26	7.7 %	13	4.8 %	21
Stuttgart	4.0 %	25	4.0 %	25	5.6 %	18	3.8 %	26
DIP-16	3.8 %	26	3.6 %	28	5.6 %	18	4.1 %	24

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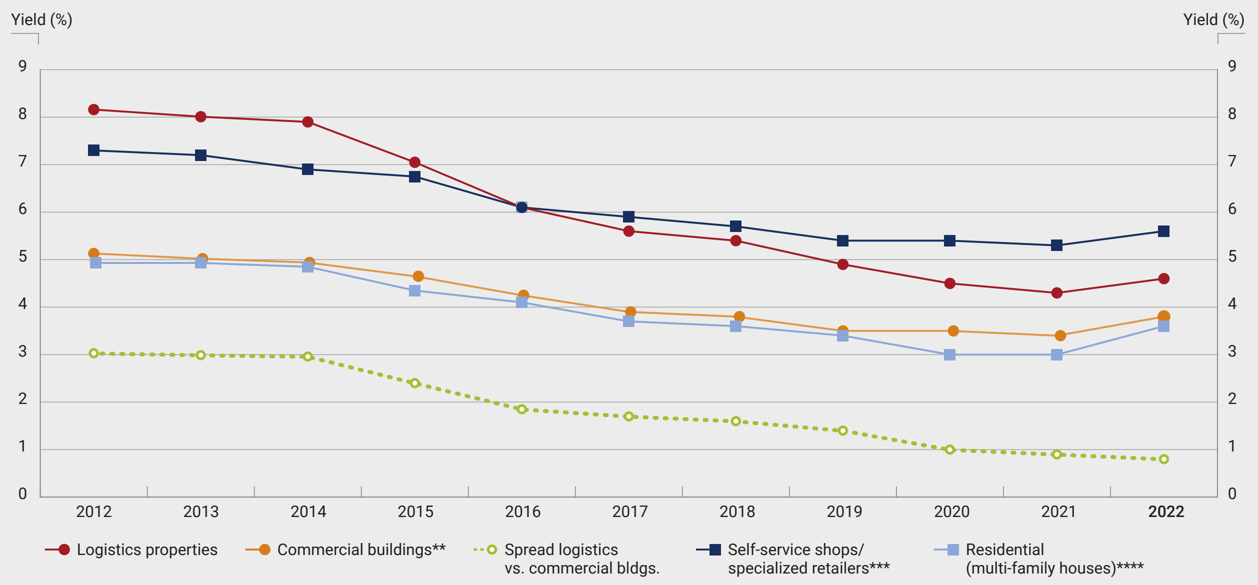
construction costs led to sometimes considerable corrections of returns in the analysed DIP locations. The cities have also seen a widely heterogeneous development: Re-adjustments of prices have progressed much more in some cities than in others. Again, Munich is topping the price list with 2.2 %, followed by Freiburg with 2.9 %. In a few isolated cases, returns rose by up to 130 basis points, for example in Berlin with currently 3.7 % or in Düsseldorf and Hamburg which saw returns increase by 100 basis points to 3.6 %.

As a result of the change in interest rate policy, the momentum will continue to fall short of previous years in 2023 as well, although we expect a moderate increase when compared to 2022. The development in 2023 will be largely influenced by the time at which financing costs find a stable level. With a current interest rate of 3.47 % (in November 2022) for mortgages for private households, interest rates that must be paid for loans have almost tripled since the previous year. Given this trend, returns are expected to rise, at least in the first half of 2023. Depending on further global and national economic developments, we might see an initially moderate increase in the pace of investment activities in the second half of the year.

Given the persistent acute housing shortage in urban areas and growth centres, coupled with the insufficient new construction, especially across segments where demand is particularly high, the asset class *Residential Investments* will remain attractive for investors, especially because it has traditionally granted a high degree of security, meaning cushioning from inflation. With an inflation rate of 7.9 % in 2022 and high volatility on the stock markets, residential investments remain a safe investment option with a prospect of long-term profit. In addition, there is ongoing surplus demand for housing. With construction in the residential sector still falling far short of what is needed, it is not possible to come anywhere close to meeting the demand for affordable properties for rent on the housing market.

Net initial yields* of real estate asset classes



* Peak ** Inner-city locations, high-quality or contemporary fittings, with a major part of retail *** Food stores and specialized retailers
**** Multi-family houses, prime locations, high-quality fittings