German economy

Positive signals from main indicators …

After a promising development in the first half of 2010 it remains to be seen if the economic recovery of the recent months will be sustainable. Germany is likely to lead the Eurozone recovery with its economy well positioned to benefit from rising exports and improving global demand. Current forecasts predict positive GDP growth in 2010 and 2011 and importantly the main indicators showed an unchanged or positive development during the 1st half of 2010. The Ifo Business Climate Index for example continued its positive upswing (+11% in 2010) over this period.

… and strong export results …

The strong economic expansion in the first half of 2010 was mainly driven by a recovery of demand for exports. However, concerns remain about the continuation of this growth and it is quite possible that the global economic recovery may slow towards the end of the year. Consequently, domestic demand will become increasingly important and will need to strengthen in the months to come.

… have led to increased consumer optimism
.

The positive economic development combined with the continued optimistic signals from the labour market have helped improve levels of consumer optimism. Nevertheless, major instability factors such as like governmental budget cuts, expiring economic stimulus packages and the financial crisis of various stimulus packages remain a concern and threat.

Germany: Key indicators and change from last year

Population (2010, Q2)	81,703,000	↘
GDP growth (2010, Q2)	2.3%	
GDP growth (2009)	–5.0%	
GDP Forecast (2011)	1.2%	↘
GDP per capita (2009, EUR)	29,278	↘
Unemployment rate (06/2010)	7.50%	↘
Total employment (06/2010)	27,663,000	↗
Share of service employment (2010, Q3)	71.4%	↗
Disposable household income (2009, EUR)*	39,215	↗
Inflation (07/2010)	1.2%	↗
ø mortgage rate > 5 years (07/2010)	4.73%	↘
10-year federal bond yield (09/2010)	2.40%	↘
3-month Euribor (09/2010)	0.90%	↗
5-year Euro SWAP rate (09/2010)	1.80%–1.85%	↘
10-year Euro SWAP rate (09/2010)	2.49%–2.54%	↘
Change in consumer sentiment index (09/2010)	0.1	
Change Ifo Business Climate Index (09/2010)	17.9%	
Change in retail turnover, real (09/2010)	2.4%	

Arrows indicate the year-on-year change (throughout the whole document)
*most recent available data.
Sources: IHK, KSK, SBD, BAA, GFK

Office market

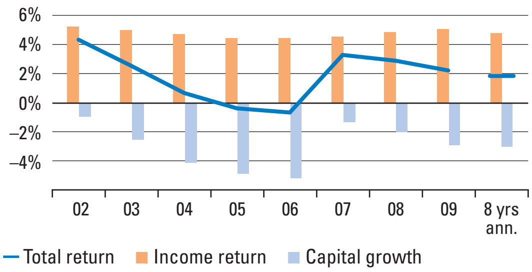
Germany's office market showed resilience …

Following 2009 the German office market environment in 2010 will remain challenging. Slightly rising demand combined with projects that are currently under construction in the major office markets are likely to result in increasing vacancy rates and softening rents until the end of the year. However, Europe's and especially Germany's office markets have exhibited resilience under challenging economic circumstances and the fundamentals have generally held up better than previously anticipated. Even if short-term demand prospects are limited, investment volumes improved markedly in the first half of 2010. Nevertheless, investors still continue to focus on core assets.

… however prime and average rents are under pressure

In general, German property markets were slower to react to financial market turbulence with rental price adjustments occurring to a much lower degree than elsewhere. Although demand, rents and yields are currently likely to recover earlier in office markets such as London, Warsaw or Paris, German office markets will nevertheless provide more moderate and less volatile opportunities. Unsurprisingly, cheaper locations close to the main business districts performed well in 2010 as already witnessed in 2009. Yields are expected to stay stable in these districts whereas prime yields in the main office markets are expected to remain under pressure in the months to come.

IPD Total return: office



	Office Stock (m², 2010, Q2)	Trend completion (Forecast)	Employment (2010, Q2)	Vacancy (2010, Q2)	Average rent (2010, Q2)	Prime rent (2010, Q2)	Prime yield (2010, Q2)
Berlin	17,620,000 ↗	↗	1,117,515 ↗	8.5% ↗	11.2 ↗	20.2 →	5.4% ↘
Munich	20,410,000 ↗	↗	690,111 ↗	8.5% ↗	14.4 →	29.0 →	5.0% →
Hamburg	14,510,000 ↗	↗	817,896 ↗	8.4% ↗	12.8 ↘	22.9 ↘	5.0% →
Cologne	7,280,000 ↗	↗	463,375 ↗	8.8% ↗	14.5 →	20.8 →	5.6% ↗
Frankfurt	11,710,000 ↗	↗	473,150 ↗	15.3% ↗	18.1 ↘	34.4 ↘	5.3% ↘
Dusseldorf	8,340,000 ↗	↗	359,937 ↗	11.4% ↗	13.5 →	23.1 →	5.4% ↘
Stuttgart	7,920,000 ↗	↗	346,908 ↗	6.4% ↗	11.5 ↘	17.8 →	5.5% ↘

Retail market

Positive retail development

After severe decreases in retail turnover in 2009, the most recent figures for 2010 show a more positive and optimistic development. The German Federal Statistical Office, reported a nominal increase in retail turnover of 14.7% in the first half of 2010. Relatively high consumer confidence and purchasing power will undoubtedly help to further reinforce this development.

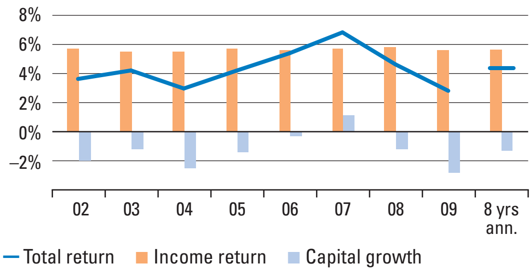
Main retail locations remain stable …

In light of these various signs of improvement Germany's retail market has proven to be more stable than anticipated. Prime rents have held stable in most cities, in particular in the main CBDs. In general, stable market conditions with very few changes in prime rents and availability are expected until the end of this year.

… while smaller locations are still not over the worst

Outside the prime shopping areas, further improvement in the overall economic outlook will be required before retail rents are able to strengthen. Despite improving financing conditions it remains unclear whether or not more large-scale deals in the retail investment segment will be possible.

IPD Total return: retail



	Retail Stock (m², 2010)		Purchasing Power Index (2010)	Retail Centrality Index (2010)	Average rent (2010, Q2)		Prime rent (2010, Q2)		Prime yield (2010, Q2)	
Berlin	4,560,000	↗	93.9	108.6	91.0	↗	230.0	↗	5.0%	↘
Munich	1,570,000	→	126.3	119.9	120.0	→	310.0	↗	4.3%	↘
Hamburg	2,500,000	→	105.4	115.4	140.0	→	230.0	↗	4.7%	↘
Cologne	1,550,000	↗	108.1	125.9	110.0	→	230.0	↘	4.7%	↘
Frankfurt	1,290,000	↗	111.7	111.9	110.0	→	260.0	↗	4.7%	↘
Dusseldorf	840,000	↗	115.6	125.4	95.0	→	230.0	↗	4.7%	↗
Stuttgart	880,000	→	109.6	125.9	100.0	→	230.0	↗	5.2%	↘

Residential rental properties

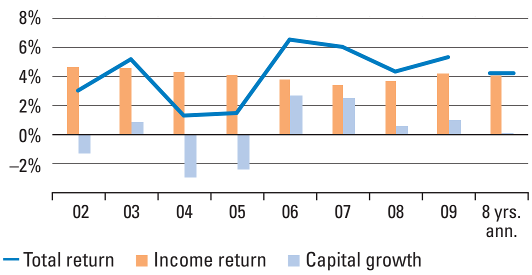
Residential property as an investment is en vogue …

Germany's residential sector faces rent increases in future periods, in particular in growing urban centres and modern standard residences. Current forecasts reveal that, on average, rents will increase up to 1.5% over the next 24 months. Even higher increases are predicted for inner districts of urban centres but also in university cities. Driving factors include supply-side issues such as low levels of new construction activity and the relatively high levels of inadequate rental apartment stock in old buildings in most cities. On the demand side quality requirements for adequate residential properties are on the increase.

… and will be scarce in selected regions

Furthermore, due to different demographic and economic trends, future development of regional demand is expected to be inconsistent. The result will be surpluses in rural areas and supply shortages in agglomerations. Consequently, an overall deficit of adequate living space in Germany is likely to result in the medium term. In conclusion, the likelihood of increasing rents for basic living space is higher with units in top locations.

IPD Total return: residential rental properties



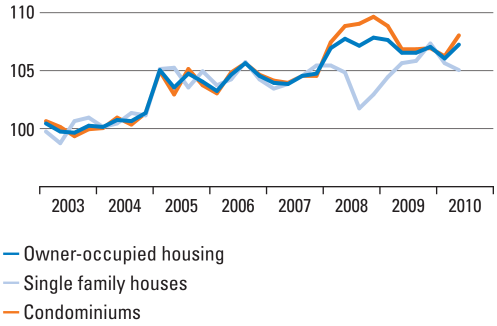
	Stock (2009)		Residents (2009)	Population growth (2009)	Building activity (2009)	Average rent (2010, Q2)		Prime rent (2010, Q2)		Prime yield (2010, Q2)	
Berlin	1,894,000	↗	3,442,700	0.16%	0.20%	6.4	→	12.2	↗	5.5%	↘
Munich	743,000	↗	1,326,807	0.86%	0.65%	12.0	→	20.0	↗	4.5%	↗
Hamburg	889,000	↗	1,773,209	0.07%	0.39%	9.4	→	18.1	↗	5.0%	→
Cologne	522,000	↗	995,420	0.00%	0.62%	8.5	→	14.7	→	6.0%	↗
Frankfurt	357,000	↗	664,838	0.88%	0.60%	10.7	→	18.1	↗	5.0%	↘
Dusseldorf	326,000	↗	584,217	0.53%	0.21%	8.3	→	15.7	→	4.8%	↘
Stuttgart	296,000	↗	600,068	0.48%	0.44%	9.1	→	14.0	↗	5.5%	→

Owner-occupied housing

The price gap between growing regions and the rest is increasing

In 2010, as in 2009, the ageing and shrinking population combined with more households and migration into agglomerations led to increasing purchase prices for owner-occupied housing in top locations and larger cities. In smaller cities, the observed markets prices were stable or declined further. In future, the often cited economic and demographic factors will result in an increasing price gap between larger cities/agglomerations and the economically less powerful rural areas. Indeed, in these weaker regions demand as well as purchase prices are both expected to decrease. At the same time in larger cities more inhabitants will be looking for contemporary living space, resulting in increasing prices for owner-occupied properties. Furthermore, rising demand in the main cities has become evident, especially in southern Germany. This is largely due to the fact that private investors are also switching capital from other asset classes to real estate and therefore are buying condominiums as investment.

Price index for new-build single-family houses (prefabricated houses, Destatis)



	Average price (EUR/m², 2010, Q2)	Prime price (EUR/m², 2010, Q2)	Owner Percentage (2010)	Single-/Double family house (prime, EUR/m², 2010, Q2)
Berlin	1,800 →	5,300 →	13% →	4,800 ↗
Munich	3,000 ↗	8,600 ↗	24% →	9,600 ↗
Hamburg	2,400 ↗	7,800 →	22% →	6,800 ↗
Cologne	1,800 →	5,000 ↗	24% →	4,900 ↗
Frankfurt	2,400 ↗	6,400 ↗	16% →	6,800 ↗
Dusseldorf	1,900 →	6,200 ↗	21% →	8,000 ↗
Stuttgart	2,200 ↗	5,500 ↗	28% →	6,200 →

Logistic properties

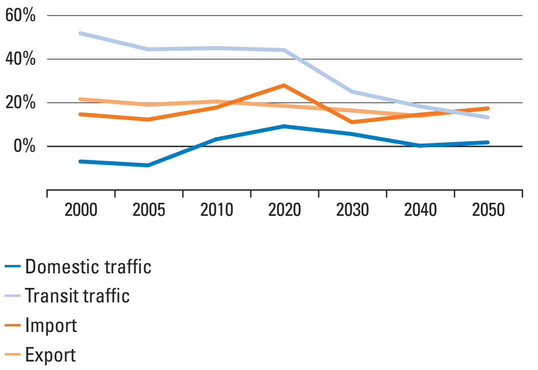
Due to positive economic factors, the logistic sector is improving

Over the year significant increases in production have helped the logistic property market to present a rather unexpected picture of stability. Rents appear to have bottomed out and improved investment sentiment combined with slowly growing transaction volumes have resulted in yields decreasing again. It is however apparent that currently activity has largely been limited to domestic investors.

Investment demand is increasing and yields are falling

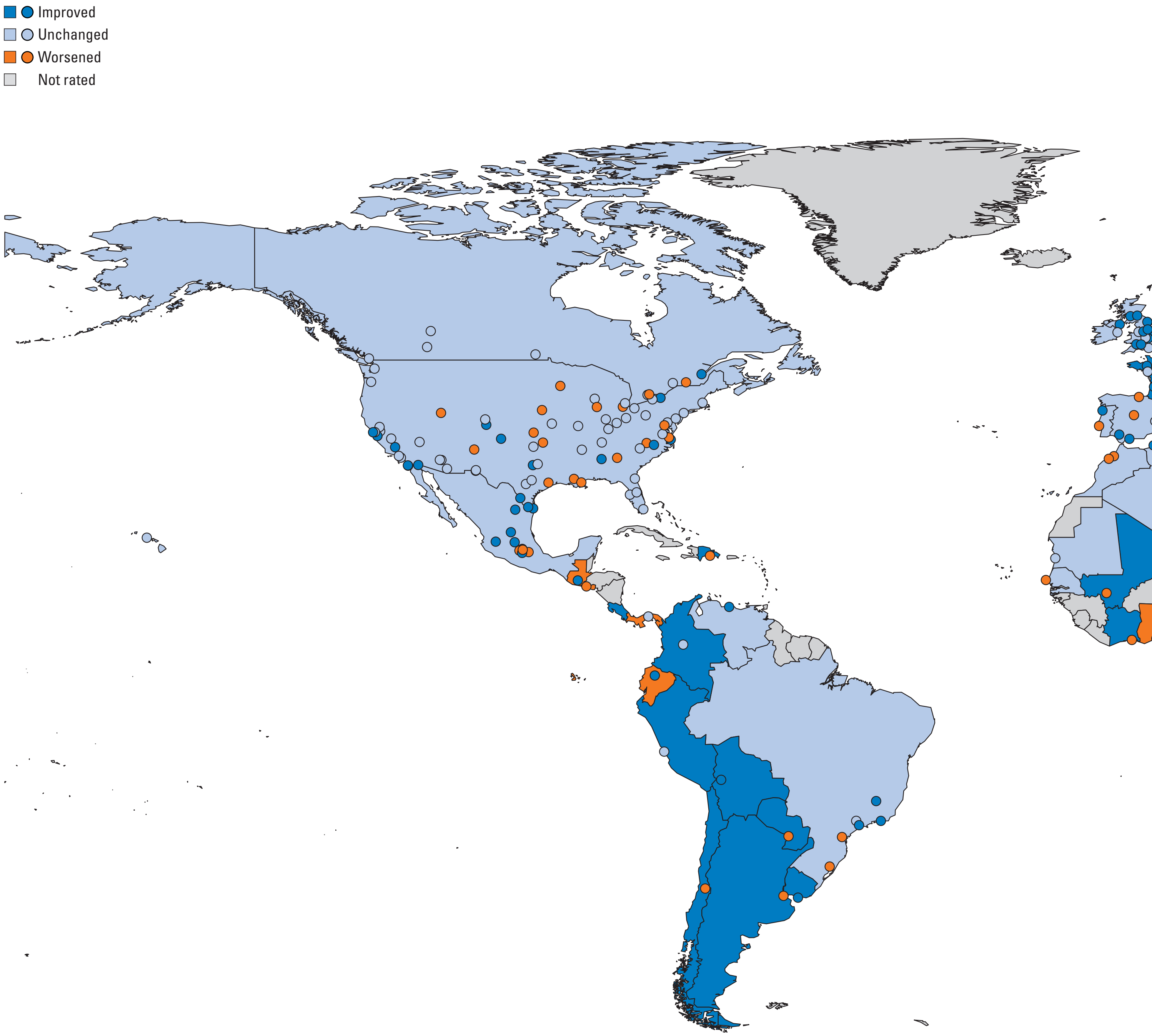
However, the negative effects of any possible decrease in export demand or slowing economic growth are not expected to be substantial enough to weaken the demand for logistic properties, which at worst is expected to level off in the future.
Interestingly, a relatively high share of newly rented space has been owner occupied. This is in part attributable to local retailers starting to restructure their logistic networks. Meanwhile, investors remain willing to pay higher prices for new-build properties with attractive tenants.

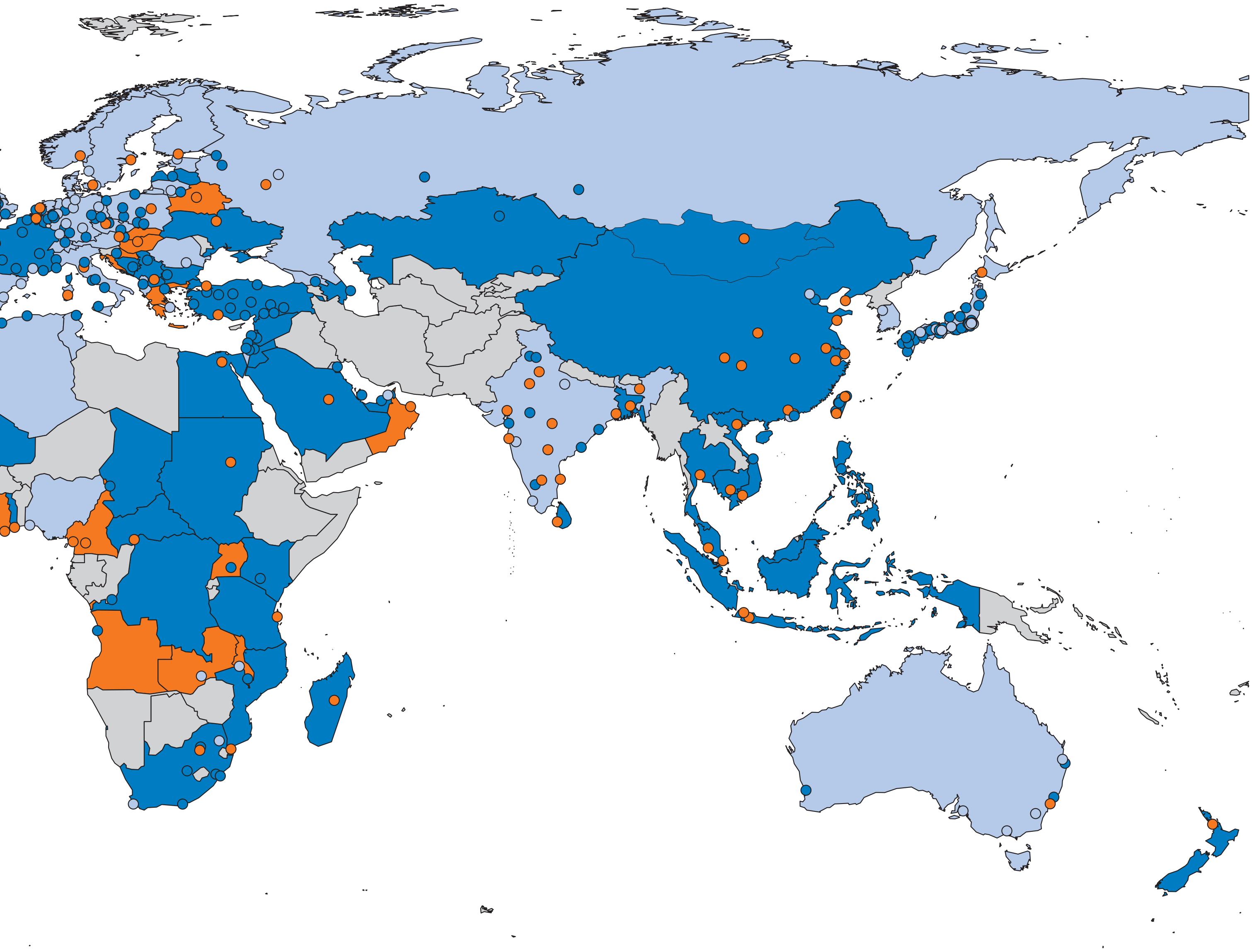
Goods transport: percentage change to previous year and forecast



	Stock (m², 2009)	Land price (EUR/m², 2010, Q2)	Average rent (2010, Q2)	Prime rent (2010, Q2)	Prime yield (2010, Q2)
Hamburg	2,650,000 ↗	100 →	3.8 ↘	5.2 ↘	7.5% ↘
Frankfurt	2,300,000 ↘	280 →	4.3 ↘	5.9 ↘	6.9% ↘
Rhine/Ruhr	2,700,000 →	90 →	3.4 →	7.5 →	6.9% →
Berlin	2,150,000 ↗	95 →	3.8 ↘	6.0 ↘	7.5% ↘
Munich	1,400,000 ↗	350 →	5.3 ↘	6.5 ↘	7.5% ↘
Dusseldorf	970,000 ↗	185 ↗	4.3 ↗	5.6 ↘	7.2% ↗

Winners and losers in the Wüest & Partner international risk index





Slightly reduced risks in the real estate metropoles

Rating as risk measurement for institutional investors

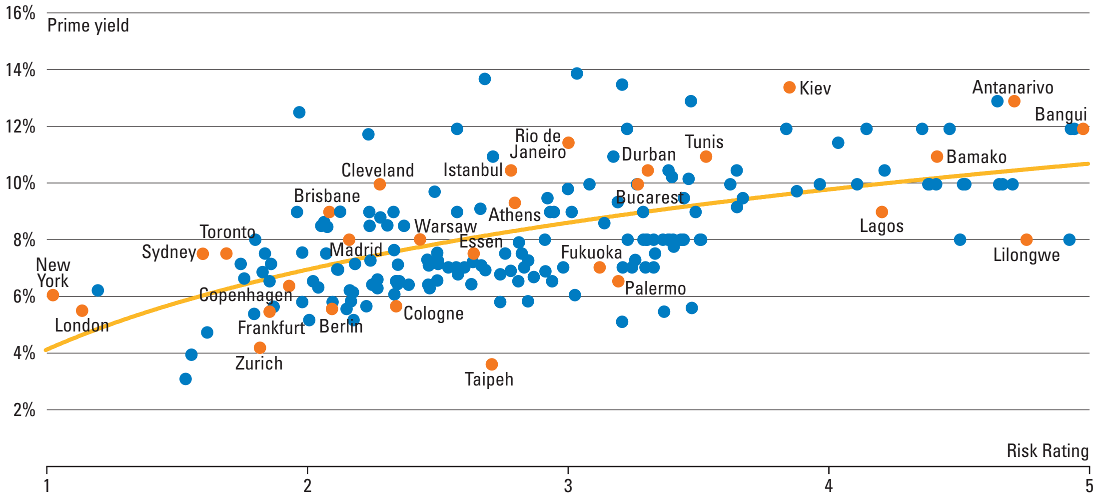
Wüest & Partner produces a city rating for 400 worldwide cities. In addition, a separate country rating is also provided as an integral part of this study. These ratings reflect the structural risk of a given location for real estate investments. In comparison to previous years, the most recent risk rating of a large number of metropoles showed improved results (196 from 401 improving, 105 showing a worse result and the remainder stable). And the same picture can also be observed on a country level.
The reasons for this improvement are two-fold: On the one hand the low yields and relatively high inflation rates of the boom years are no longer evident and on the other hand the negative effects of the financial crisis have started to ease in a number of countries. Overall, the weighted risk index for all metropoles decreased by 0.4 points and the weighted index for all countries decreased by 0.8 points. Unsurprisingly, the countries with an increasing risk index are for example Greece and Hungary, whereas Germany, the UK and many Asian countries show a lower risk profile. On a city level Lisbon and Madrid for example show negative results whereas Dusseldorf or Stuttgart, and also B-locations like Leeds or Cattowice show improving results.

The Wüest & Partner risk rating for real estate metropoles worldwide combines 20 factors on a city and country level. These include demographic indicators, business conditions, real estate transparency, rents and other economic factors.
Wüest & Partner publishes factsheets providing general and real estate information for each rated location. This rating tool aims to help international investors to optimise their asset allocation from a risk and return perspective. Furthermore, it provides users with the possibility of analysing extreme scenarios. For example, such as if London were to lose its status as a major financial centre. More information is available upon request from the Wüest & Partner staff.

A broad picture in the risk/return-profile

B-Locations with interesting risk/return profile

It is true to say that risk alone has no meaning and the same holds true for return. However, in general, higher return leads to higher risk and vice versa, a fact that can certainly also be observed in real estate markets. Combining the Wüest & Partner risk rating for real estate metropoles (1.0 = low risk, 5.0 = high risk) with corresponding prime office yields, the usual suspects amongst international investment markets, for instance New York or London, produce the expected risk/return-profile. Cities such as Sydney and Toronto are to be found in a second group, whereas Zurich seems to have quite a low yield for the same risk. Importantly, these results must also be analysed relative to inflation and interest rates. Indeed, in analyses using real yields (i.e. corrected for inflation), some of the high yield destinations no longer appear as attractive as first believed.
It is interesting to note that many B-locations in the top countries have a very efficient risk/return profile. This is due to the fact that many investors – and especially those from outside the country – prefer to invest in the larger locations, which in turn leads to higher prices and lower yields for these locations. Hence it can be a very interesting, and not always too risky, strategy to invest in so-called B-locations.



International prime rents

		Office (local currency/m² p. a.)	Office (EUR/m² p. a.)	Retail (local currency/m² p. a.)	Retail (EUR/m² p. a.)	Exchange Rates (EUR, September 2010)
Europe	Amsterdam	350 EUR ↗	330 ↗	2,300 EUR ↘	2,300 ↘	1.00
	* Budapest	240 EUR →	240 →	1,260 EUR →	1,260 →	1.00
	Brussels	280 EUR ↗	280 ↗	1,630 EUR →	1,630 →	1.00
	Copenhagen	1,780 DKK →	240 ↘	17,000 DKK ↗	2,280 ↘	0.13
	Frankfurt	410 EUR →	410 →	3,120 EUR →	3,120 →	1.00
	Helsinki	300 EUR →	300 →	1,800 EUR ↗	1,800 ↗	1.00
	London	770 GBP ↘	920 ↘	6,450 GBP ↗	7,730 ↗	1.20
	Madrid	350 EUR →	350 →	2,400 EUR ↘	2,400 ↘	1.00
	* Moscow	620 EUR →	620 →	2,890 EUR ↘	2,890 ↘	1.00
	Oslo	3,040 NOK ↗	390 ↗	14,000 NOK ↗	1,770 ↗	0.13
	Paris	730 EUR ↗	730 ↗	9,750 EUR ↗	9,750 ↗	1.00
	* Prague	250 EUR →	250 →	2,010 EUR ↗	2,010 ↗	1.00
	Rome	440 EUR ↗	440 ↗	3,750 EUR ↗	3,750 ↗	1.00
	Stockholm	3,820 SEK ↗	420 ↗	14,000 SEK ↗	1,520 ↗	0.11
	Vienna	270 EUR ↗	270 ↗	2,770 EUR ↗	2,770 ↗	1.00
	* Warsaw	270 EUR ↘	270 ↘	1,000 EUR ↗	1,000 ↗	1.00
	Zurich	950 CHF ↗	720 ↗	7,500 CHF ↗	5,690 ↗	0.76
America	** Buenos Aires	400 USD ↗	310 ↗	1020 USD ↗	790 ↗	0.77
	** Mexico City	350 USD ↗	270 ↗	590 USD ↘	450 ↘	0.77
	New York	680 USD ↘	520 ↘	18,030 USD ↗	13,880 ↗	0.77
	São Paulo	1,330 BRL ↗	600 ↗	1,750 BRL ↘	790 ↘	0.45
	Toronto	270 CAD →	200 →	3,230 CAD ↗	2,420 ↗	0.75
Asia	Hong Kong	9,670 HKD ↘	960 ↘	86,080 HKD ↘	8,530 ↘	0.10
	Mumbai	35,310 INR ↘	590 →	45,530 INR ↘	760 ↘	0.02
	Seoul	517,460 KRW ↗	340 ↗	4,814,560 KRW ↘	3,200 ↘	0.001
	Shanghai	2,830 CNY ↗	320 ↗	20,140 CHN ↗	2,300 ↗	0.11
	Singapore	850 SGD ↘	490 →	4,700 SGD →	2,710 ↗	0.58
	Tokyo	127,670 JPY ↗	1,150 ↗	544,500 JPY ↗	4,910 ↗	0.01
Australia	Sydney	640 AUD →	460 ↗	5,320 AUD ↗	3,840 ↗	0.72
Africa	Johannesburg	1170 ZAR ↗	130 ↗	5,070 ZAR ↗	550 ↗	0.11

* Most lease contracts denominated in Euro
** Most lease contracts denominated in USD

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Sources

This market survey is based on a broad internal data pool. It also draws on data provided by the following German and international institutions: Federal Statistical Office, Federal Office for Building and Regional Planning, Federal Ministry of Transport, Building and Urban Affairs, the GFK as well as the market reports of several brokers: CB Richard Ellis, Jones Lang LaSalle and Cushman & Wakefield. All total return data is supplied by IPD.

Notes

Rents: EUR per square metre usable area per month for the German data and for the international data in the local currency per square metre and year.
Yields: net initial yield (cash flow before capex/price).
Building activity: new-build residential rental properties (last 12 months) as a share of total stock.
Arrows indicate the year-on-year change (throughout the whole document).
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