Press release

The German real estate market: current topics and outlook for 2023

Frankfurt/Main, 12 December 2022 – At the turn of 2022/2023, Ulrich Höller, Managing Partner at ABG Real Estate Group, comments on current topics and issues in the real estate sector and gives an outlook for the year ahead.

1. Market update and assessment of rental and investment markets 2022/2023

Ulrich Höller on the big picture of 2022: "In 2022, the German commercial real estate market was defined by four central developments that put an end to the long-standing and unbroken economic upswing: firstly, there was the **interest rate turnaround** that brought significantly increasing financing costs. Secondly, the highest **levels of inflation** in decades, with **very high energy prices and costs of materials**, led to a considerable increase in building costs. However, due to the high number of halted projects and the corresponding drop in demand, there are already signs of improvement here. Thirdly, there was (and still is) a glaring **shortage of skilled workers**, and finally the new **reticence of many domestic and foreign investors**, for whom Germany has temporarily lost its attractiveness. As a result, the German real estate market has slowed markedly: the number of requested and granted building permits decreased by almost 10 per cent. A whole series of real estate projects were put on hold or delayed. Especially in the second half of 2022, transaction volumes decreased sharply, not least due to the investors taking a cautious or very selective approach. While volumes reached around €20 billion in the first quarter of 2022, estimates for the fourth quarter are only around €6 billion."

Ulrich Höller on the expectations for 2023: "We can see a number of signals that might indicate a waning in the momentum of inflation, interest rates, energy as well as material and construction costs. However, we do not expect a sustainable trend reversal before 2024, by which time the economy should also be picking up speed again."

Ulrich Höller on the development of rental prices: "Existing rents will increase for two main reasons: rents for commercial real estate are usually index-linked. Taking into account the high inflation rates, this means that rents will increase accordingly. At the same time, the reduced number of development projects will increase the demand for existing properties, therefore putting further upwards pressure on rents. In particular, rents for objects in sought-after locations as well as for high-quality and energy-efficient properties will increase significantly because supply will not be able to meet demand in the foreseeable future. The so-called global war for talent, in which the working environment has become a key competitive factor, further adds to this. If you are to perform well, you want to work in an attractive environment – in addition to a comfortable infrastructure, this also includes options for communication with space for individual personal meetings. Companies or employers are investing heavily in order to motivate employees to be present in the office in order to promote internal communication and creativity. After all, the trend of working from home as a hybrid form of working – which smartly combines presence and absence in the traditional office – reduces the need for space in total, but it also increases focus on the requirements for top office space with the aforementioned characteristics."

Ulrich Höller on the purchase price development for office and business properties: "We have already seen an adjustment of purchase prices for commercial real estate – with substantial discounts compared to the peak in the second half of 2021, of up to 20 per cent depending on the quality and location of the property. The very top properties are most resilient to this trend. Residential real estate sales have also slowed significantly and become more difficult: potential buyers are unsettled and largely inactive due to the market and financing developments."

Ulrich Höller on the future behaviour of real estate investors: "The fact is that the majority of institutional investors are currently holding back on investments in real estate. However, the development of interest rate levels points to an easing of the situation. For the second quarter of 2023, we therefore expect the market and commitments to pick up again. At that point, Germany will come back into focus as an investment location – not so much as a safe haven, but because the lower entry level and the strong dollar will offer attractive yield opportunities. Moreover, opportunistic investors, especially from the Anglo-Saxon countries, will reposition themselves in view of the expected market shakeout. In this context, they will also focus their considerations on the German market. This development can already be observed today."

2. Current trends and developments

Ulrich Höller on the shortage of skilled workers: "The shortage of skilled workers has turned into a serious business risk in the construction industry as well. At the beginning of 2022, in a survey by the Association of German Chambers of Commerce and Industry (*Deutscher Industrie- und Handelskammertag* – "DIHK"), 78 per cent of construction companies identified the shortage of skilled workers as the main risk to their own economic development. In 2010, by contrast, it was only 21 per cent. Labour costs have always been very important in the personnel-intensive construction industry. Here, only changes in the legal framework can produce relief: Germany urgently needs an efficient and targeted immigration law that provides the economy with significantly more qualified and motivated workers who want to learn and prove themselves."

Ulrich Höller on the ESG topic: "The number one subject of discussion in 2021 was the implementation of ESG requirements. Even though it was pushed into the background in 2022, this will return to be the prevailing topic in the future. The issue of climate protection, decarbonisation and the required reduction of the CO_2 footprint presents us with dramatically growing challenges around the globe. This is particularly true for the real estate sector, which accounts for almost 40 per cent of CO_2 emissions worldwide. We will only be able to meet this challenge if we really move all levers at our disposal to address the issue seriously and with conviction. This also holds true for investors, especially as ESG suitability currently still means lower returns, and it remains to be seen who is willing to take this route under the present challenging conditions. Moreover, there will be a greater emphasis of the S and the G – the social and governance components. I think the real estate industry still has a lot of work to do in this respect, and there are significant opportunities for it to position itself."

Ulrich Höller on portfolio allocations to real estate: "Most investors have continuously increased their portfolio allocation to real estate over recent years. Of course, there has been a slowdown now. Some investors initially halted their net acquisitions in response to this, also because bonds have become more attractive for them again. And yet, we do not see a sustained exodus of capital investments from the real estate asset class, which has gained dramatically in importance over the last decade, has become significantly more professional, and will thus remain a long-term component of portfolios."

Ulrich Höller on the outlook for project developments: "The framework conditions for **new project developments** are worsening, at least temporarily. It will become increasingly difficult to structure both equity as well as loan financing, and their costs have already increased markedly. The market will separate the wheat from the chaff: renowned and successful players with years of experience will hold up well and reliably receive funding, while opportunistic participants in particular will fall victim to a healthy consolidation process. But even **current project developments** cannot escape the changed framework conditions: many ongoing projects have to be re-evaluated, which may lead to price corrections. Mezzanine capital is being looked at more critically; some project developments will certainly have to be restructured in terms of capital and project structure. Certain projects can no longer be profitable and will have to be terminated with a loss. In contrast, projects with good locations, top equipment and high design flexibility will survive; they might even benefit from declining supply."

3. Update on ABG

Ulrich Höller on the development of ABG Real Estate Group: "Despite the very difficult market environment, we at ABG Real Estate Group have been able to expand our business as planned, as we focused exclusively on top-segment projects that are subject to less volatility than the market as a whole. The Group has a total of €3.5 billion in assets under management, including eleven large-scale projects in Germany's top locations that are currently under construction and proceeding according to plan. In 2022 alone, we added four projects to our portfolio in the investment business: Sky (Eschborn, near Frankfurt/Main), the Kerpen Logistics Centre (Kerpen), Palais am Roßmarkt (Frankfurt/Main) and the VTG Center (Hamburg), with a total investment volume of €455 million. In the same year, we sold VOLTAIR in Berlin almost fully let (total investment volume of around €460 million). We were also able to show an exceptional performance and a large market share in lettings, with a total of around 90,000 sqm of prime space spread across Germany's major cities. Looking ahead, we are monitoring market developments very closely, as we expect the upcoming shakeout or realignment of the market to offer attractive entry opportunities in the next few years. With this in mind, this year we have laid the groundwork for being able to invest in 2023/2024 and exploit attractive opportunities."

About ABG Real Estate Group:

ABG Real Estate Group, founded in Munich in 1967, looks back on a success story spanning more than 55 years. With its ABG Development, ABG Immobilienmanagement and ABG Capital business lines, the Group is a one-stop shop covering the entire real estate cycle – from project development and construction management to renting, financing and investment management. ABG's focus is firmly on Germany, with offices in Hamburg, Frankfurt am Main, Berlin, Cologne and Munich. With more than 80 staff, it plans and implements mainly commercial properties, but also residential projects and entire urban districts or quarters. Assets under management currently amount to more than €3.5 billion. ABG's reference sites comprise renowned properties such as the Skyper skyscraper in Frankfurt am Main, the Ericus-Contor/SPIEGEL publishing house in Hamburg, the Living Isar residential project in Munich, the landmark VoltAir building in Berlin, and the combined residential and office building at Pariser Platz in Berlin. Current ABG projects include the new Deutschlandhaus in Hamburg, the landmark VoltAir building in Berlin, Yorcks in Dusseldorf, the Central Parx building complex in the centre of Frankfurt am Main as well as other project developments in Munich and Cologne.

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