5% STUDY 2018 – WHERE IT STILL PAYS TO INVEST

Residential properties offer hardly any protection from inflation

With the valued support of the BEITEN BURKHARDT law firm and HIH Real Estate GmbH, bulwiengesa has examined the yield potential on the German real estate market for the fourth time. The 5% study, which is being released on 6 September 2018, examines markets in terms of yield.

The results in brief

- **Residential property investments offer hardly any protection from inflation**
- **A office markets: many slip below 3%**
- **Yields fall significantly again – only shopping centres post increase**
- **High yields now only in niche markets**

Berlin/Frankfurt, 6 September 2018 – Compared to the previous year, yields (IRR)[1] have fallen significantly again in all asset classes – except for shopping centres. This is one of the key findings of the fourth 5% study. “The statement from last year still applies: yield-focussed investors have to switch to niche markets,” says Sven Carstensen, manager of bulwiengesa’s Frankfurt branch and author of the fourth 5% study. These niche markets may include business properties or offices in D cities, for example.

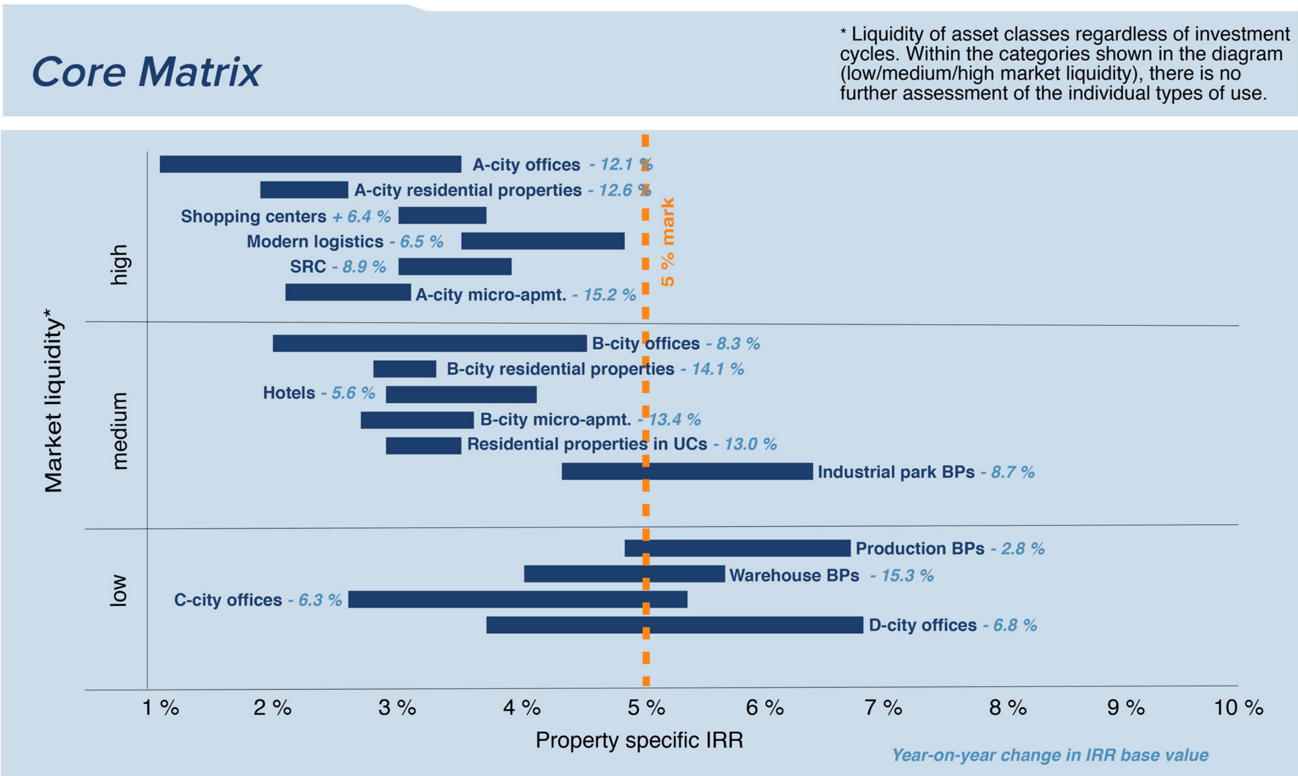
Residential properties offer hardly any capital preservation anymore

Prices for residential properties in Germany’s major cities have once again increased. The attainable yield for core properties in the A cities is between 1.9% and 2.6%. This year, the yield level for residential properties in B markets also slipped below the 3% mark for the first time and is now between 2.8% and 3.3%.

“The further decrease in yields shows that many investors are finding it increasingly difficult to achieve their minimum goal of protection from inflation,” says Sven Carstensen. Especially since the inflation rate is also rising again, most recently to around 2.0%.

The attainable IRR in university cities, which are in demand among investors, has also fallen by 13% to a current level of 3.2%. Overall, bulwiengesa expects that the tense situation on the housing markets will continue and that the current price level will also remain unchanged, at least in the major cities. However, it cannot be ruled that lower-quality locations and properties may need to be repriced if the market cools.

1 IRR = internal rate of return. This figure is used to estimate the profitability of potential investments. A holding period of ten years is assumed.



Even smaller office markets gradually being scoured

Even in the major office markets, it is almost impossible to generate decent yields anymore. Due to the extremely long-lasting boom, demand for office space is at a very high level, especially in the A cities, and the majority of the other markets have also been developing dynamically. This high demand is coming up against a limited supply due to the relatively low level of construction activity in recent years. Office properties have become more expensive, causing the IRR base value in the A office markets to fall by around another 12% to a level of 2.9%. The other office markets are also under yield pressure still. With an IRR of 3.5%, the B cities are currently at the level recorded by the A cities in 2015.

“Yield-focussed investors looking for stable cash flows in the office sector have to switch to smaller markets,” says Carstensen. Although the yields here have also decreased, they are still at 4.3% for C cities and 5.5% for D cities. However, in some cases there are only a small number of risk-appropriate investment properties here. Moreover, the C and D markets certainly cannot all be lumped together. The yields in D cities, for example, vary significantly between 4.6% in Passau and 7.3% in Suhl. A detailed analysis is essential.

Profitable but risky: non-core office properties

Non-core office properties do not come into question for most investors, even though they offer considerably higher yields. In the office markets of the A cities, they are generally to be found in peripheral locations. These properties generally have management deficiencies (e.g. vacant space) and unstable letting structures. IRRs of up to 8.6% can be generated here. But even in the non-core segment, properties are difficult to find in the A cities, and on top of this the economic risk is considerably higher. The highest yields for non-core investors of up to 12.3% can be expected in smaller D-city office markets.

Uncertainty in retail

Many investors are sceptical as to whether an investment in the retail segment is sustainable. They are concerned about how bricks-and-mortar retail will develop in relation to the rapidly growing online retail sector. And in actual fact, annual growth rates for home shopping (online retail and traditional mail-order retail) are several times higher than those for bricks-and-mortar retail. This scepticism is also reflected in the yield figures. Prices for shopping centres, which many investors currently think are heading south, actually remain largely constant. The IRR has increased slightly due to somewhat higher inflation expectations and is now at a level of 3.0% to 3.7%. Specialist stores are still highly sought-after as investment targets. They are seen as being less at risk from online retail.

About the 5% study

Since 2015, the 5% study has been offering a compact overview of the market and providing a new approach for describing property markets. The study uses a dynamic model to determine the probable internal rate of return (IRR) on an investment, assuming a holding period of ten years. This makes it possible to calculate annual returns for investments and compare the yield prospects of different asset classes. The internal rate of return method differs from the static yield assessments that are typical on the market and is used by many investors.

Real estate investments are classified as core or non-core assets based on the criteria of cash flow reliability and liquidity.

This 5% study examines the performance expectations in the main asset classes that currently dominate the German investment market:

- Residential
- Office
- Shopping centres and specialist retail centres
- Hotels
- Logistics properties
- Micro-apartments
- Business properties

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About bulwiengesa

bulwiengesa is one of the major, independent real estate industry analysis companies in continental Europe. For over 30 years, bulwiengesa has supported its partners and clients in questions of real estate, including with location and market analyses, sound data services, strategic advice and bespoke surveys, analyses and valuations. Meaningful individual data, time series, forecasts and transaction data are supplied by the information system RIWIS online. Users of the data from bulwiengesa include the Deutsche Bundesbank for the ECB, BIS and OECD.

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