Trend barometer on the real estate investment market 2023

Ernst & Young Real Estate GmbH

January 2023

EY

Building a better working world

Agenda

> "The real estate market has been turned on its head. The adjustment process has begun but will take some time."

Florian Schwalm
Managing Partner

Editorial

Dear readers,

You are receiving our 17th trend barometer on the real estate investment market in turbulent times. The figures speak for themselves: after many years of setting new records, transaction volumes are now headed downward.

While some observers believe that the worst could soon be over, this may be too optimistic. The real estate markets and their players will need time to adapt to a changing environment – and there is certainly no lack of change at present. A war, an energy crisis, inflation and an interest rate turnaround are radically impacting the real estate market.

Prices are expected to fall across the entire spectrum of use types and locations and sellers and buyers are taking a step back. It remains to be seen when and at what level a new price structure will emerge. At the same time, real estate investments are no longer without alternatives, as they were in the low interest rate environment. It is not without reason that, for the first time in years, the survey respondents this year rated the interest rate development as the most relevant trend, ahead of demographic change, digitalization and climate change.

Nevertheless, climate change will likely remain a decisive driver in the long term. Upgrading the real estate portfolio to improve energy efficiency is an essential yet challenging process. Progress is suffering from a scarcity of materials and qualified personnel, exacerbated by rising financing costs and tenants already feeling the squeeze from high utility bills.

We are extremely grateful to all of those who have taken part in our survey. Your valuable input is greatly appreciated. We rely on our dialog with you about our market and our industry to provide us with the insights we need to (re)act, move forward and, with you, master the challenges ahead step by step.

We hope you enjoy reading this publication and look forward to continuing our conversation. Please feel free to contact us!

Florian Schwalm
Managing Partner

Paul von Drygalski MRICS
Director

1 In a nutshell

In a nutshell

1 Attractiveness

- Real estate investments in Germany are becoming less attractive

2 Investment volume

- Lower investment volume forecast for 2023

3 Transaction market

- Sharp rise in real estate in need of restructuring

4 Transaction obstacles

- Price expectation gap remains a major transaction obstacle

5 Market environment

- Despite the political will, new construction is slow

6 Purchase price development

- Price corrections in all segments

In a nutshell

7 Financing market

- Tighter financing conditions reflect a higher market risk

8 Investment focus

- Residential and office properties remain in high demand among buyers
- Berlin, Frankfurt and Munich are still the preferred markets

9 Megatrends

- Interest rate developments in the current market environment are the top megatrend

10 ESG

- Energy efficiency in buildings is being driven by rising energy prices

11 Top trend - residential

- Reversal of trend in living space per capita?

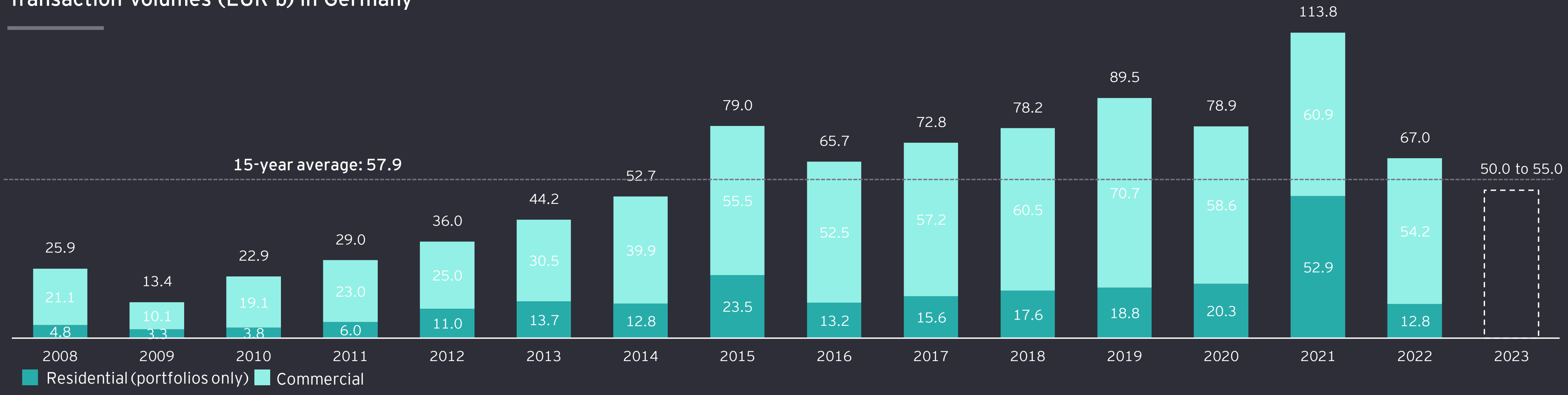
12 Top trend - office

- High energy costs have the potential to boost office attendance

2 Real estate transaction market

Transaction volumes over the past 15 years ...

Transaction volumes (EUR b) in Germany*



2021

- A new transaction volume record was set in the pandemic year 2021
- Vonovia's takeover of Deutsche Wohnen in the residential sector contributed substantially to this outcome

2022

- War, inflation and the interest rate turnaround have triggered a paradigm shift in the real estate market
- Mounting uncertainty among market participants is reflected in a declining transaction volume

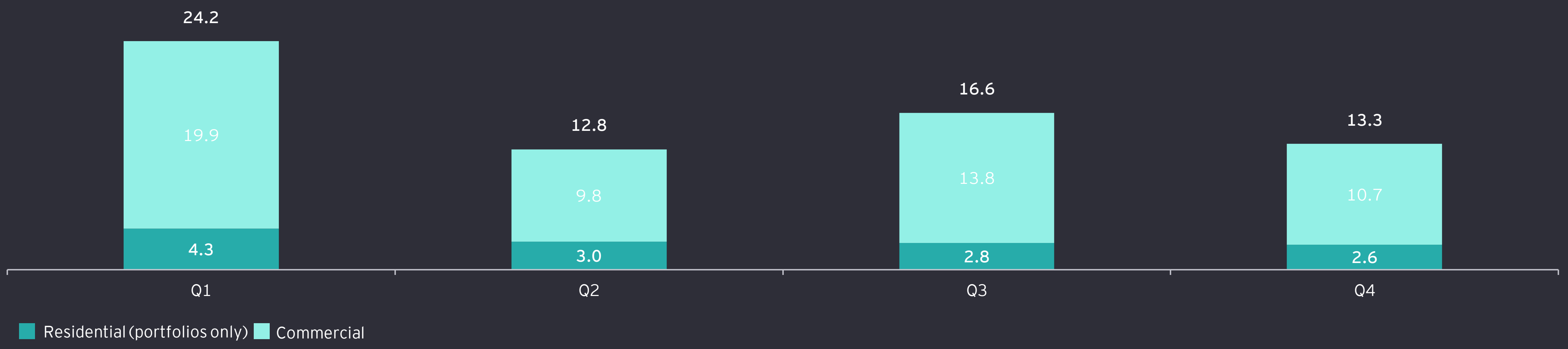
Outlook for 2023

- For 2023, we anticipate a level slightly below the 15-year average, which would mark a further decline compared to 2022
- In particular, the first two quarters will continue to be shaped by hesitancy and market restraint

*Published transactions only; source: EY research

… and in each quarter of 2022

Transaction volumes in 2022 (EUR b) in Germany*



Residential

- Q4 was lowest-revenue final quarter since 2012
- More activity from high-equity investors with long-term goals
- Moderate rise in initial yields observable

Commercial

- Q1 highest-revenue first quarter of a year on record
- Many investor groups very reserved due to the outbreak of war on 24 February 2022
- Rising initial yields for all use types observable

Development

- Total investment volume per quarter between EUR 12.8b and EUR 24.2b
- There was no year-end rally in Q4, in contrast to prior years
- In spite of an ample supply, relatively few portfolio transactions were notarized

*Published transactions only; source: EY research

The largest German commercial real estate transactions* …

Quarter	Sellers	Buyers	Target	Units	Price
Q1	Alstria Office REIT	Brookfield	Alstria acquisition (shareholding: 91.6%)	110	EUR 4,500m
Q3	Deutsche Euroshop	Oaktree, Cura Vermögensverwaltung	Acquisition of Deutsche Euroshop (shareholding: 64.3%)	21	EUR 1,400m
Q1	VIB Vermögen	DIC Asset	VIB acquisition (shareholding: 60.0%)	106	EUR 900m
Q1	Aermont Capital, Pecan Development	DWS, NPS	Marienturm in Frankfurt a. M.	1	EUR 830m
Q1	Deutsche Industrie REIT	CTP	DIR acquisition (shareholding: 98.1%)	73	EUR 800m
Q2	Oxford Properties, Madison International	Norges	Sony Center in Berlin (shareholding: 50%)	1	EUR 677m
Q1	Aroundtown	Apollo Global Management	"Alphabet" office property portfolio in top 7	13	EUR 500m
Q3	ABG Real Estate Group, Gädeke & Sons,	Norges, Swiss Life	Office complex "VoltAir" in Berlin	1	EUR 457m
Q3	Aggregate	Vivion Investment	Quartier Heidestraβe Berlin – construction phases QH Core and QH Spring	2	EUR 456m**
Q1	UBS Real Estate	Prologis	Logistics property portfolio, Germany-wide	11	EUR 450m

Seller groups (overall market)

- REOCs/REITs were the most active seller groups in 2022

Buyer groups (overall market)

- With a slightly smaller share of just under 55%, the market continues to be dominated by domestic German capital
- Real estate investment funds (special, public and private equity funds) have the highest transaction revenue on the buyer side

Transaction size (top deals)

- Only two transactions with a volume greater than EUR 1,000m
- Top deals are mainly shaped by acquisitions
- Single asset transactions with focus on the top 7, in particular on Berlin and Frankfurt

* Published transactions only; source: EY Research | ** Urban development scheme with commercial and residential spaces (commercial > residential)

EY

… and residential real estate transactions* in 2022

Quarter	Sellers	Buyers	Target	Units	Price
Q1	Adler Real Estate	KKR/Velero	Portfolio in medium-sized cities in eastern Germany	14,400	EUR 1,050m
Q4	S Immo	CPI Property Group	Acquisition of S IMMO, share of residential property	-	EUR 850m**
Q3	Catella	ZBI/Union Investment	"Erasmus" portfolio	4,000	n/a
Q4	Aggregate	Imfarr	Quartier Heidestrasse – Construction phases QH Colonnades, QH Straight and QH Crown South	-	EUR 488m***
Q4	Allianz	Heimstaden	Joint venture investment of 43.75%	3,100	EUR 243m
Q4	Brack Capital/Adler Real Estate	Tristan Capital Partners, Dr. Lübke & Kelber	Residential portfolio in Leipzig	3,000	EUR 240m
Q2	BaseCamp	Xior Student Housing	Student housing portfolio	1,100	EUR 220m
Q2	Not known	Pinebridge Benson Elliot, Surplus Equity Partners, Fundament Advisory	Portfolio in Berlin	1,000	n/a
Q2	Private owner	Deutsche Investment	"Saxony" portfolio	820	n/a
Q2	Not known	KKR/Velero	Residential portfolio in NRW	1,600	n/a

Seller groups (overall market)

- Project developers account for the largest sales volume in 2022
- For the first time, project developments/forward deals have ousted property portfolios as the highest-revenue type of sale

Buyer groups (overall market)

- At 5%, transaction revenue from REOCs/REITs is at an all-time low
- At just under 75%, German investors account for the largest portion of the transaction volume
- Investments in top 7 locations make up 50% of total revenue

Transaction size (top deals)

- Steep decline in deal volumes – only three transactions greater than EUR 500m
- Berlin remains the investment hotspot in the German real estate investment market

* Published transactions only; source: EY Research | ** Estimated on the basis of the Q3 results presentation of S Immo AG | *** Urban development scheme with commercial and residential spaces (commercial > residential)

3 About the study

About the study

The findings of the study are based on our survey (October 2022) of some 250 investors active on the German real estate market in recent years

The survey addressed the following:

- General assessment of the German real estate investment market in 2023 by active market players
- Real estate investment strategy with regard to developing the real estate market

The companies surveyed cover a representative cross-section of the German real estate investment market, including:

- Banks
- Real estate funds
- Real estate corporations/REITs
- Institutional investors
- Project developers
- Investment companies
- Opportunity/private equity funds (PE)
- Private/family offices
- Housing companies

In addition to choosing from a list of answers, participants had the option to submit a comment for each question.

4 Results of the trend barometer on the real estate investment market 2023

Assessment of the German transaction market by market players

2021

"The worldwide pandemic will result in a shift in target investment locations in 2021. Security will become an increasingly important factor."

"Germany will continue to fulfill its role as Europe's "safe haven" in 2021. Moreover, certain catch-up effects can be expected due to cautious investments in 2020."

"Demand for real estate with secure and long-term cash flows will increase."

2022*

"Germany remains one of the best locations worldwide in social, environmental and economic terms."

"After the pandemic abates, international investors will return to the German market in much greater numbers."

"Great uncertainty on the real estate market ahead of the entry into force of the EU taxonomy."

2023

"The huge change in the interest rate environment combined with a macroeconomic weakening have fundamentally transformed the market environment."

"In the face of geopolitical uncertainty and rising interest rates, people are averse to jumping aboard a sinking ship."

"2023 will be the year in which the market bottoms out. Only price corrections will allow trade to pick up again."

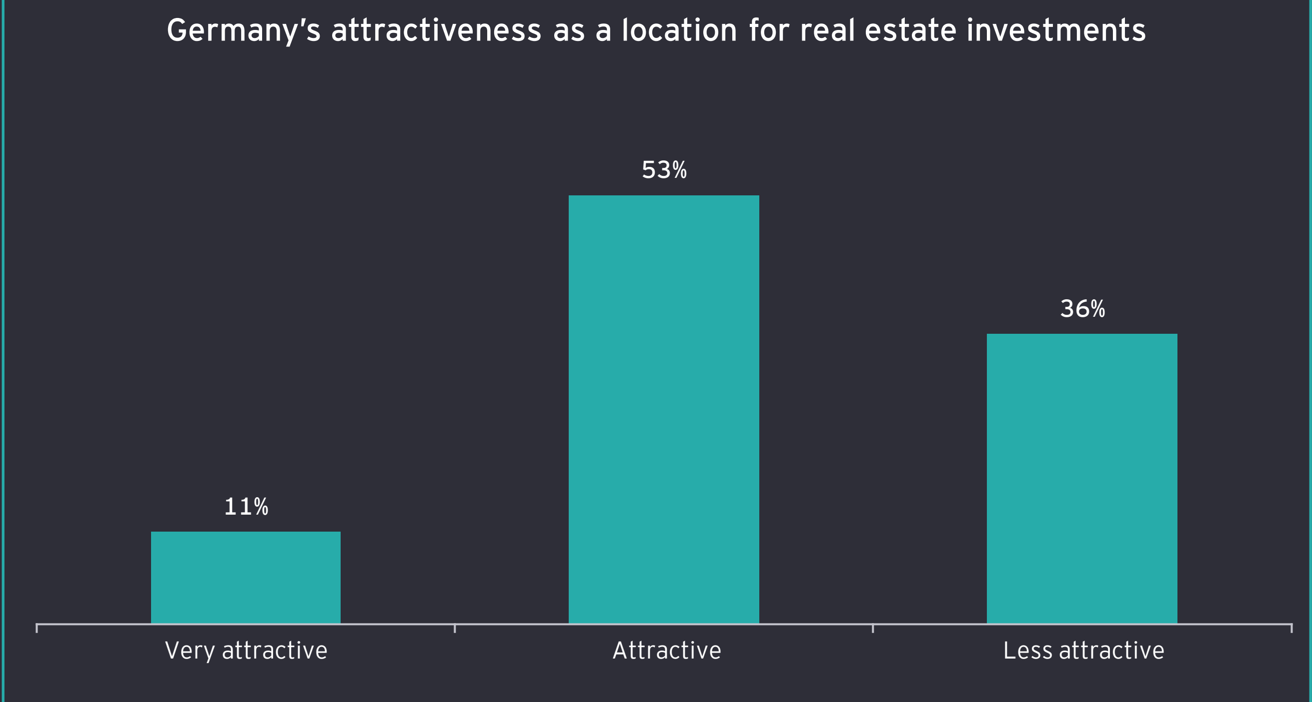
* Assessments of market participants from October 2021

Real estate investments in Germany are becoming less attractive

"How do you rate Germany's attractiveness as a location for real estate investments in 2023?"

Key statements

- In 2023 as well, around two thirds of the survey respondents view Germany as an "attractive" or "very attractive" location for real estate investments (64% vs. 96%).
- For 2023, more than half of the survey respondents continue to view real estate investments in Germany as "attractive" (53% vs. 52%).
- The percentage of participants who rate Germany as "less attractive" was considerably higher than in the prior year (36% vs. 4%).



Statements

- "There will be little change in the attractiveness of Germany in 2023 as a location for real estate investments."
- "General recession fears have curbed Germany's attractiveness for real estate investments."
- "The risks have risen considerably, but Germany (still) remains attractive compared to other markets."

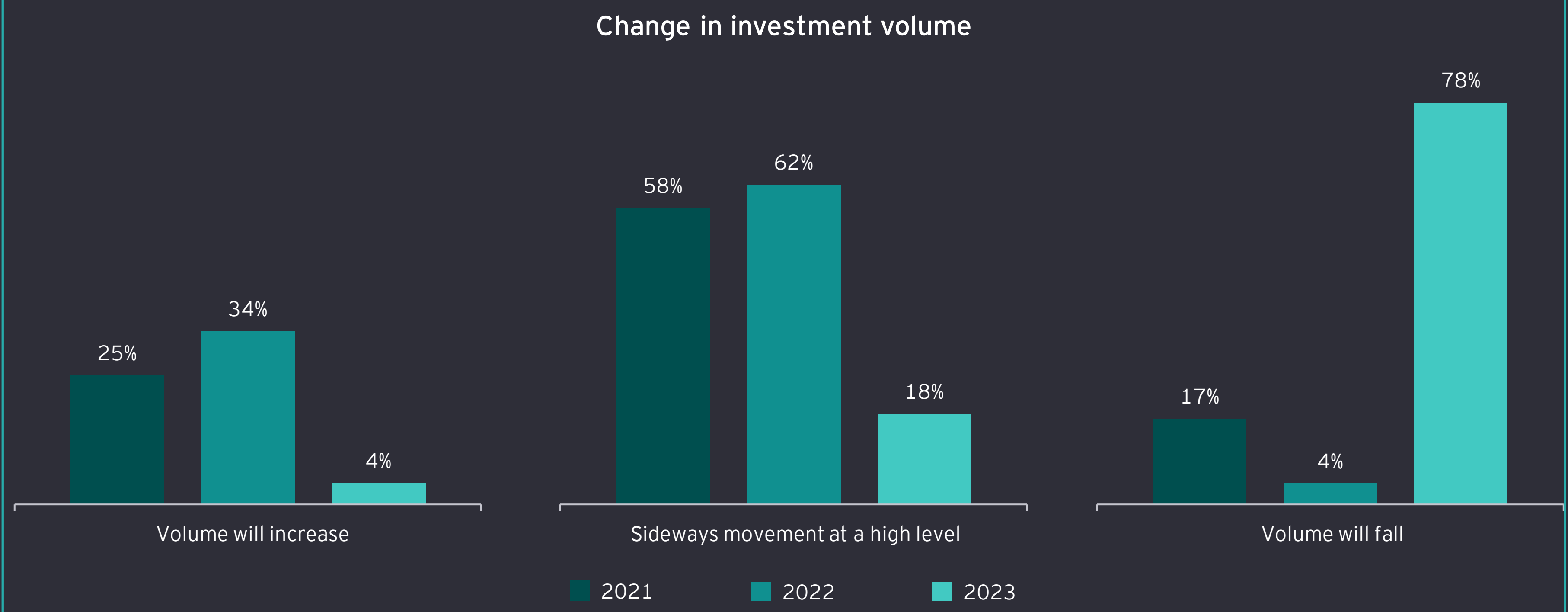
Comparison with the prior year (2023 vs. 2022)

Lower investment volume forecast for 2023

"How will the investment volume develop in Germany in 2023?"

Key statements

- Only a small number forecast a rising investment volume in the upcoming year (4%).
- More than three quarters of the survey respondents expect a decline in investment volume for 2023 (78%).
- The expectations of the survey respondents have shifted over the past three years from a rising to a declining investment volume.

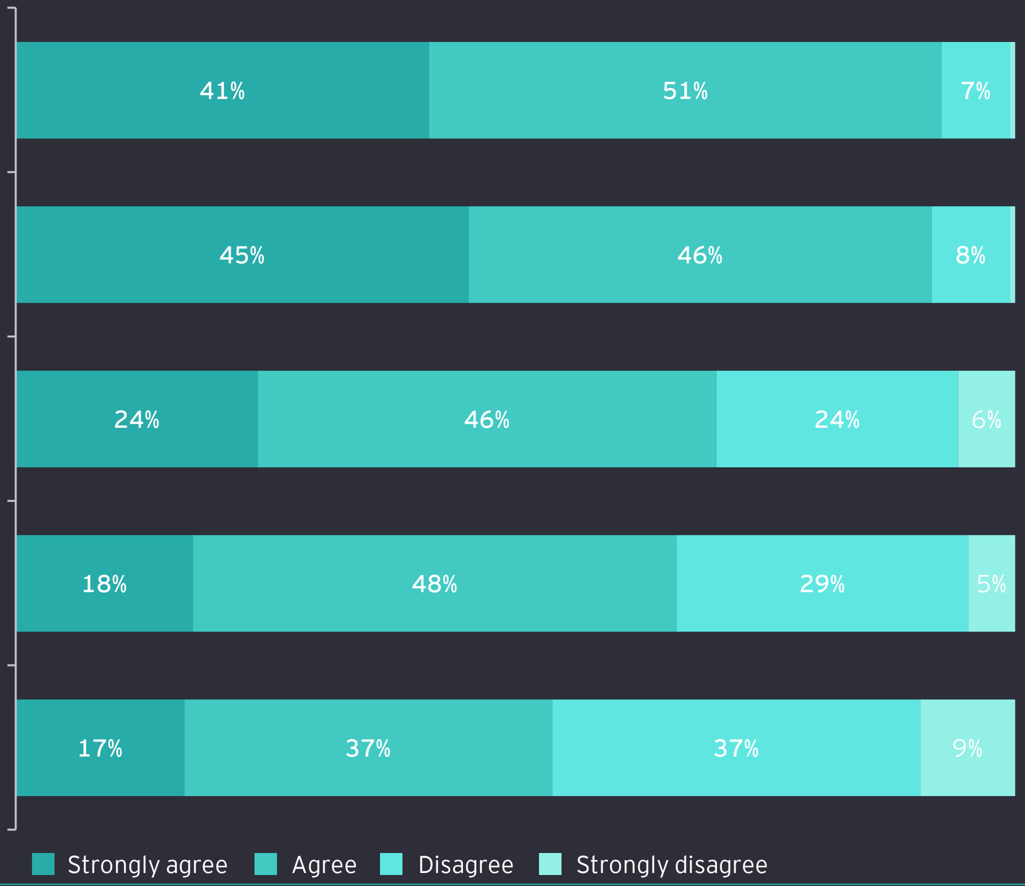


Considerable rise in real estate in need of restructuring

“Which of the following statements about the real estate transaction market do you agree with for 2023?”

Key statements

- The market participants are focusing increasingly on their core business (92%).
- The survey respondents forecast that 2023 will see a rise in properties in need of restructuring listed for sale (91%).
- Share deals have become more attractive as they allow good financing conditions to be taken over (70%).
- Around two thirds of the survey respondents assume that buyers and sellers will again reach an agreement on prices (66%).
- More than half of the survey respondents expect private housing companies to increasingly act as net sellers (54%).



“Persistent uncertainty in the market will lead to a further specialization of investment profiles.”

“In 2023, an increasing number of properties in need of restructuring will appear on the market (possible causes: refinancing, ESG requirements).”

“Share deals could become more attractive as they allow better financing conditions to be taken over (existing loan agreements).“

“Price expectations of sellers and buyers will converge again in 2023.”

“Private housing companies will sell more properties than they buy.“

Price expectation gap remains a major transaction obstacle

"What are the impediments in 2023 for a fast closing of real estate transactions?"*

Key statements

- The market participants regard the price expectation gap as a major hurdle to a quick conclusion of real estate transactions.
- Only a few of the survey respondents view ESG risks as an obstacle to transactions.
- Furthermore, the survey respondents view the following factors as impediments to transactions:
    - Instability of banks
    - Energy prices
    - Geopolitical uncertainties
    - More attractive alternative investment classes
    - Rising construction prices

Rank	Obstacle
1	Price expectation gap
2	Uncertain macroeconomic development (inflation, demand for space)
3	Uncertain financing conditions
4	Increasing risk awareness
5	ESG risks
6	Other reasons

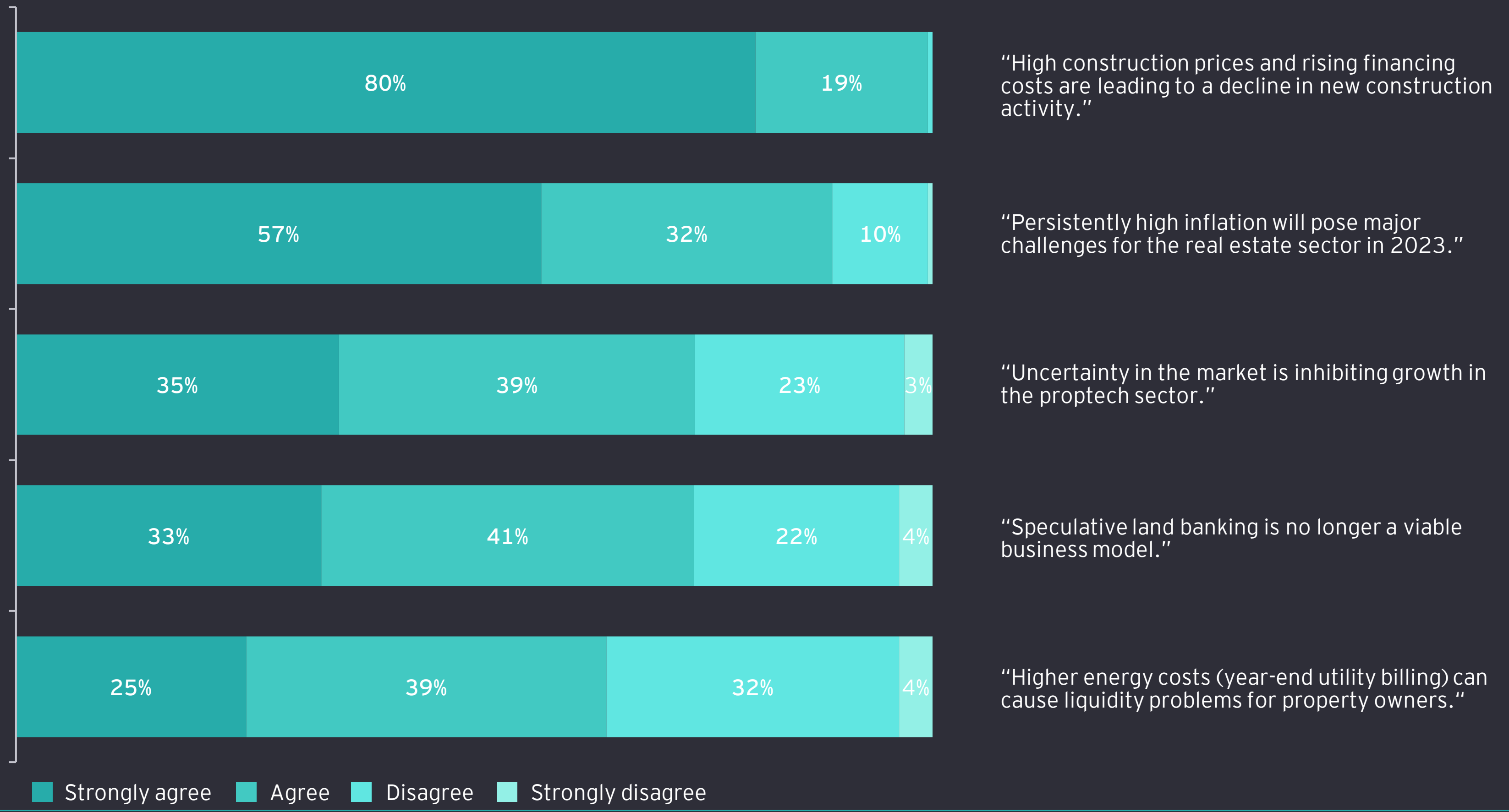
*Multiple answers possible

Despite the political will, new construction is slow

"Which of the following statements about the German real estate market do you agree with for 2023?"

Key statements

- More adverse general conditions are having a negative impact on new construction activities (99%).
- The survey respondents in 2023 expect to see high inflation rates and all they entail (89%).
- The proptech sector is suffering from the general economic situation (74%).
- The industry no longer views speculative land banking to be an effective business model (74%).
- The market participants assume that rising energy costs can cause liquidity problems for property owners (64%).

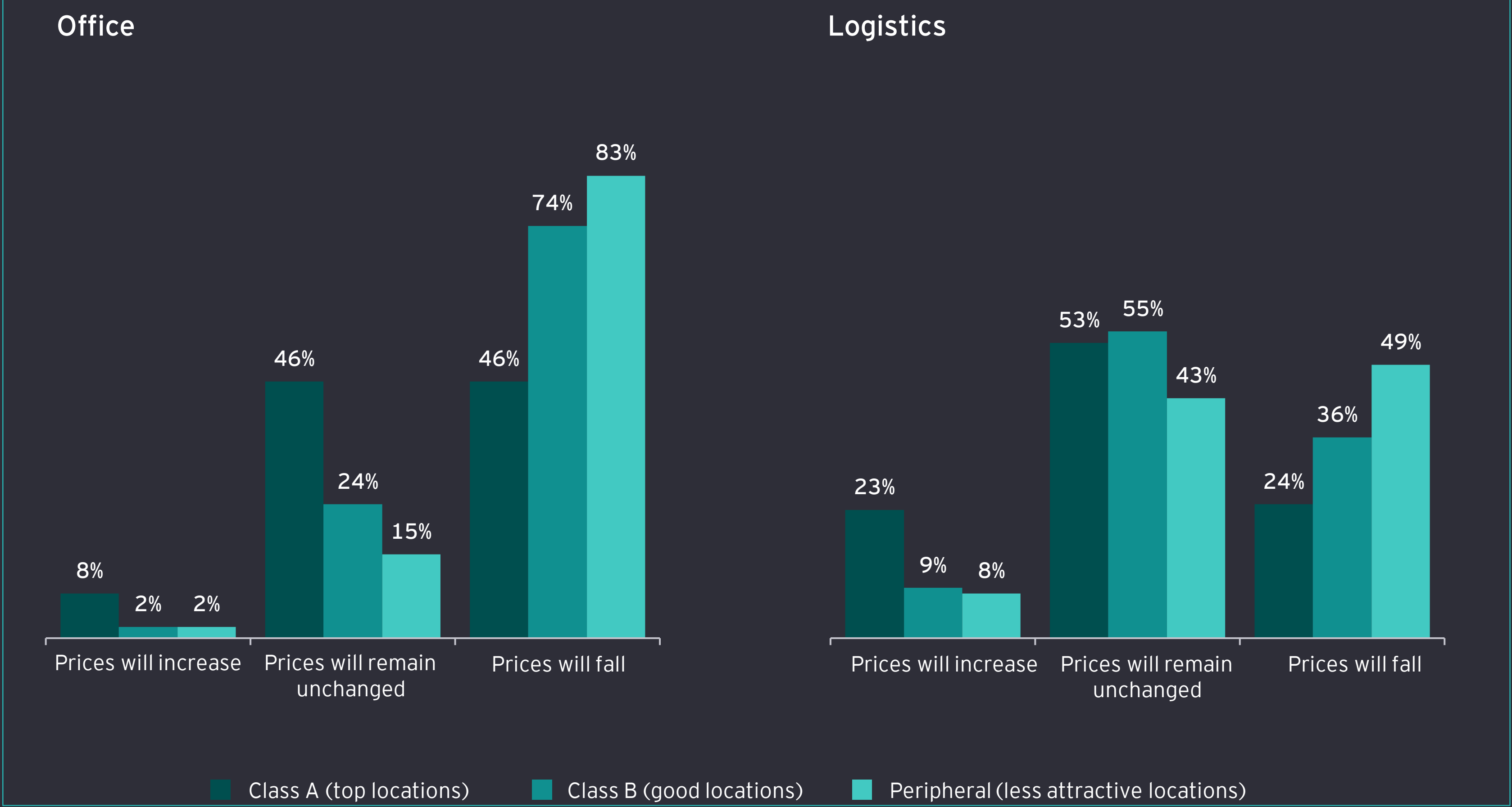


Price cuts expected in the office segment – logistics prices are steadier

"How do you expect purchase prices to develop in Germany in 2023 based on type of use and location?"

Key statements

- The industry forecasts falling office property prices across all locations
(Class A: 46% vs. 4%
Class B: 74% vs. 27%
Peripheral: 83% vs. 60%).
- Price expectations have dampened in particular in class A office locations – only 8% anticipate rising prices in 2023 (8% vs. 39%).
- In the logistics sector, the majority of the respondents anticipate a stable price level
(Class A: 53% vs. 22%
Class B: 55% vs. 33%
Peripheral: 43% vs. 53%).
- The majority expect prices for logistics properties in peripheral locations to remain stable or to decline.



Comparison with the prior year (2023 vs. 2022)

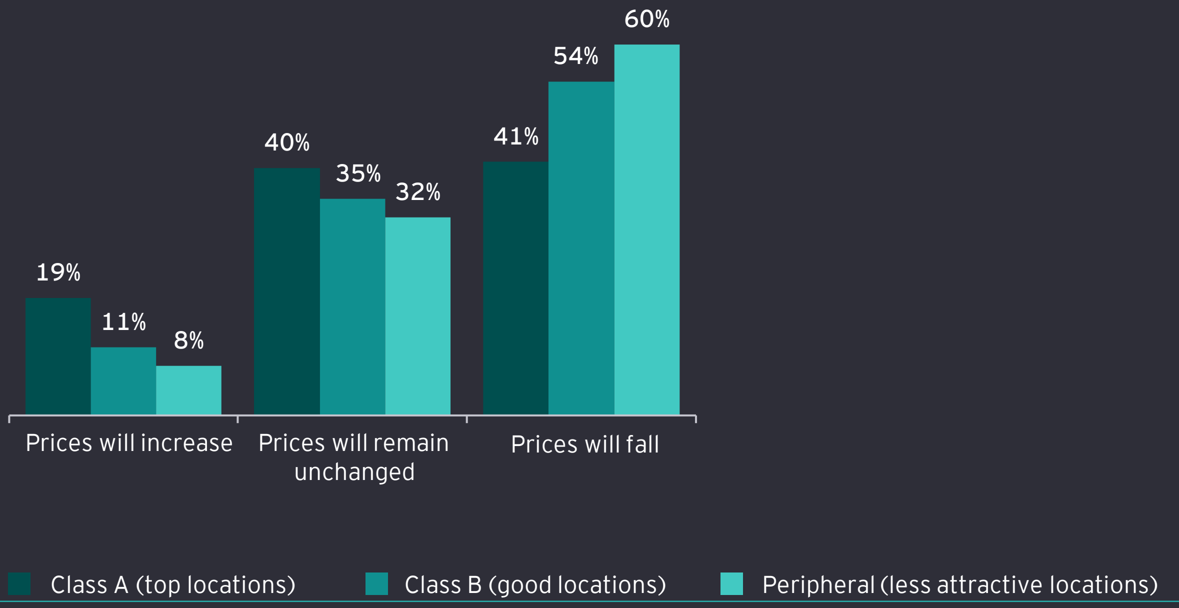
Market participants must brace for price corrections in the residential segment

"How do you expect purchase prices to develop in Germany in 2023 based on type of use and location?"

Key statements

- The majority of respondents expect prices for even premium residential real estate to remain unchanged or decline (81% vs. 20%).
- Outside of class A locations, predominantly declining prices are forecast for residential real estate
(Class B: 54% vs. 1%
Peripheral: 60% vs. 4%).
- As a result, the vast majority of survey respondents anticipate declining prices for residential real estate.

Residential



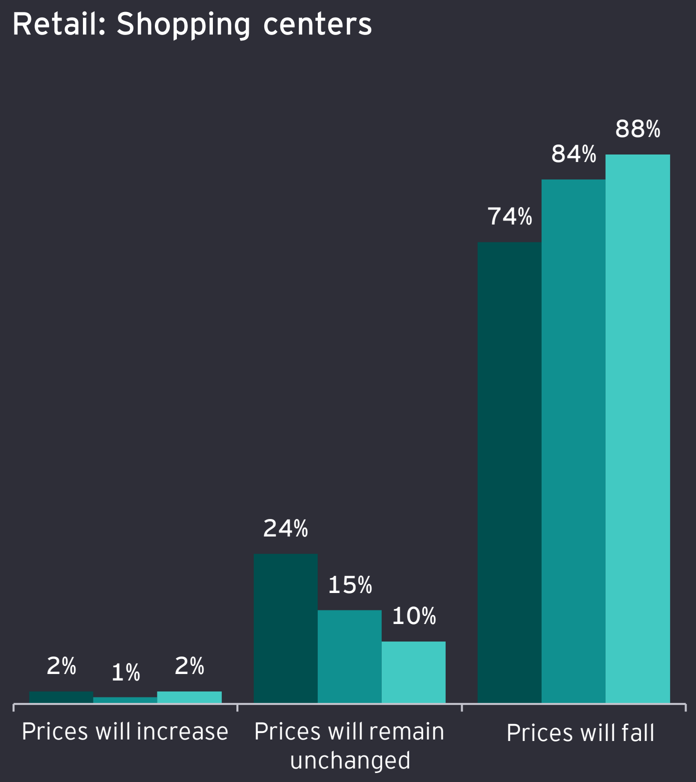
Comparison with the prior year (2023 vs. 2022)

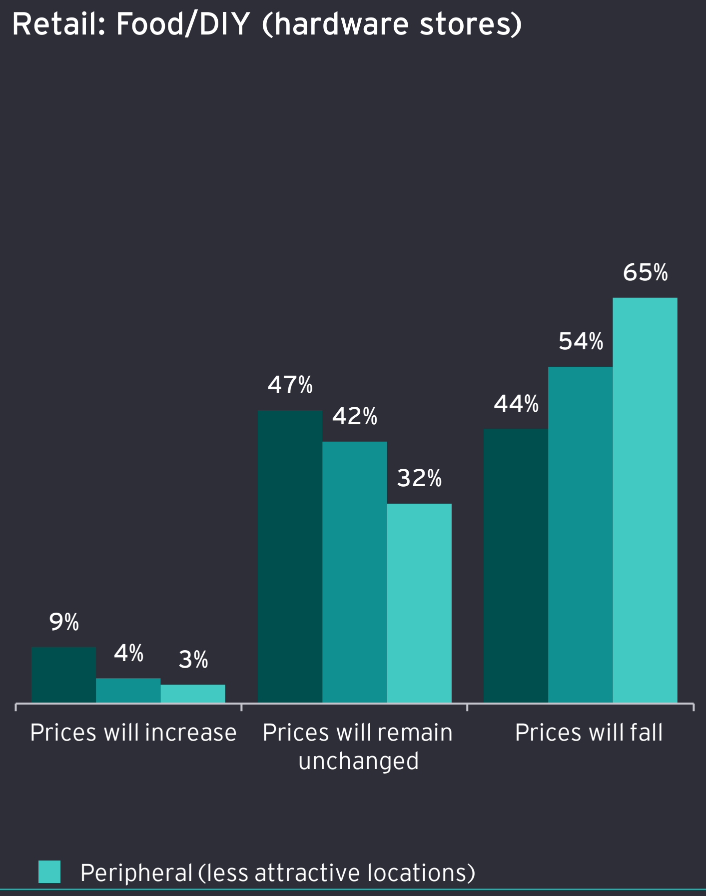
Shopping centers have come under the strongest price pressure

"How do you expect purchase prices to develop in Germany in 2023 based on type of use and location?"

Key statements

- The majority of those surveyed expect prices for shopping centers to fall across all locations.
- More than half of the survey respondents forecast stable or declining prices across locations for food/DIY real estate
  (Class A: 91% vs. 55%
  Class B: 96% vs. 70%
  Peripheral: 97% vs. 80%).
- Only some market participants anticipate price increases in the food/DIY segment
  (Class A: 9% vs. 45%
  Class B: 4% vs. 30%
  Peripheral: 3% vs. 20%).





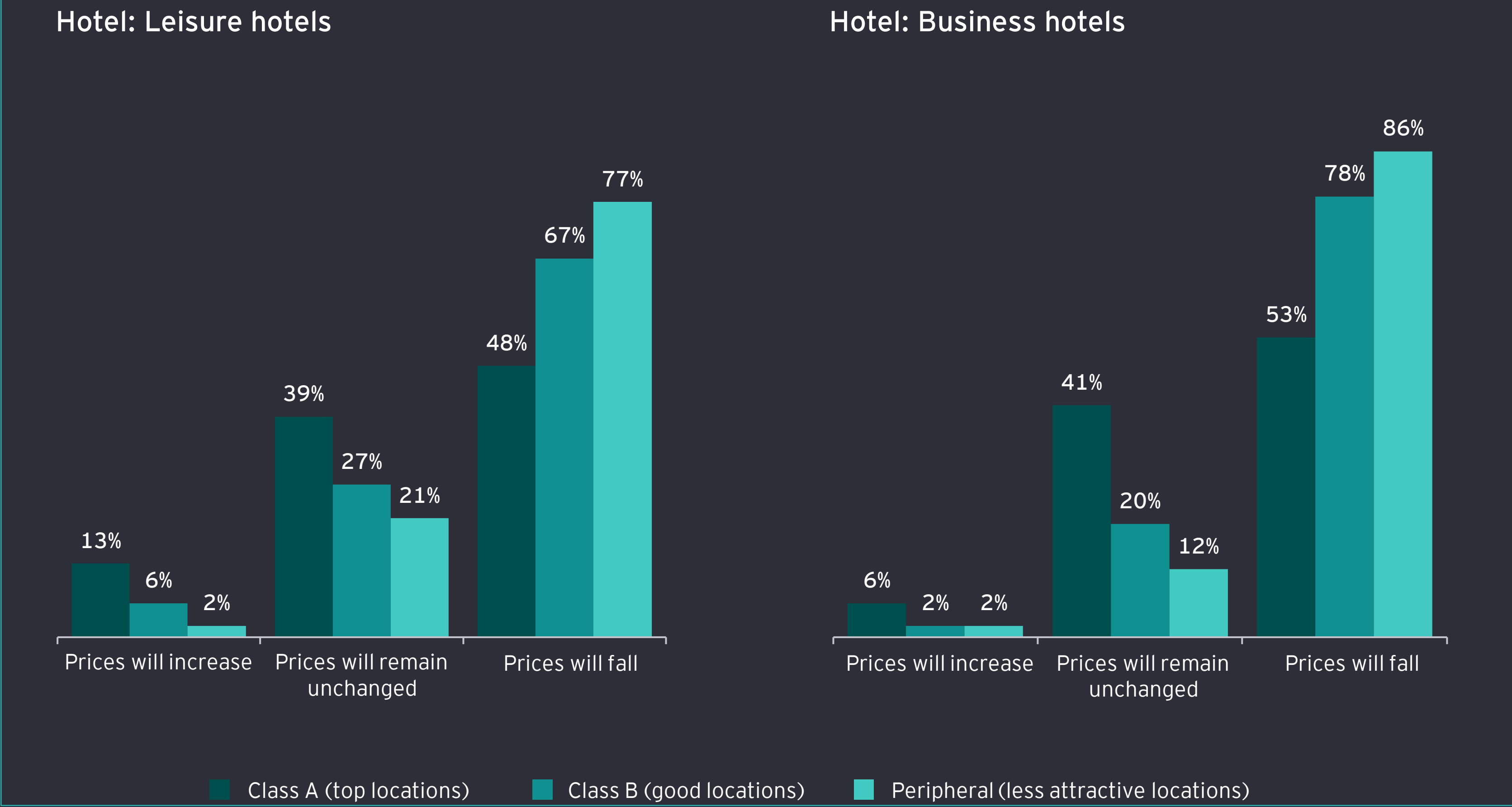
Comparison with the prior year (2023 vs. 2022)

Price expectations for leisure hotels now also plunging

"How do you expect purchase prices to develop in Germany in 2023 based on type of use and location?"

Key statements

- The industry expects to see declining prices for hotels across locations.
- In particular hotels outside of the top locations are subject to price corrections.
- The price outlook in the leisure hotel sector is somewhat more stable than in the business hotel sector.



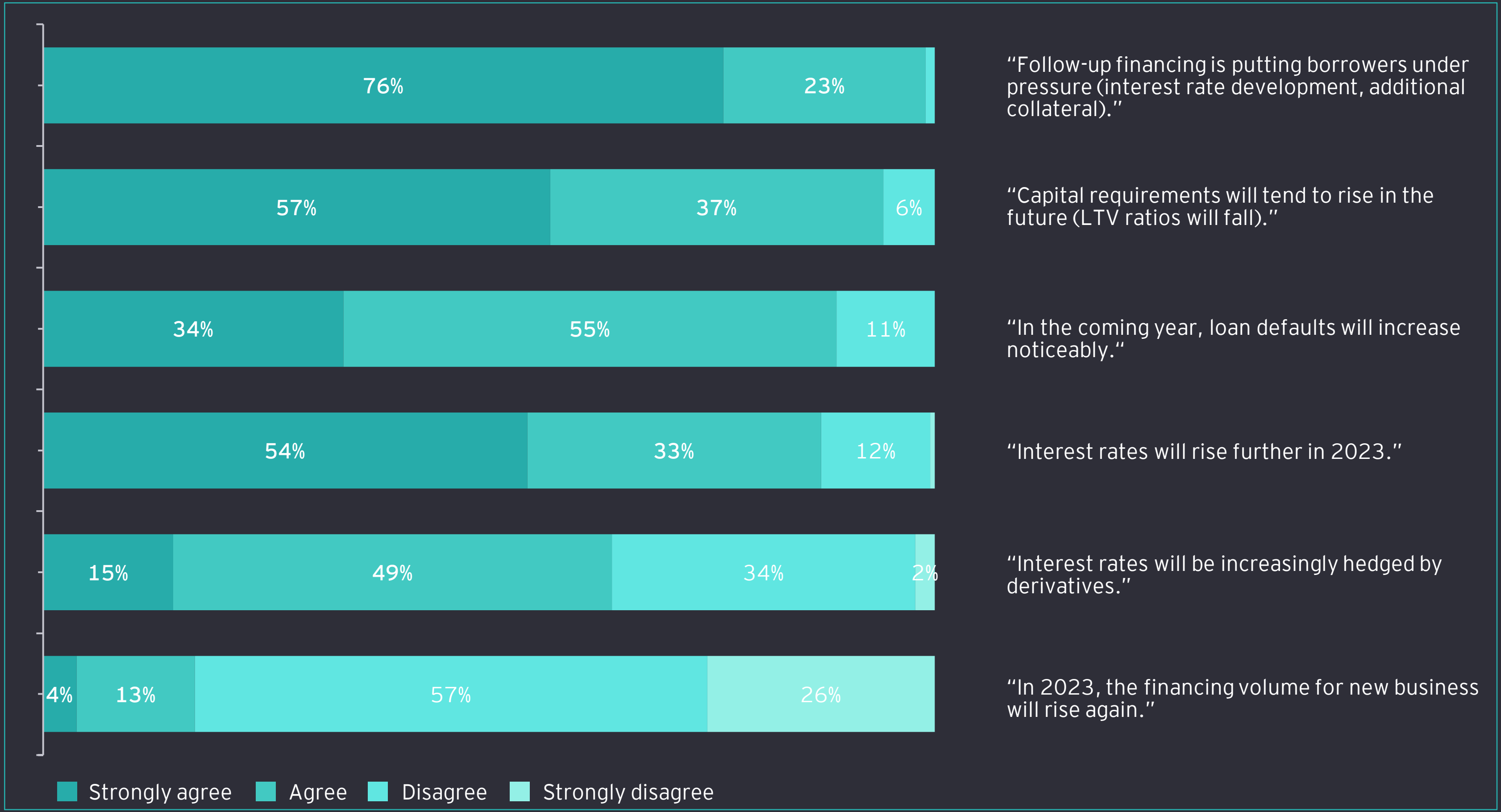
Comparison with the prior year (2023 vs. 2022)

Tighter financing conditions reflect a higher market risk

"Which of the following statements about the German real estate transaction market do you agree with for 2023?"

Key statements

- Changes in renewal conditions are making follow-up financing more difficult (99%).
- The survey respondents expect an increase in equity requirements in 2023 (94%).
- The majority of the industry fears an increase in loan defaults in the upcoming year (89%).
- For 2023, market participants forecast a further rise in interest rates (88%).
- Derivatives are an effective method of hedging against interest rate volatility (64%).
- In line with expectations, most of the market participants do not anticipate an increase in new business volume for 2023 (83%).

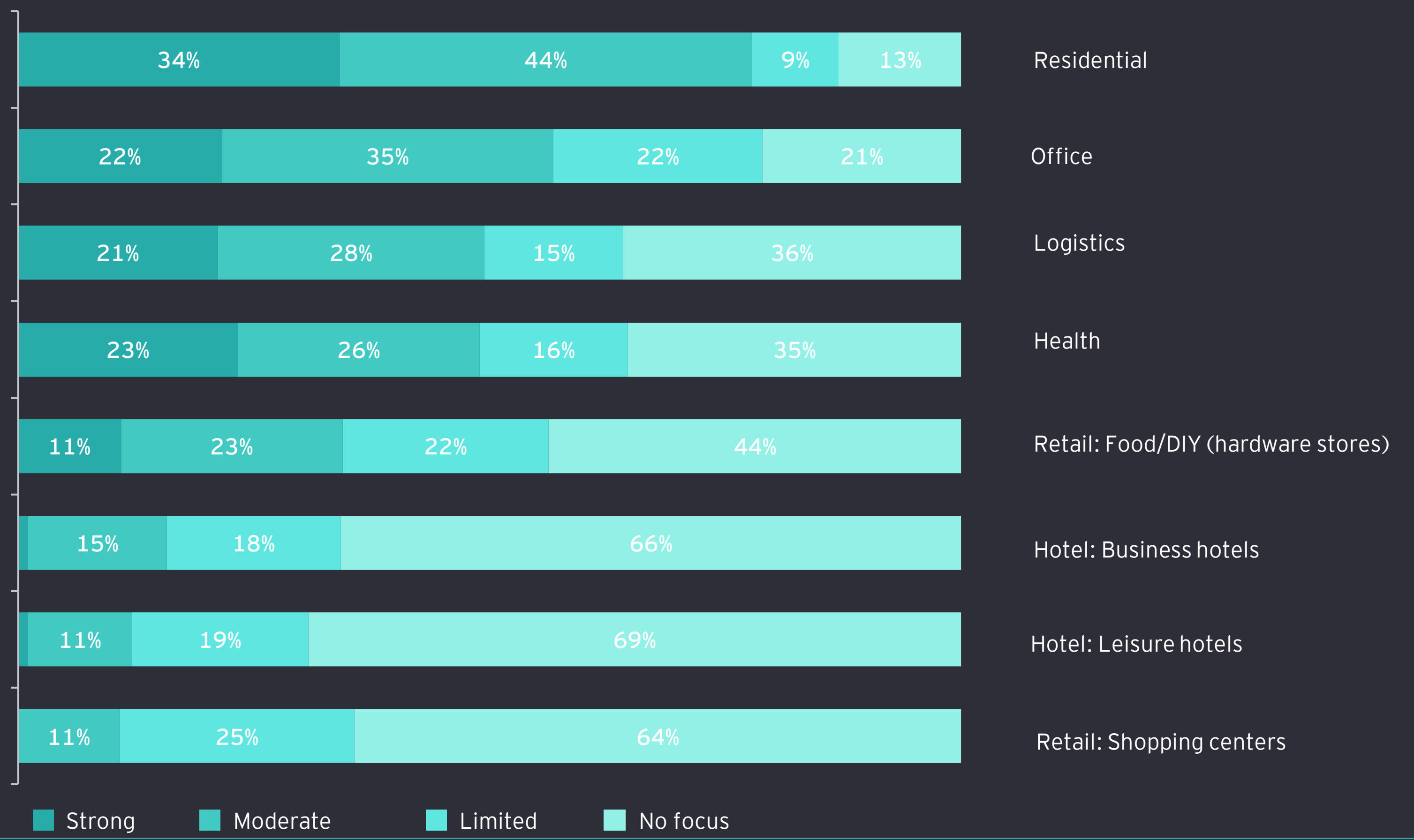


Residential and office properties remain in high demand among buyers

"How strong is your focus on the following types of use for investments in 2023?"

Key statements

- The focus of many investors in 2023 will remain on residential property. (strong/moderate: 78% vs. 81%)
- Investor interest in office investments is waning again. (strong/moderate: 57% vs. 63%)
- The logistics and healthcare asset classes enjoy similar popularity.
  Logistics (strong/moderate: 49% vs. 58%)
  Healthcare (strong/moderate: 49% vs. 52%)
- Demand for hotel investments remains patchy.
  Leisure hotels (limited/no focus: 88%)
  Business hotels (limited/no focus: 84%)
- There is a clear preference for food/DIY (hardware stores) over shopping centers.
  Food/DIY (hardware stores) (strong/moderate: 34% vs. 47%)
  Shopping centers (strong/moderate: 11% vs. 13%)



Comparison with the prior year (2023 vs. 2022)

Berlin, Frankfurt and Munich are still the preferred markets

"Which locations in Germany are you particularly focusing your investments on in 2023?"*

Residential

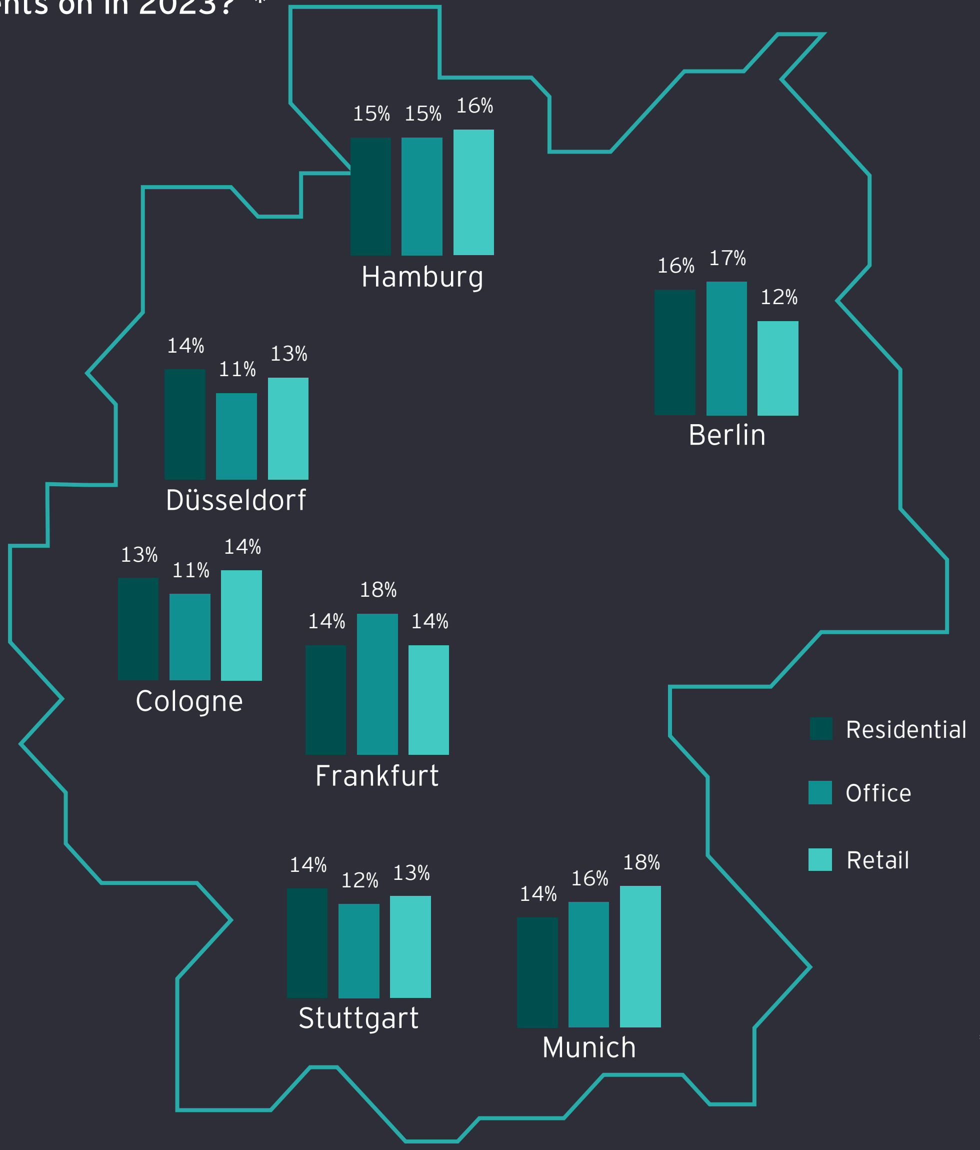
- Berlin retained a slight edge (16% vs. 14%) as the most significant real estate location within the top 7.
- All other top 7 locations enjoy a similar level of popularity.

Office

- The center of office real estate investors' attention is Frankfurt am Main (18% vs. 13%).
- After this, Berlin and Munich generate the strongest interest in office real estate investment.

Retail

- By a relatively large margin, the city of Munich remains the most popular retail location (18% vs. 19%).
- Compared to the top 7, Berlin recorded the lowest demand in the retail segment.

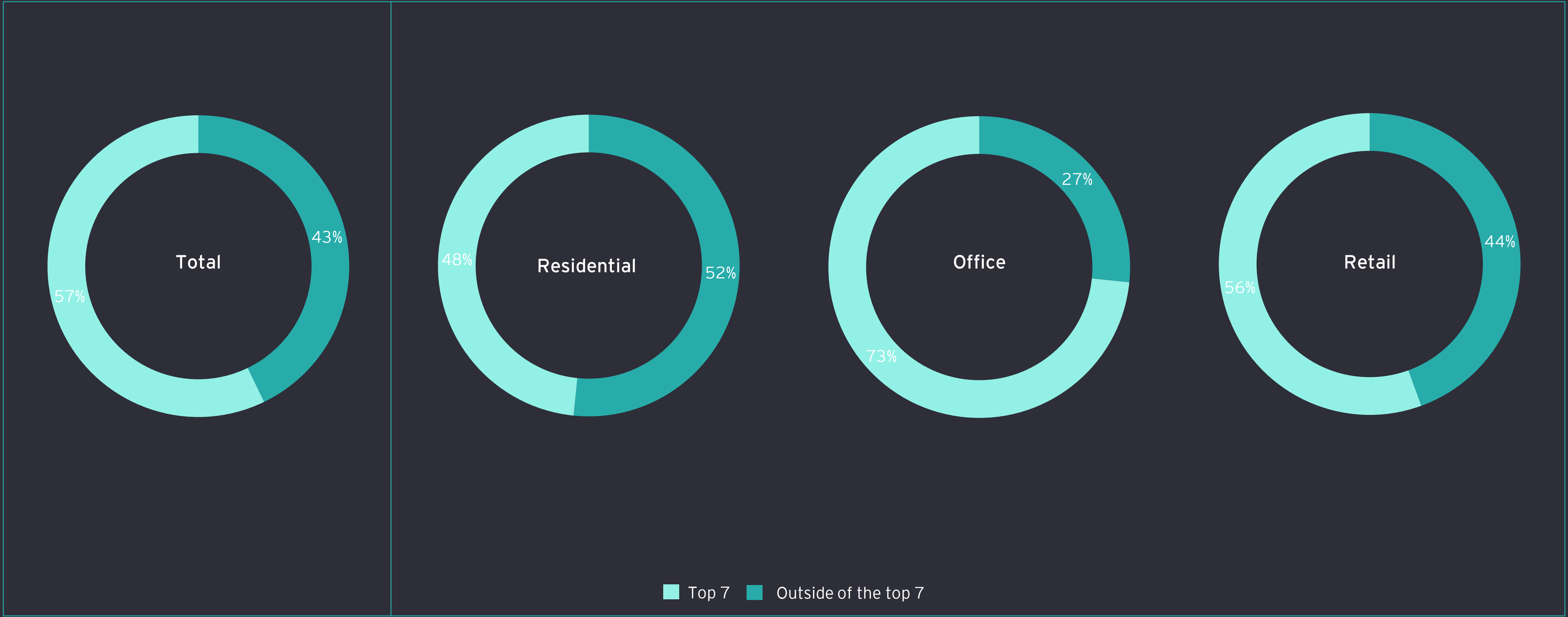


Comparison with the prior year (2023 vs. 2022)

*Multiple answers possible

A continued clear focus on the top 7 locations

"Which locations in Germany are you particularly focusing your investments on in 2023?"



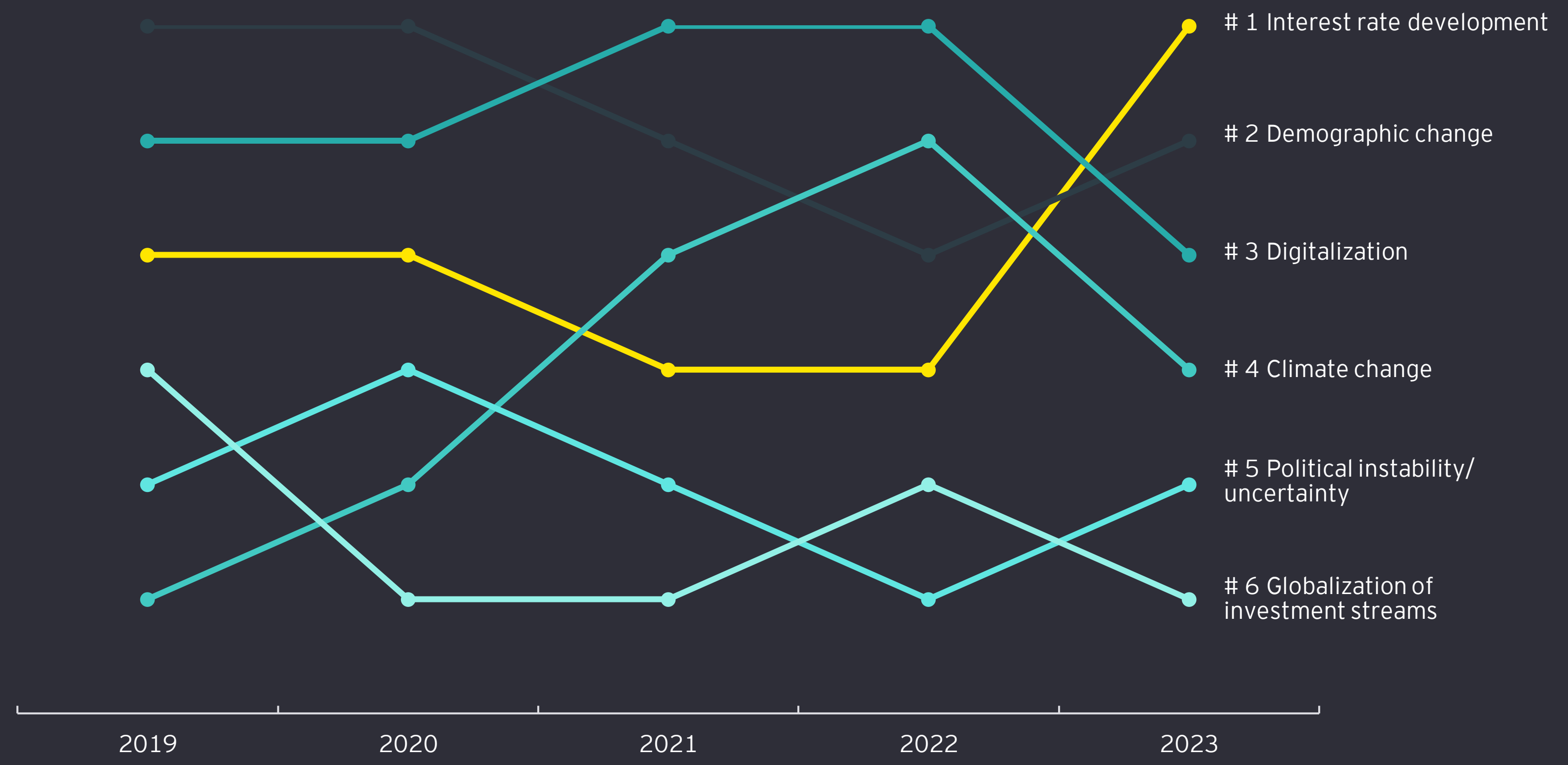
Interest rate developments in the current market environment are the top megatrend

"Which megatrends will have the most influence on the German real estate market in the next 5 to 10 years?"

Key statements

- Sharp rise in importance of interest rate development in the face of current market volatilities.
- The megatrends of digitalization and demographic change have been a high to very high priority in the sector since 2019.
- After increasing in significance in recent years, climate change fell behind the other trends in relevance in 2023.
- Over time, the industry assesses political instability/uncertainty and the globalization of investment streams as the weakest megatrends.

Ranking of megatrends over time

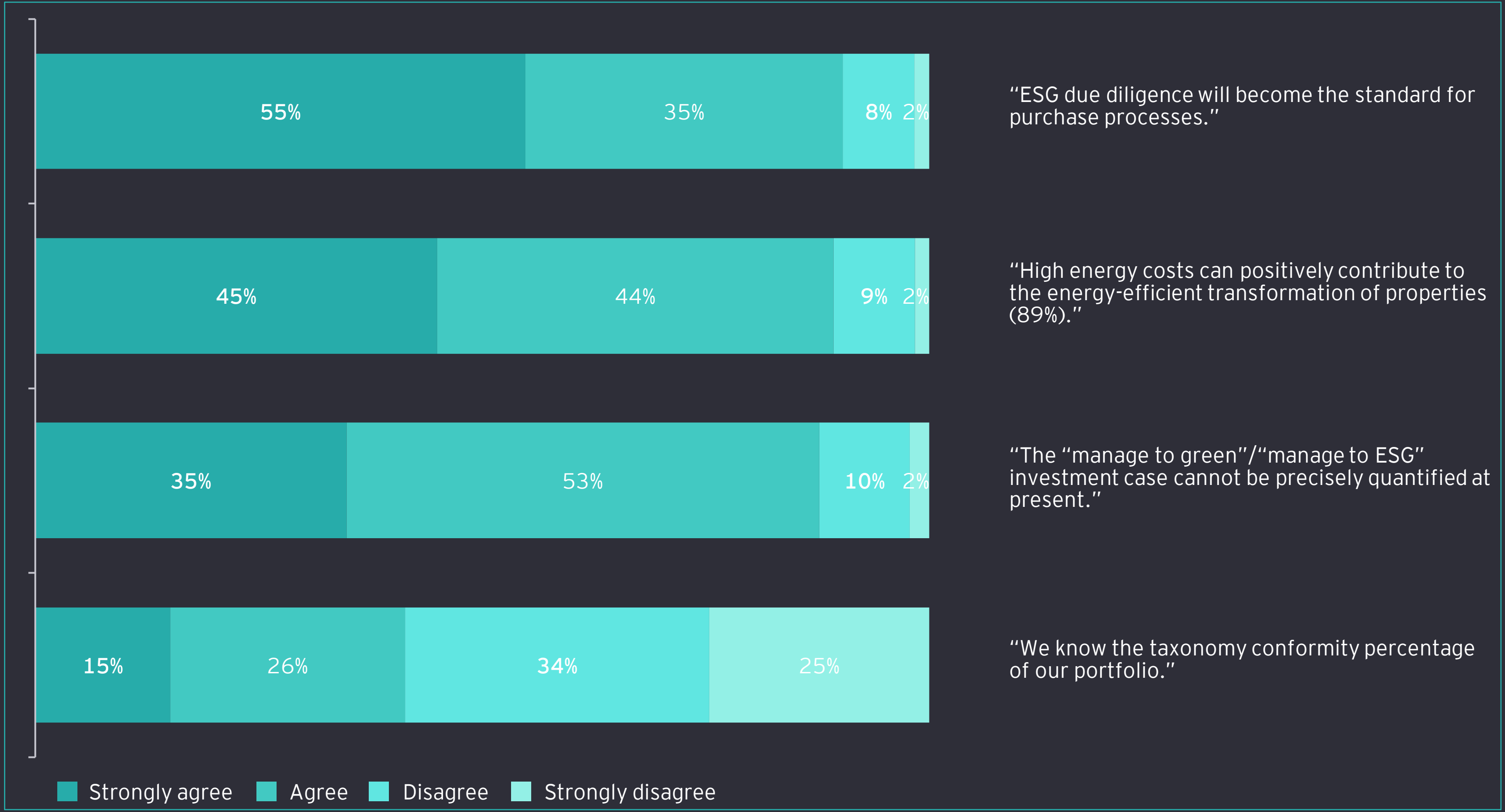


Energy efficiency in buildings is being driven by rising energy prices

“Rate the following statements about ESG (environmental, social, governance) aspects.”

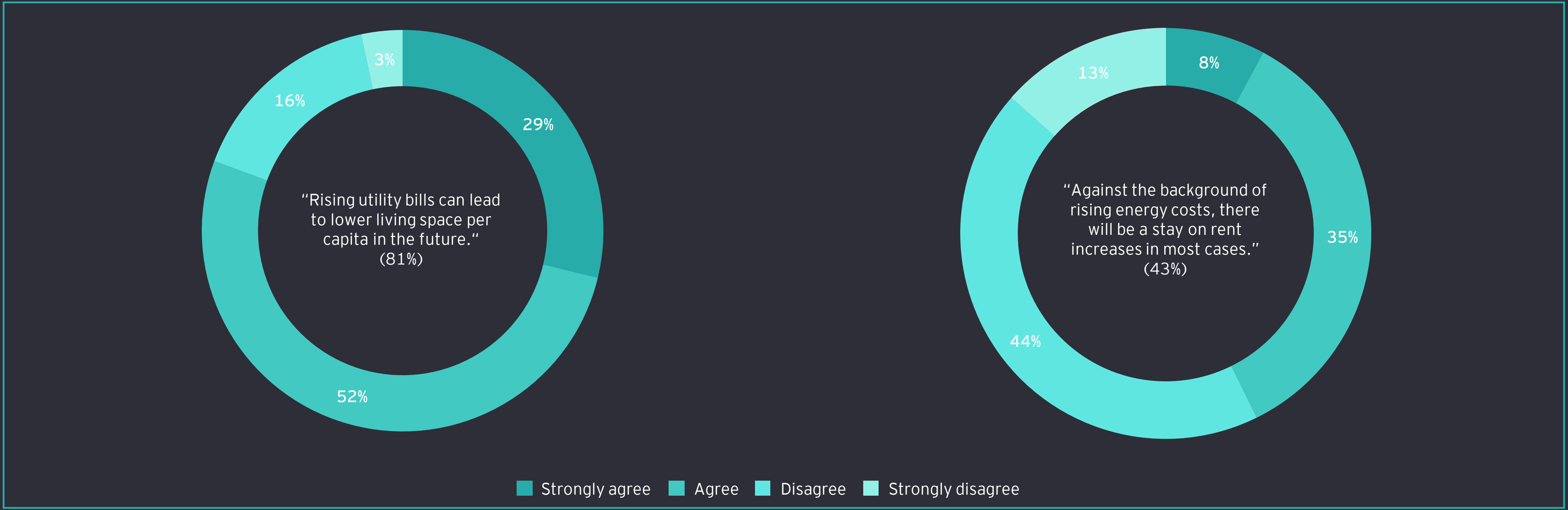
Key statements

- An ESG due diligence review will become a major component of the purchase review (90%).
- High energy costs offer incentives for energy-efficient transformation of properties (89%).
- Lack of experience/benchmarks make it difficult to implement “Manage to green” strategies in a targeted manner (88%).
- The majority of the survey respondents do not know the taxonomy conformity percentage of their portfolios (59%).



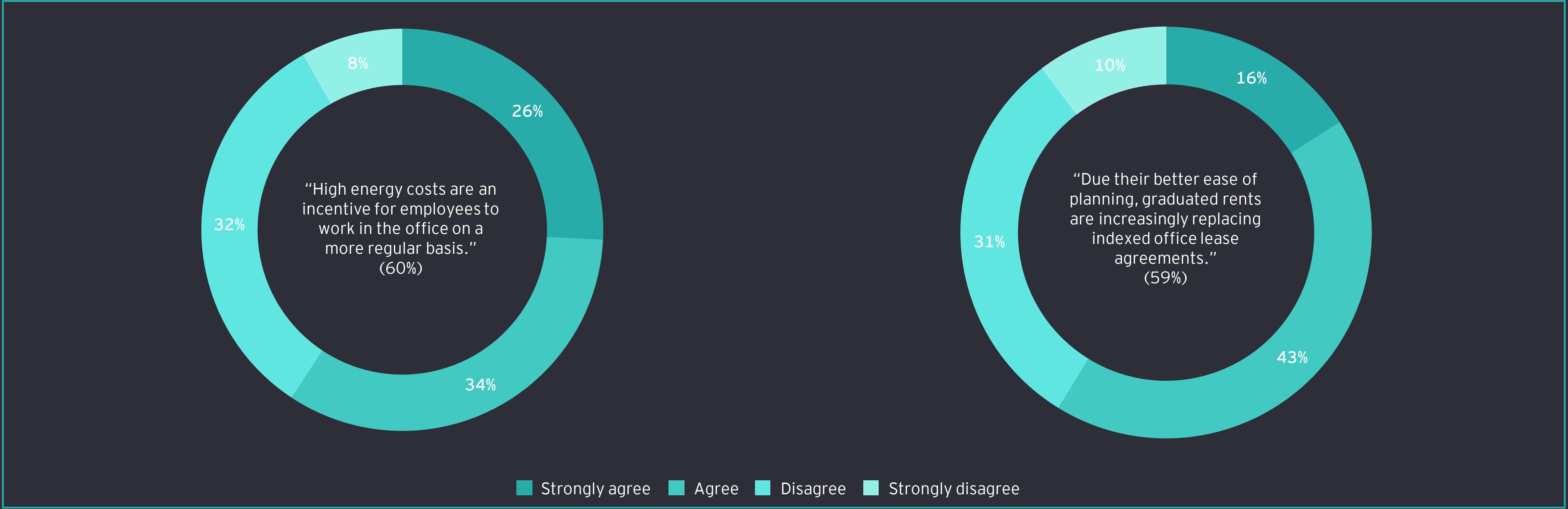
Reversal of trend in living space per capita?

"What will be the top trends in the residential use category in 2023?"



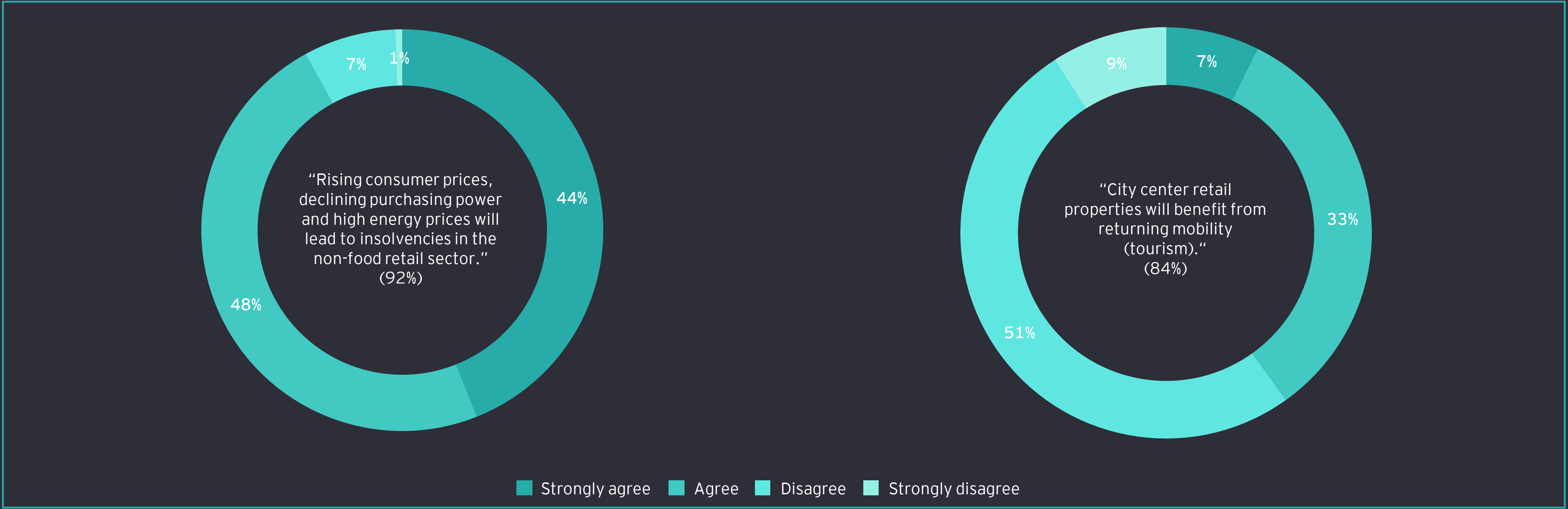
High energy costs have the potential to boost office attendance

"What will be the top trends in the office use category in 2023?"

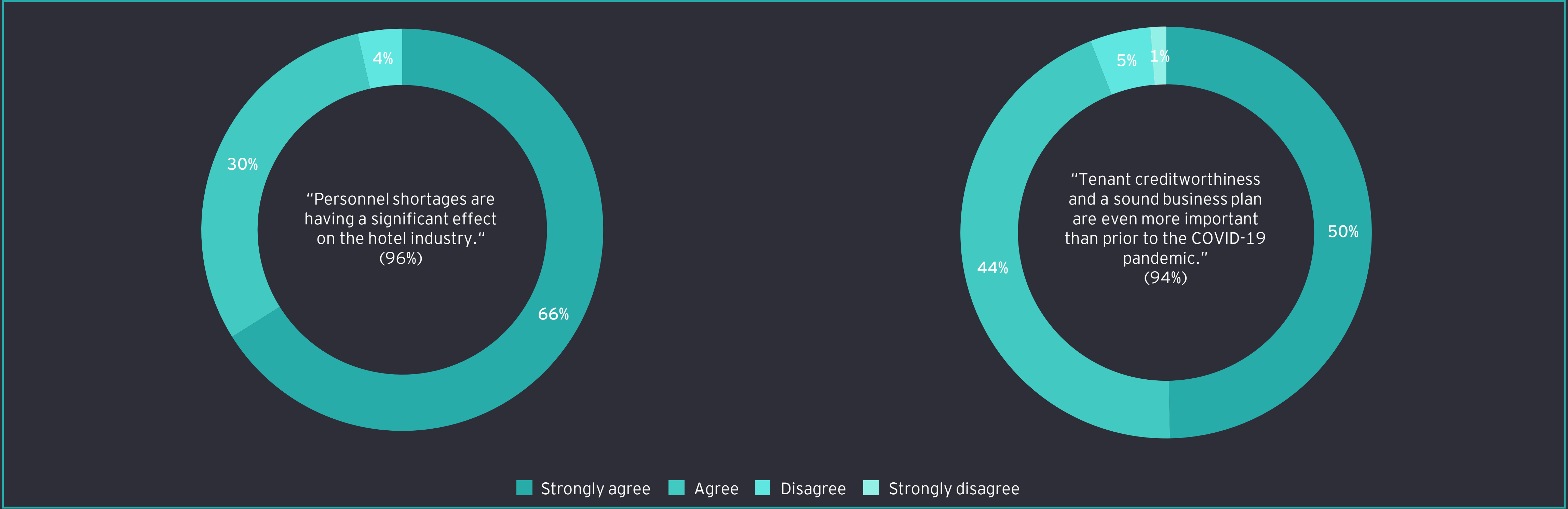


Industry discerns a greater risk of insolvencies in the non-food retail sector

"What will be the top trends in the retail use category in 2023?"



Personnel shortages are significantly affecting the hotel industry



5 Contact

Your contacts for questions and feedback on the study

Florian Schwalm

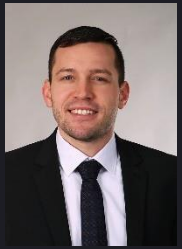
Email: florian.schwalm@de.ey.com
LinkedIn

Paul von Drygalski MRICS

Email: paul.von.drygalski@de.ey.com
LinkedIn

Thomas Frank

Email: thomas.frank@de.ey.com
LinkedIn



Tobias Buse

Email: tobias.buse@de.ey.com
LinkedIn

Karin Vogt-Schmitt

Email: karin.vogt@de.ey.com
LinkedIn

Dominik Reess

Email: dominik.reess@de.ey.com
LinkedIn

EY | Assurance | Tax | Transactions | Advisory

About the global EY organization
The global EY organization is a leader in assurance, tax, transaction and consulting services. We leverage our experience, knowledge and services to help build trust and confidence in the capital markets and in economies the world over. We are ideally equipped for this task – with well trained employees, strong teams, excellent services and outstanding client relations. Our global purpose is to drive progress and make a difference by building a better working world – for our people, for our clients and for our communities.

The global EY organization refers to all member firms of Ernst & Young Global Limited (EYG). Each EYG member firm is a separate legal entity and has no liability for another such entity's acts or omissions. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. See ey.com/privacy for information about how EY collects and uses personal data as well as a description of the rights of data subjects pursuant to the German Data Protection Act. For more information about our organization, please visit ey.com.

In Germany, EY has 20 locations. In this publication, "EY" and "we" refer to all German member firms of Ernst & Young Global Limited.

Images: Pexels

ey.com/de