Germany | Office Leasing and Investment | Q1 2015

MARKET REPORT

Strong activity on the office leasing market – Commercial investment market continues strong upward trend

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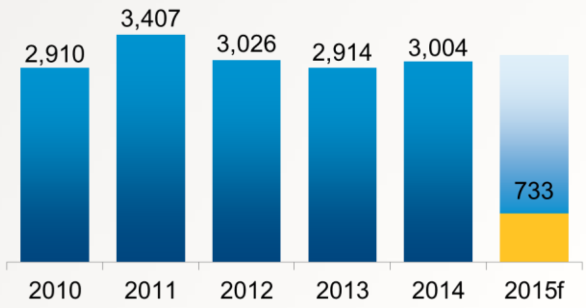
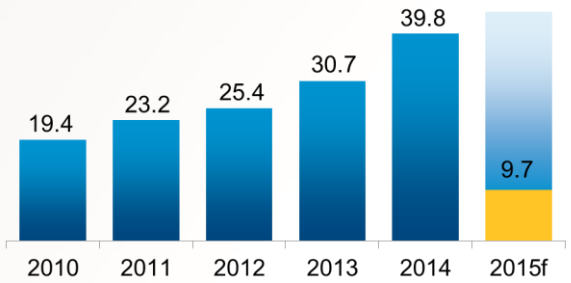
- Steep 12% increase in take-up
- Strongest Q1 since 2008
- Large-volume owner-occupier deals impact market
- Ongoing drop in vacancy and high net absorption
- Transaction volume matches previous year level of around €10 billion
- International investors continue to extend market share
- Ongoing yield compression
- Demand for German commercial real estate remains strong

Take-up of Office Space in the Top Seven Cities (in 1,000 m²)



Commercial Transaction Volume in Germany (in billions of euros)



Take-up in the seven largest German office markets of Berlin, Düsseldorf, Frankfurt/Main, Hamburg, Cologne, Munich and Stuttgart posted a total of 732,900 sqm in Q1 2015, the highest we have seen since early 2008. The year-on-year increase was correspondingly steep at 12%.

German commercial investment market transaction volume came to slightly more than €9.7 billion during Q1, matching its excellent Q1 results from the previous year.

Office Leasing

At first glance, the quarter results appear quite positive. A detailed analysis, however, shows that two large-scale owner-occupier deals were primarily responsible for the significant increase in take-up. The Free and Hanseatic City of Hamburg purchased part of the Axel Springer building complex at the start of the year and is planning to move the city's central district office into the approx. 32,000 sqm of office space in 2016. Deutsche Vermögensberatung also purchased 32,000 sqm of office space in a building that has been vacant since 2011 and is located in Frankfurt's Bahnhofsviertel. The company also plans to move into the property in 2016. Net leasing performance, which excludes owner-occupiers, only increased year-on-year by around 2%.

Increase in take-up in most of the top seven

Take-up including owner-occupiers rose by at least 6% in all of the locations analyzed. The Stuttgart office market recorded the steepest increase. Tenants leased 69,700 sqm in the capital of Baden-Württemberg, reflecting an almost 23% increase year over year. These results can primarily be attributed to four leases signed for more than 5,000 sqm, including one signed by Robert Bosch for approx. 9,300 sqm in the Zeppelin-Carré building complex. Hamburg also saw a considerable increase in take-up. Q1 results of 123,000 sqm in take-up reflect a year-on-year increase of more than 17%. However, net leasing performance (excluding owner-occupiers) in the Hanseatic City is also worth a look. Net leasing performance was down 8%,

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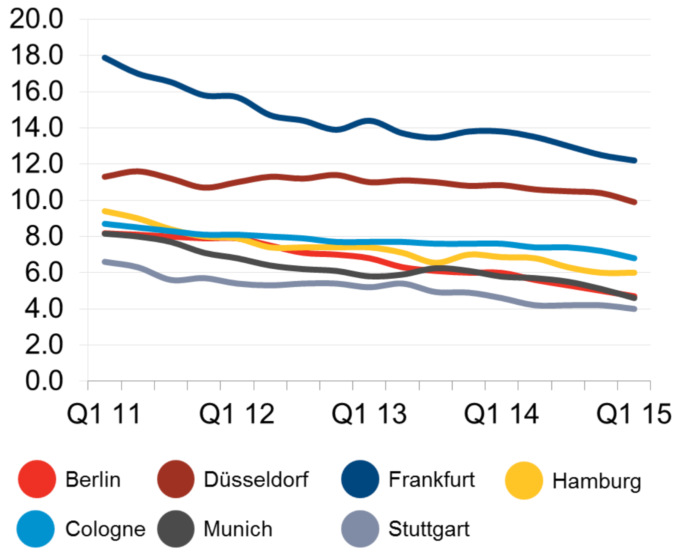
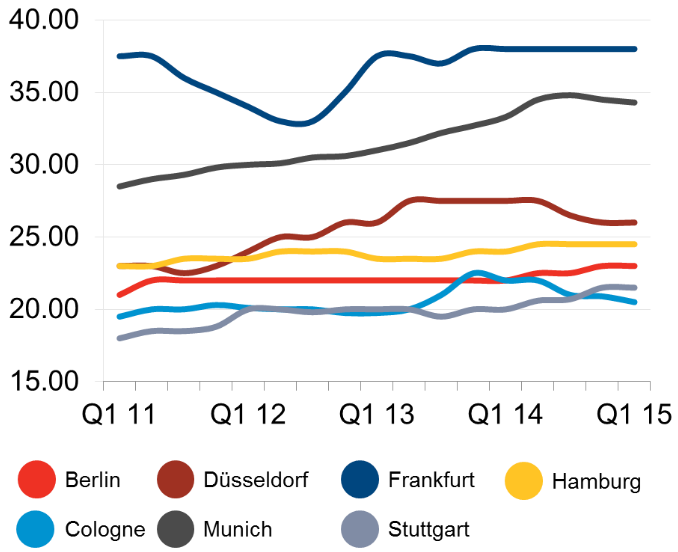
reflecting ongoing reluctance on the part of office tenants, particularly in the large space segment.

Comparison of Vacancy Rates (in %)



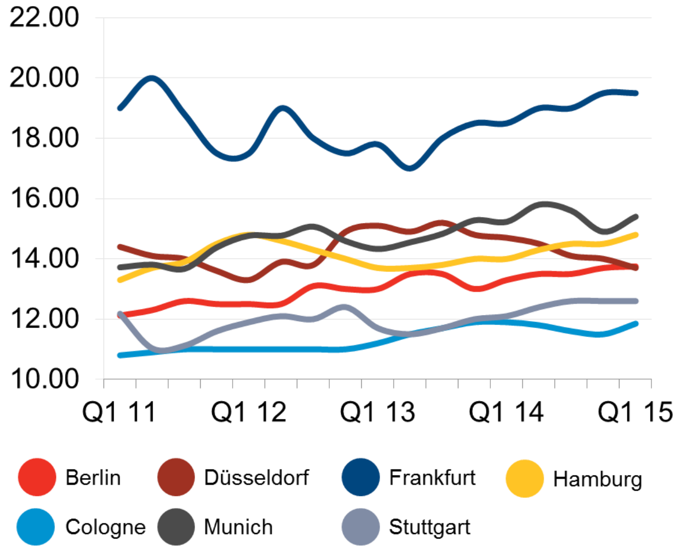
Munich recorded a 12% year-on-year increase in take-up in Q1 to 180,600 sqm. Both tenants and owner-occupiers were more actively looking to lease in Munich than they were 12 months ago. More office space has been leased in Munich than in any other city, a development that can in part be attributed to seven leases signed for more than 5,000 sqm. The largest leases include one signed for more than 10,000 sqm of office space on Landsberger Straße and one signed by the Heisse Kursawe Eversheds law firm for around 5,000 sqm in the city center.

Comparison of Prime Rents (in €/m²)



Berlin was the runner-up with a total of roughly 133,100 sqm in office take-up, reflecting an increase of slightly more than 9%. A lease for the GSW high-rise signed by Rocket Internet in the Kreuzberg district for approx. 22,000 sqm of office space was the largest non-owner-occupier lease signed in the top 7 cities in Q1 2015.

Comparison of Average Rents (in €/m²)



Similar to what we saw in Hamburg, there were two different developments on the Frankfurt office market. Although total take up was posted at 87,000 sqm, up more than 6%, only one deal was responsible for these results - the only major deal, which was signed by owner-occupier Deutsche Vermögens-beratung, and without which results would have been down by around one-third. However, take-up volume for space smaller than 500 sqm and between 2,000 sqm and 5,000 sqm was up considerably year over year, a very positive development. We also saw increases in take-up along the Rhine River. Take-up in both Düsseldorf and Cologne rose 8% year over year to 73,500 sqm and 66,000 sqm, respectively. While only one lease signed in Düsseldorf by T-Systems exceeded the 5,000-sqm mark, four leases of this scale were signed further up the Rhine: the Bank für Sozialwirtschaft's new building features around 8,000 sqm, Jobcenter Cologne leased almost 7,600 sqm, Internationale Filmschule/FH Cologne leased more than 6,200 sqm and DLA Piper leased around 5,300 sqm.

Vacancy rate continues to drop significantly

Over the past 12 months, office vacancy in the top 7 cities dropped by more than 930,000 sqm to 5.7 million sqm as recorded at the end of Q1. The vacancy rate fell from an average 7.5% in the previous year to a current 6.4% as a result of increased take-up in the past two quarters, the low completion volumes we have been seeing for several years now and space reduction due to conversion and renovation projects. Berlin, Munich and, particularly, Stuttgart, are posting vacancy rates of less than 5%, putting the vacancy rate in these cities at a level that could lead to supply bottlenecks in some space segments and submarkets, particularly for potential tenants looking for large-scale leasing options. The high net absorption of more than 1.4 million sqm over the past 12 months is also noteworthy. It’s proof that the number of office employees is growing. With an average of 20 sqm to 25 sqm per employee, 1.4 million sqm of additional occupied office space means around 56,000 to 70,000 new jobs.

Rents mostly on the up

Aside from a few contrary trends, prime and average rents in the top 7 cities were up year over year. High-priced leases signed in the past six months for space in new buildings or properties still under construction like Opernplatz 14, TaunusTurm and MainTor-Quartier made sure that Frankfurt remained Germany’s most expensive office location at the beginning of the year with prime rent at €38.00 per sqm and average rent at €19.50 per sqm. Munich followed with a difference of around four euros, recording prime rent at €34.30 per sqm and average rent at €15.40 per sqm. Prime and average rents increased considerably in Stuttgart (€21.50 and €12.60 per sqm), Berlin (€23.00 and €13.75 per sqm) and Hamburg (€24.50 and €14.80 per sqm), whereas Cologne posted prime and average rents almost level with previous year results at €20.50 and €11.85 per sqm, respectively. Düsseldorf was the only city to record a decrease in prime and average rents to €26.00 and €13.70 per sqm, respectively. This drop was due on the one hand to reluctance on the part of potential tenants in the high-price segment and, on the other, to scarce supply of a larger selection of high-price properties in coveted locations.

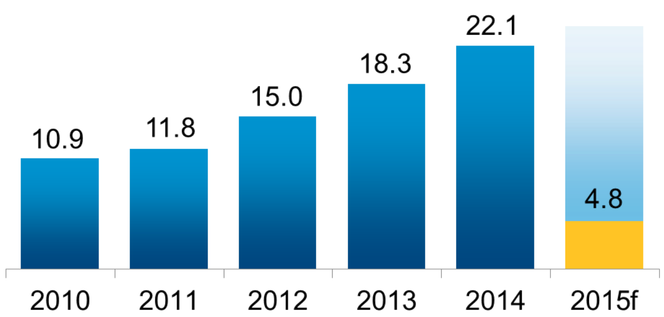
Outlook: Upturn not felt everywhere

At first glance, it would seem that we’ve had a successful start to the year throughout the German office market. But a closer look reveals a high share of owner-occupiers on some markets, which are less relevant in terms of take-up. Because of this development, we cannot yet talk about a long-term upswing. The fact that the number of office employees continues to rise, however, is worth mentioning. This should result in a continued increase in leasing take-up. The shrinking supply, particularly in Berlin, Munich and Stuttgart, will most likely give some project developers the arguments they need to get work going on speculative project developments.

Investment

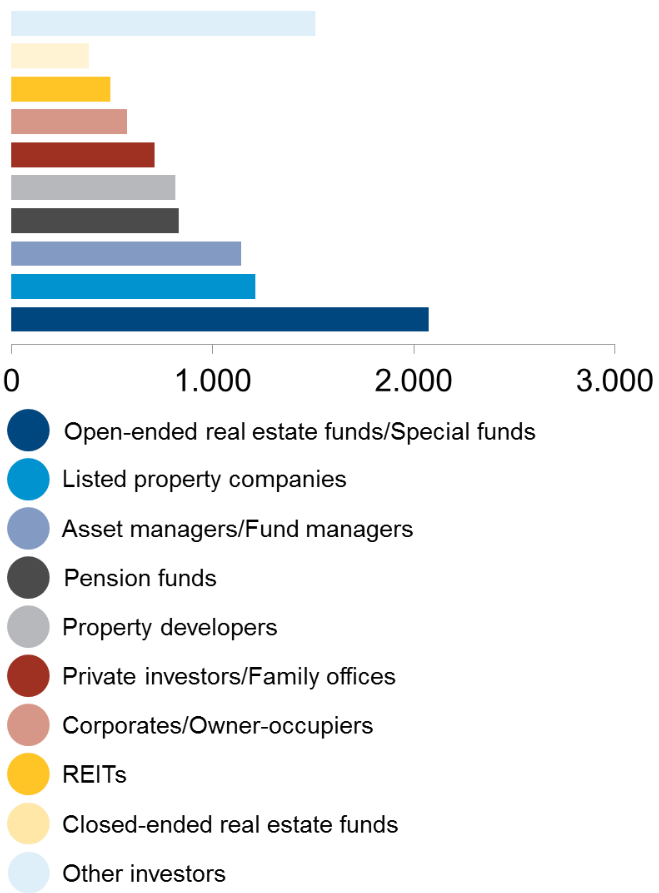
Slightly less than €3.2 billion, or one-third of total capital invested, was Germanwide poured into real-estate portfolios. Five shopping malls, Boulevard Berlin, Centrum Galerie Dresden, Forum Duisburg, Königsgalerie Duisburg and Arneken Galerie Hildesheim, with a combined value of €1 billion, accounted for the largest share of transaction volume. The five malls were purchased by French shopping mall investor Klépierre, who is new to the German market, within the scope of acquiring their Dutch competitor Corio. In Europe, Germany is the most important real-estate investment market following the UK. Compared to other countries, Germany boasts an excellent mix of prime real-estate locations and attractive secondary locations. And supply in the different property and price categories remains high despite the scarcity in core asset classes. This is an important aspect for investors from Germany and abroad when it comes to deciding to buy property in Germany as opposed to other countries. The German investment market is currently benefitting from Germany's economic prowess and, in particular, from the upward trend on the leasing markets. Another plus point is that in an international comparison Germany partially still offers higher potential yields than Asian metropolises, for example.

Commercial Transaction Volume in the Top 7 Cities (in billions of euros)



Slightly more than 42% (approx. €4.1 billion) of total capital invested in Q1 came from investors outside of Germany. This share is expected to increase in view of the number of already existing investors and the large number of new investors on the German market. Due to Klépierre's takeover of Corio, most capital invested in German commercial real estate to date has come from French investors. Investors from the UK invested slightly more than €1 billion and investors from the US slightly less than €600 million. Asian investors poured a total of roughly €560 million into the German commercial market. Special real-estate funds managed by numerous institutional investors were among the most active buyers. Together with open-ended real-estate funds, they generated total investment volume of slightly below €2.1 billion, accounting for a 21% market share. They were followed by real-estate companies (€1.2 billion) and asset and fund managers (€1.1 billion).

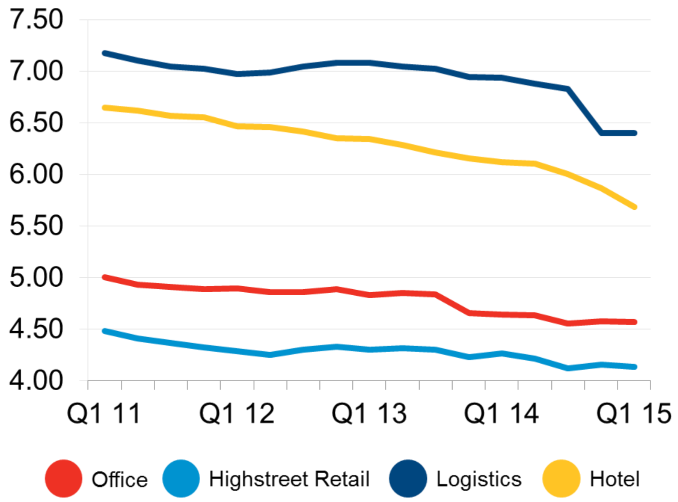
Transaction Volume according to Buyer Groups (in millions of euros)



Market share of retail properties higher than in past years

In addition to the sale of the shopping mall portfolio mentioned above, large-volume single and package transactions involving specialist stores and specialist store portfolios contributed to a transaction volume for retail properties in the amount of €3.6 billion, reflecting a market share of around 37%. This is significantly higher than in previous years. Other large-volume deals worth mentioning in the current year include the sale of a supermarket portfolio comprised of 107 supermarkets, which was purchased by Patrizia from Eurocastle, a Fortress subsidiary, for €286 million and a package deal consisting of 56 retail properties that was bought by Redefine Properties for €157 million. Despite these numbers, retail properties did not quite make first place. Around €3.9 billion, or 40% of total market share, was invested in office properties in Q1. Unlike the activity we saw in the retail segment, the office segment was dominated by single deals in the first three months of the year. The Norr porten portfolio in Hamburg was the only deal to make the top 10 with a transaction volume of roughly €140 million. Hotel properties got off to a good start, generating transaction volume of more than €600 million and putting them in third place in terms of investment volume. This can particularly be attributed to the sale of one portfolio. The French REIT, Foncière des Murs, purchased 22 B&B hotels from B&B shareholder Carlyle for €128 million.

Average Gross Initital Yield according to Type of Use in the Top 7 Cities (in %)



Almost all top locations indicate upward trend

Almost all of the seven top real-estate hubs in Germany recorded significant increases in activity in Q1 year over year. Berlin, Düsseldorf, Frankfurt, Hamburg, Cologne, Munich and Stuttgart posted a combined transaction volume of more than €4.7 billion. This reflects roughly half of the Germany-wide Q1 investment volume and an increase of around €1 billion, or 29%, year over year. The highest transaction volume of €1.1-€1.2 billion with a similar number of recorded transactions was registered in three cities with Munich posting a wafer-thin lead over Berlin and Frankfurt. These three real-estate hubs were able to significantly outperform previous year results for the most part. The largest properties changing hands at these locations within the scope of single and portfolio deals included the above-mentioned purchase of Boulevard Berlin, the MainZero in Frankfurt am Main, which was sold to South-Korean pension fund NPS, and a deal signed for the new Brainlab headquarters in Munich, which was purchased by a WealthCap fund at the beginning of the year from developers Wöhr + Bauer. In Hamburg, the sale of commercial properties and lots generated around €750 million, reflecting a significant increase of 30% compared to the previous year. In addition to the above-mentioned sale of the Norrporten portfolio, the partial sale of the Axel Springer building complex to the Free and Hanseatic City of Hamburg for slightly below €131 million accounted for a considerable portion of total transaction volume. Cologne recorded the steepest increase in transaction volume. A total of €286 million was invested there in Q1, reflecting a year-on-year increase of 165%. The purchase of the Kalk Karree by Bayerische Ärzteversorgung and the Triforum by Internos accounted for a large share of this result. Stuttgart and Düsseldorf recorded a transaction volume of €182 million and €180 million, respectively, putting them at the bottom of the list. While Stuttgart recorded a year-on-year increase of 14%, Düsseldorf's transaction volume recorded a steep drop by two-thirds due to last year's high-volume sale of Herzogterassen, which generated an extremely high result in the previous year. Ongoing strong demand once again led to a slight yield compression in the core segment.

Due to ongoing strong demand for these properties, average weighted gross initial yield for prime office properties recorded a drop compared to the previous quarter of one basis point and by eleven basis points to 4.57% year over year. The noticeably increasing interest in real estate in the value-add segment and in secondary locations has led to an adjustment in yields in these areas as well

Outlook: Higher risk, more portfolio deals

The most active buyers in the core and core plus segments are German investor groups and, among these, insurance companies and pension funds, in particular. For these investors, real estate is basically the only asset class to exhibit a reasonable profit-risk ratio. The competition for the few core properties is not going to get any less. This can primarily be attributed to the fact that a number of Asian investors are currently looking for large-scale investment opportunities for which they are willing to pay premium prices. We are still seeing bottleneck supply. On the one hand, the supply of new buildings is limited due to low completion rates, and, on the other, many owners of prime properties are currently not looking to sell. They could get excellent prices for their properties at the moment. If they did sell, however, they would face the same problem as many investors: a lack of investment alternatives. That's why an increasing number of investors are moving into the value-add segment. Portfolios throughout all property types are currently experiencing a renaissance as well. The tendency toward taking risk is significantly lower than in 2006 and 2007 and the use of own capital is higher. Additionally, checks have been intensified and investors are not buying without reason. That's why we believe that the German real-estate market is not running the risk of creating a bubble. Overall, we expect transaction volume in Q2 to be very high as well. Many transactions are about to be signed and a number of owners are willing to sell due to the excellent market environment. This will not only lead to increased supply but also to higher transaction volumes.

Office and Investment Market Germany (figures for Q1)

Market overview

	GERMANY	BERLIN	DUSSELDORF	FRANKFURT	HAMBURG	COLOGNE	MUNICH	STUTTGART
OFFICE LETTING MARKET								
Office stock in million m²	88.96	18.50	7.63	11.55	13.28	7.66	22.80	7.54
Take-up, 2015, in m²	732,900	133,100	73,500	87,000	123,000	66,000	180,600	69,700
Take-up, 2014, in m²	656,000	121,900	68,000	82,000	105,000	61,000	161,300	56,800
Percentage change y-o-y	11.7%	9.2%	8.1%	6.1%	17.1%	8.2%	12.0%	22.7%
Prime rent, 2015, in €/m²	34.00	23.00	26.00	38.00	24.50	20.50	34.30	21.50
Prime rent, 2014, in €/m²	33.90	22.00	27.50	38.00	24.00	20.50	33.30	20.00
Percentage change y-o-y	0.3%	4.5%	-5.5%	0.0%	2.1%	0.0%	3.0%	7.5%
Average rent, 2015, in €/m²	15.10	13.75	13.70	19.50	14.80	11.85	15.40	12.60
Average rent, 2014, in €/m²	14.67	13.30	14.70	18.50	14.00	11.90	15.20	12.10
Percentage change y-o-y	2.9%	3.4%	-6.8%	5.4%	5.7%	-0.4%	1.3%	4.1%
Vacancy, 2015, in m²	5,699,700	870,000	753,000	1,410,000	800,100	522,000	1,040,000	304,600
Vacancy, 2014, in m²	6,631,100	1,090,000	817,100	1,592,400	910,300	559,000	1,316,900	345,400
Vacancy rate in %	6.4%	4.7%	9.9%	12.2%	6.0%	6.8%	4.6%	4.0%
COMMERCIAL INVESTMENT MARKET								
Transaction volume in millions of euros €, 2015	9,742	1,100	180	1,100	750	286	1,160	182
Transaction volume in millions of euros €, 2014	9,887	497	560	732	575	108	1,033	160
Percentage change y-o-y	-1.5%	121.3%	-67.9%	50.2%	30.4%	164.7%	12.3%	13.7%
Largest group of investors	Open-ended real estate funds / Special funds 23%	Listed property companies 42%	Asset Managers/ Fund Managers 30%	Pension funds 23%	Asset Managers/ Fund Managers 27%	Open-ended real estate funds / Special funds 23%	Pension funds 27%	Open-ended real estate funds / Special funds 58%
Largest group of sellers	Property developers 21%	Open-ended real estate funds / Special funds 39%	Open-ended real estate funds / Special funds 30%	Banks 27%	Property developers 27%	Open-ended real estate funds / Special funds 22%	Open-ended real estate funds / Special funds 41%	Opportunity Funds / Private Equity Funds 51%
Most important type of real estate	Office 40%	Retail 51%	Office 62%	Office 83%	Office 60%	Office 53%	Office 79%	Retail 58%
Prime yields office	4.57%	4.75%	4.90%	4.75%	4.50%	5.10%	4.00%	5.00%
Prime yields retail	4.14%	4.50%	4.25%	4.20%	4.50%	4.20%	3.50%	4.00%
Prime yields logistics	6.40%	6.55%	6.45%	6.25%	6.50%	6.45%	6.30%	6.50%

Sources: Colliers International Deutschland, Grossmann & Berger GmbH (Hamburg), Larbig & Mortag (Cologne)

502 offices in 67 countries on 6 continents

United States: **140**

Canada: **31**

Latin America: **24**

Asia Pacific: **199**

EMEA: **108**

€ 1.75
billion
in annual revenue

€ 75
billion in transaction volume with more than 80,000 investment and leasing deals

160
million square meter
under management

16,300
professionals
worldwide

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