Frankfurt | Office Letting and Investment | Q1 2015

MARKET REPORT

Investment market off to strong start in 2015, leasing market up thanks to owner-occupiers

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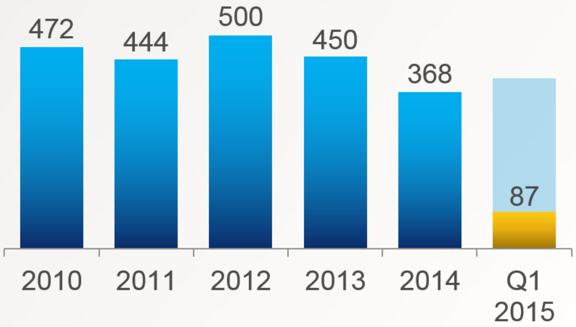
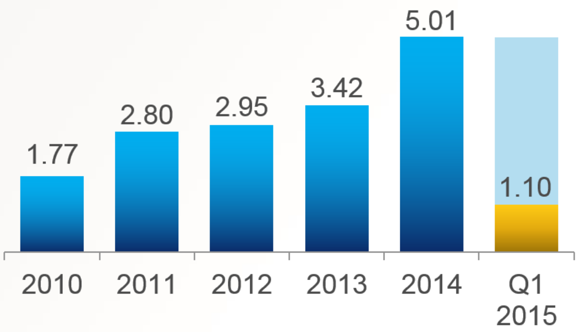
- Take-up posts year-on-year increase of around 6%
- Only one major deal signed in Q1
- Increased market activity in space segment under 5,000 sqm
- Vacancy continues to drop due to large-scale conversion and renovation
- Investment market: up 50% year-on-year
- Many transactions between €20 million and €85 million
- International investors flood the market

Take-up of office space
(in 1,000 sqm)



Commercial transaction volume
(in billion EUR)



Frankfurt Skyline (Bild: iStockphoto©Thinkstock)

The Frankfurt office letting and investment market got off to a good start in 2015. Following a weak 2014, the office letting market posted 87,000 sqm in take-up in Q1, reflecting a year-on-year increase. The commercial investment market ran with the positive momentum we saw at the end of 2014, recording €1.1 billion, an increase of around 50%.

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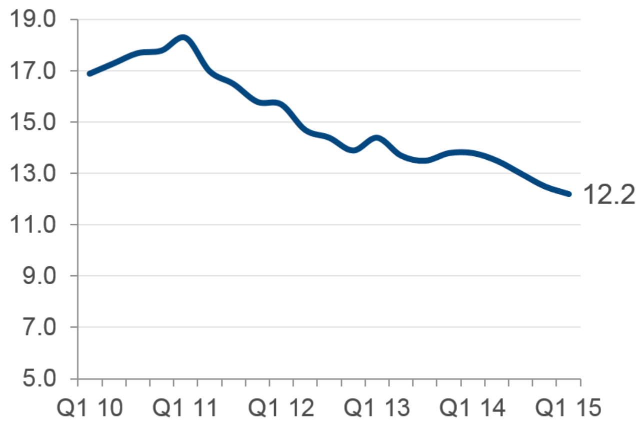
Office Letting

The Frankfurt office letting market posted take-up of around 87,000 sqm during the first three months of 2015, reflecting an increase of more than 6% compared to Q1 2014. Deutsche Vermögensberatung signed the largest deal with their purchase of a building on Windmühlstraße featuring around 32,000 sqm, which the company plans to occupy itself. That put the owner-occupier share at 37%, well above previous year levels. As a result, net leasing performance (excluding owner-occupiers) registered a 33% decrease compared to Q1 2014, in which no owner-occupier deals were recorded. The renewed momentum we are currently experiencing on the letting market can be attributed to a positive trend in the space segment of less than 5,000 sqm. Five additional leases reflecting around 4,300 sqm in take-up gave us an increase in the number of leases signed and in take-up by around 6%. Seven businesses signed leases in the space segment between 2,000 and 5,000 sqm for a total of 20,700 sqm of office space, more than twice as much as in Q1 2014. In addition to leases signed in the CBD, e.g., Opernplatz and Nextower, tenants also leased larger-scale space in the peripheral submarkets. The bio-tech company, Grifols, signed a lease for an IVG project in Niederrad and Zühlke leased space in a project in Eschborn. Both companies already had offices in the submarkets and decided to lease space in projects that can now be started.

Central station/Westhafen leads the pack

The Central station/Westhafen submarket generated by far the highest take-up among the Frankfurt submarkets with 37,000 sqm, partially due to the large-scale deal signed by Deutsche Vermögensberatung. The submarket came in second in terms of the number of leases signed. The City submarket was the only one to register more leases. This shows that the Central station /Westhafen submarket is in high demand even without the large-scale lease, a fact that is also reflected in the trend we have seen over the past several years. 43 leases were signed for around 16,100 sqm in total in the City submarket. Aside from the two leases featuring more than 2,000 sqm in the Nextower building and on Eschersheimer Landstraße, the City submarket is traditionally characterized by a large number of leases in the space segment of less than 1,000 sqm. This segment accounted for around 72% of take-up in the City submarket in Q1. The CBD's market share in Q1 only came to 31% due to comparably low take-up in the Banking distrcit and Westend submarkets as well as high take-up in Central station/Westhafen and in some of the peripheral submarkets. The Eschborn, Niederrad and Frankfurt West submarkets stand out among the peripheral submarkets, posting an increase in take-up due to leases signed in the space segment over 2,000 sqm.

Vacancy rate of office space (in %)



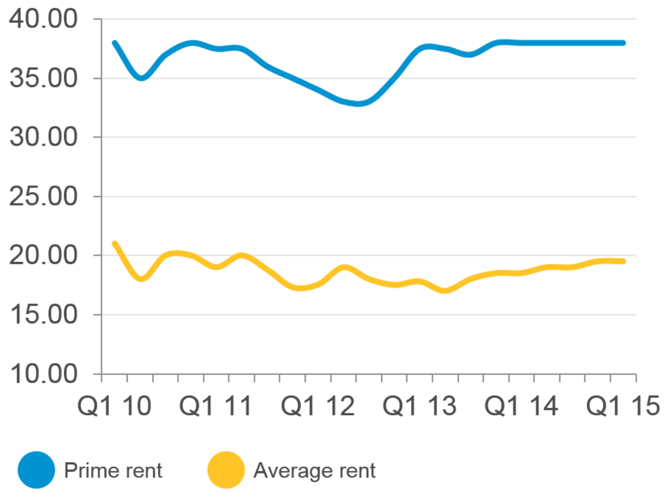
Vacancy rate toes 12% threshold

The drop in vacancy continued in Q1 2015. Almost 100,000 sqm of office space was taken off the market in the first three months of the year due to conversion and renovation projects as this space will temporarily or permanently not be available or listed as office space. In addition to Windmühlstraße 14, which was bought by Deutsche Vermögensberatung and is being renovated before the company moves in, this includes the former Metzler-Stammhaus building on Große Gallusstraße and the Westend Ensemble on Ludwig-Erhard-Anlage. In terms of supply, roughly 28,000 sqm of new space was introduced to the market in Q1. A total of around 130,000 sqm of space is expected to be completed by the end of the year, around 50% of which is has been pre-leased. Only slightly more than half of the new office space will be located in the CBD (67,000 sqm) since larger projects like St. Martin Tower and the new building for the called "kleines Behördenzentrum" are being built outside the CBD. The vacancy rate dropped in Q1 by 30 basis points to a current 12.2%, reflecting 1.41 million sqm of office space available for immediate tenancy. Office space no longer suited to the market will continue to be taken off the market in the months and years to come as conversion into residential space continues to be highly attractive in many areas of the city. Due to the foreseeably low completion volume in the next few years, we can therefore expect vacancy to continue to drop with a vacancy rate of below 12% being likely this year.

Rents remain high

Prime and average rents remained unchanged compared to Q4 2014 at €38.00 per sqm and €19.50 per sqm, respectively. Average rent posted a year-on-year increase of more than 5%. Prime rent was only paid for a few properties in top CBD locations such as Opernplatz and TaunusTurm. There is currently very little office space available for more than €40.00 per sqm. Average rent has benefited from large-scale leases in the CBD over the past 12 months as well as from an ongoing trend toward signing leases in the CBD and downtown submarkets.

Prime and average rent for office space (in EUR per sqm)



Banks and consulting firms continue to dominate letting market

As in previous years, the largest lease signed in Q1 involved the banking and financial service provider industry, which accounted for around 40% of total take-up with 12 leases signed for a total of 34,700 sqm. Consulting firms signed the most leases, putting them in second place with 27 leases signed for around 12,800 sqm. Companies from the health and social services sector followed these two industries, which are traditionally the most important industries on the Frankfurt office leasing market, signing 9 leases for around 7,300 sqm of office space in total. Almost 60% of that space was taken up by a lease signed for a clinic located at Opernplatz. Six additional industries leased more than 2,000 sqm each, indicating widespread demand from different economic sectors not only limited to the financial and consulting sector.

Property index down slightly

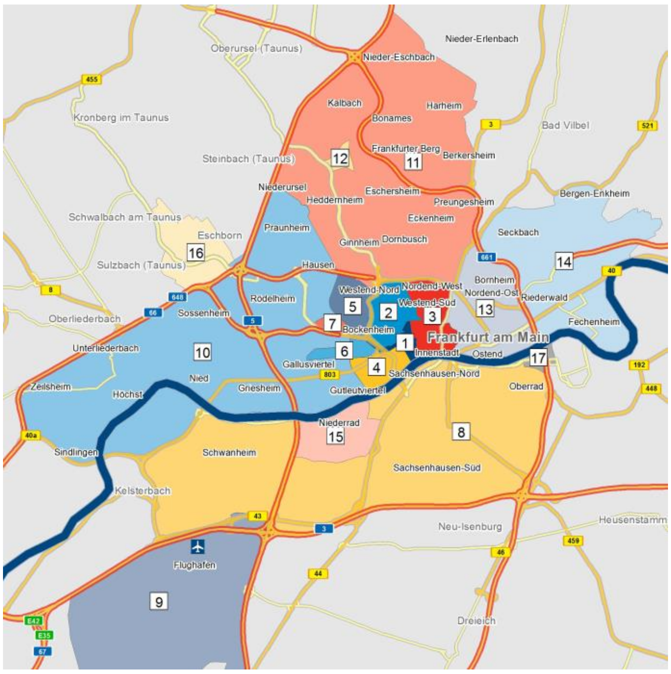
The property index compares the supply of office space with take-up of space over the past twelve months, making it an indicator of the relationship between supply and demand. After posting an increase in the second half of 2014, the property index was down slightly in Q1 from 4.62 to a current 4.43. This can be attributed to an increase in take-up compared to Q1 2014 as well as to the continued drop in vacancy, which has a positive effect on the relationship between supply and demand.

Outlook: Upward trend continues

Following a below-average 2014, the results for Q1 2015 on the Frankfurt office letting market indicate an upward trend. Although the scarcity of large-scale leases can still be felt, lively activity in the space segment of less than 5,000 sqm has caused take-up to increase by around 6%. The widespread demand across space and rent segments as well as industries is good news as well and emphasizes Frankfurt's attractiveness as a business location. We can particularly expect demand to remain high over the course of the year in the space segment of less than 5,000 sqm. Large-scale users continue to carefully weigh their decisions to move locations as the supply of modern, attractive office space in the CBD is limited and property owners are offering attractive incentives for renewing leases at current locations. However, we can expect to see more leases signed by large-scale users over the course of the year, which will have a positive impact on take-up. Based on the above, we consider take-up of around 400,000 sqm to be realistic for 2015.

Fast Facts	
Office Letting	
Take-up of space	87,000 sqm
Leased space	54,800 sqm
Prime rent	€ 38.00 per sqm
Average rent	€ 19.50 per sqm
Vacancy rate	11.2 %
Stock of office space	11.5 million sqm

Sub-markets Frankfurt



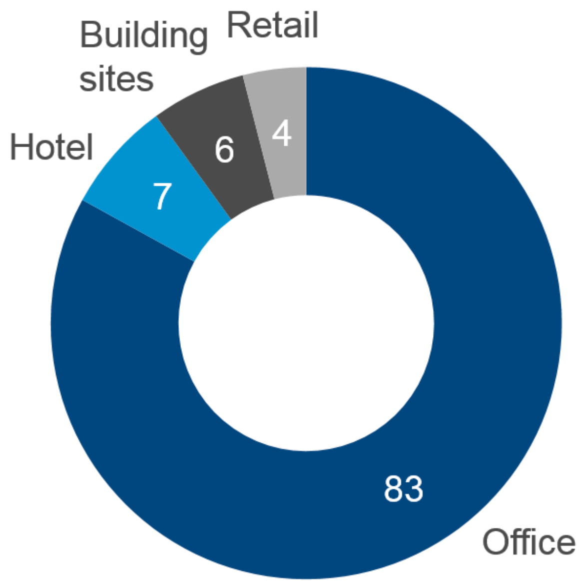
Frankfurt office letting market indicators (Q1 2015)

Market Overview					
Location	Take-up of space (in sqm)	Achievable rents (in EUR per sqm)	Average rents (in EUR per sqm)	Vacancy rate (in %)	Vacant space (in sqm)
(1) Banking district	9,400	25.00 - 41.00	30.70	14.3	200,400
(2) Westend	1,400	18.00 - 35.00	21.00	10.7	89,200
(3) City	16,100	12.00 - 33.00	20.90	10.1	117,500
(4) Central station/ Westhafen	37,000	9.00 - 22.50	14.50	6.8	69,500
(5) Bockenheim	1,700	12.00 - 16.50	15.20	6.0	14,500
(6) Europaviertel/ Fair district	1,200	16.50 - 20.00	19.00	9.8	7,100
(7) City West	400	11.50 - 18.50	15.00	14.7	90,500
(8) Frankfurt South	2,600	10.50 - 18.00	14.50	9.0	60,000
(9) Airport	900	15.00 - 26.00	18.00	15.9	83,400
(10) Frankfurt West	3,400	9.00 - 13.00	10.40	7.4	105,200
(11) Frankfurt North	0	8.50 - 12.00	10.50	12.8	55,000
(12) Mertonviertel	300	9.50 - 12.00	11.50	44.1	121,300
(13) Eastend West	2,400	8.00 - 16.00	12.80	6.2	29,700
(14) Eastend East	100	8.00 - 12.50	9.60	16.2	41,500
(15) Niederrad	3,500	9.00 - 14.50	12.00	18.5	125,400
(16) Eschborn	6,600	9.00 - 15.50	12.50	15.6	145,600
(17) Kaiserlei	0	9.00 - 11.00	10.00	22.8	54,100
Total market	87,000	8.00 - 41.00	19.50	12.2	1,409,900 m²

Investment

The investment market carries over the strong momentum from the end of 2014. 28 commercial properties and building sites with a volume of around €1.1 billion changed hands during the first three months of the year, reflecting a year-on-year increase of 50%. Two large-volume transactions of more than €100 million generated approx. 37% of total transaction volume, an indication of lively activity in the price segment below €100 million. Half of the 28 properties and lots were sold for between €20 million and €85 million.

Types of properties (in %)



Office property traditionally sets the pace for transaction activity and was once again the number one investor favorite in Q1 2015 with a market share of more than 83% and a transaction volume of €916 million. Hotel properties followed in second place with investors pouring around €79 million into three transactions. Third place went to commercial building sites with a volume of around €60 million, the majority of which was invested in the Siemens property in Rödelheim. Retail properties came in fourth with only two property sales and a volume of around €45 million. The limited supply of property can particularly be felt in the retail property segment where very few high-street properties are currently listed. Demand in this segment, as in all other asset classes, remains high.

Fast Facts	
Investment	
Transaction volume	1.10 billion €
Largest group of purchasers	Pension funds 23%
Largest group of sellers	Banks 27%
Most important property type	Office 83%
Prime yield office	4.75 %

Pension funds and asset and fund managers are largest buyers

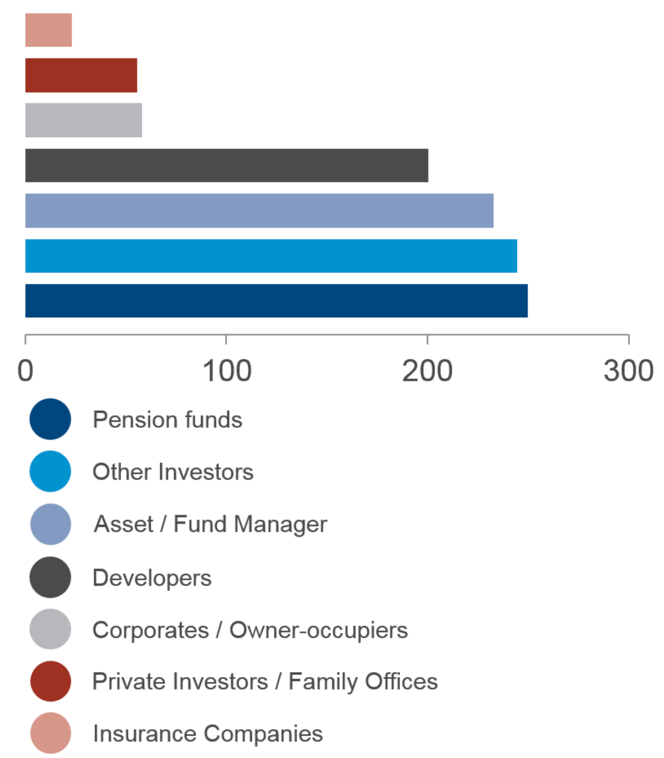
Pension funds were involved in the largest deal in Q1, investing the highest volume at around €250 million in a single deal. Asset and fund managers came in second with four transactions totaling at €233 million. Project developers were the most active buyers, purchasing eight building sites/properties for roughly €200 million.

Banks led the pack in terms of selling with three transactions and a volume of €295 million, followed by project developers (€293 million) and opportunity/private equity funds (€134 million).

More than 50% of investment volume from international investors

Non-German investors were very active in Q1, accounting for more than 50% of total transaction volume on the buyer and seller side. While around €587 million was invested by foreign buyers, properties worth around €574 million were sold by foreign sellers, i.e., a positive net inflow of capital from abroad. International investors were once again particularly active in the price segment of more than €50 million with German investors taking on a dominant role below €50 million. We can expect more international investors to become active over the course of the year, participating in bids in large numbers and possibly landing some large-scale deals.

Transaction volume according to buyer groups (in millions of euros)



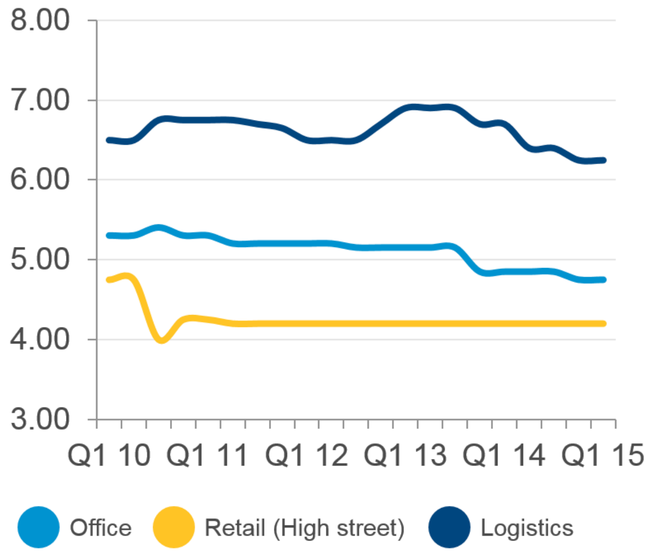
Limited supply forces investors to take on more risk

Four core properties were sold in Q1 with a combined transaction volume of more than €380 million, reflecting a market share of 35%. This market share was significantly higher in Q1 2014 at more than 50%. However, compared to the previous year more money was invested in the remaining risk classes. More than €275 million was poured into ten development and refurbishment projects, including the Westend Ensemble with a transaction volume of more than €80 million. The value-add segment also recorded high demand with transaction volume totaling at approx. €210 million. In Q1, all risk classes saw investment volumes of more than €50 million each, highlighting the diversified demand from different investor types in Frankfurt.

Yields remain under pressure

Gross prime yields remained unchanged compared to the previous quarter at 4.20% (retail), 4.75% (office) and 6.25% (logistics). However, due to high demand and limited supply of profitable alternative investment options, yields remain under pressure, making it likely that we will be seeing ongoing yield compression in the coming months. Investors from Asia, in particular, are used to yield levels from their local markets below the ones currently recorded on the Frankfurt market.

Gross prime yield by asset type (in %)



Outlook: Ongoing lively activity, large deals in pipeline

German and international investors will continue to focus on Frankfurt commercial real estate in 2015 as well. Frankfurt not only benefits from Germany's stable economy and the current situation on the financial markets, but also from a wide spectrum of different investment opportunities spanning large-scale core, core plus and value-add properties to refurbishment and repurposing projects. Supply is particularly tight in the core segment, making it difficult to meet ongoing high demand. This leads to bidding wars for large-scale core properties, which puts pressure on yields. Many investors are not willing to buy in such conditions and prefer to accept the risks associated with core plus and value-add properties as well as location and leasing risks to achieve their investment goals. We also see increasing pressure on yields in secondary locations and in the city periphery.

We do not expect demand for commercial properties to slow down in Frankfurt during the remainder of this year. More transactions are in the pipeline not only when it comes to big-ticket deals of more than €200 million, but also in the price segments of between €50 million and €100 million as well as below €50 million. We therefore expect the number of transactions in 2015 to match previous year results, which will also have an impact on transaction volume.

502 offices in 67 countries on 6 continents

USA: **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 m² under management

16.300
Professionals and staff

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