PRIMONIAL REIM GERMANY

JULY 2023

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PRIMONIAL REIM GERMANY PERSPECTIVES

Investor´s view on the German Real Estate Market

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The Research & Strategy Department´s role is to formalize Primonial REIM´s real estate investment strategies, based on continuous monitoring of the European markets. By nature, real estate is at the crossroads of financial (interest rates), economics (tenants), demographics and social factors. This is why a broad analysis is needed, which is also long term and therefore matches the horizon of most real estate investors.

Primonial REIM relies on its local teams to provide on-the-ground research on the German markets. As Germany is a polycentric market, with specific real estate features, standards of valuation, demographic challenges and industrial forces, we want to provide a regular analysis of Germany´s real estate markets, from the investor´s viewpoint. This is the purpose of our quarterly *Real Estate Perspectives Germany study.*

FIGURES 2023

FORECAST ECONOMIC GROWTH (GDP)

-0.5%

FORECAST INFLATION

+5.6%

10-YEAR GOVERNMENT BOND YIELDS

+2.4%

Source: Oxford Economics, Bundesbank

ECONOMY

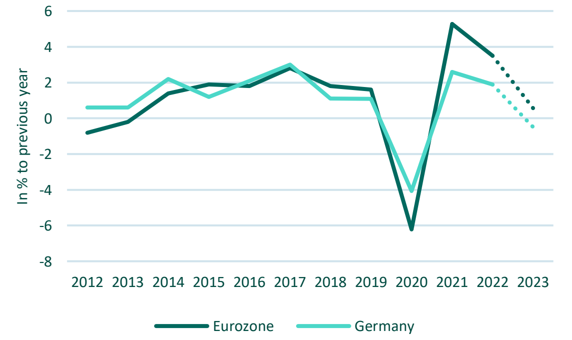
The first quarter of 2023 was the second quarter with declining economic growth, so that Germany is technically in a recession. For the year as a whole, economic growth is also expected to be slightly negative at -0.5 %. Nevertheless, the Bundesbank is already seeing signs of initial improvement. For the second quarter, it even expects a slight increase in economic output. In a European comparison, Germany is at the lower end in terms of growth prospects. The main reasons are the great dependence on gas supplies and the global supply chains.

INFLATION

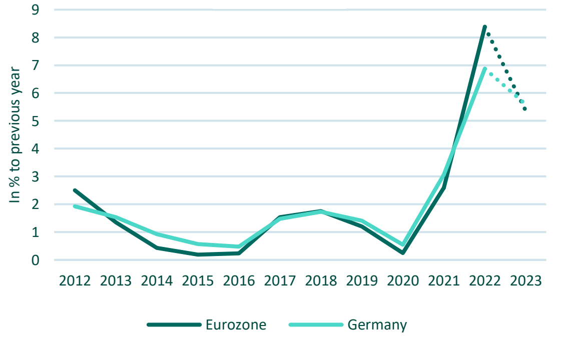
The inflation trend has lost momentum compared to the end of 2022 and stood at 6.4% in June 2023. For the year as a whole, inflation of 5.6% is expected. For key interest rates and the associated development of construction interest rates, this would mean a continued rather restrictive monetary policy with further interest rate hikes. In the USA and the UK, inflation has already fallen noticeably, which points to an end of key interest rate increases in these countries in the medium term. Such signals are not yet discernible for the Eurozone. In particular, core inflation, which does not take energy and food prices into account, remains at a high level. The slight recession in Germany, significantly lower energy prices as well as further key interest rate increases nevertheless lead us to expect falling inflation rates by the end of the year.

The interest-rate-induced property devaluations could therefore soon come to an end and lead to greater clarity regarding the current price level on the property markets.

GDP



Inflation

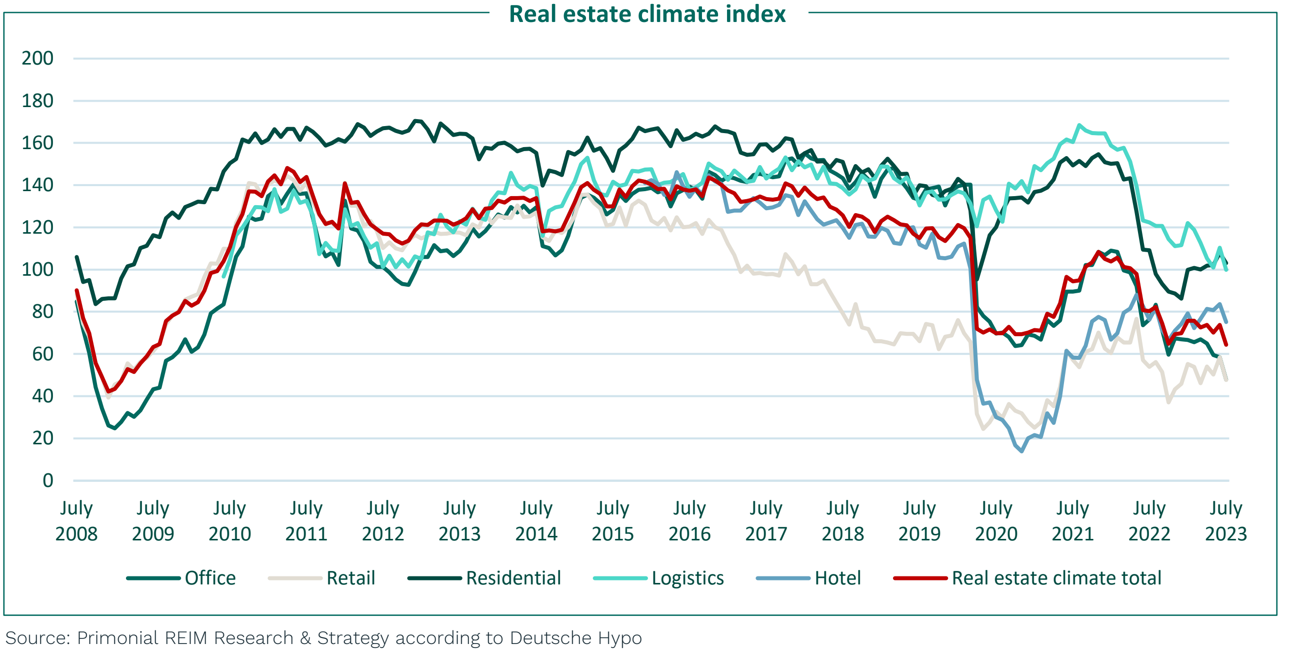


Source: Oxford Economics

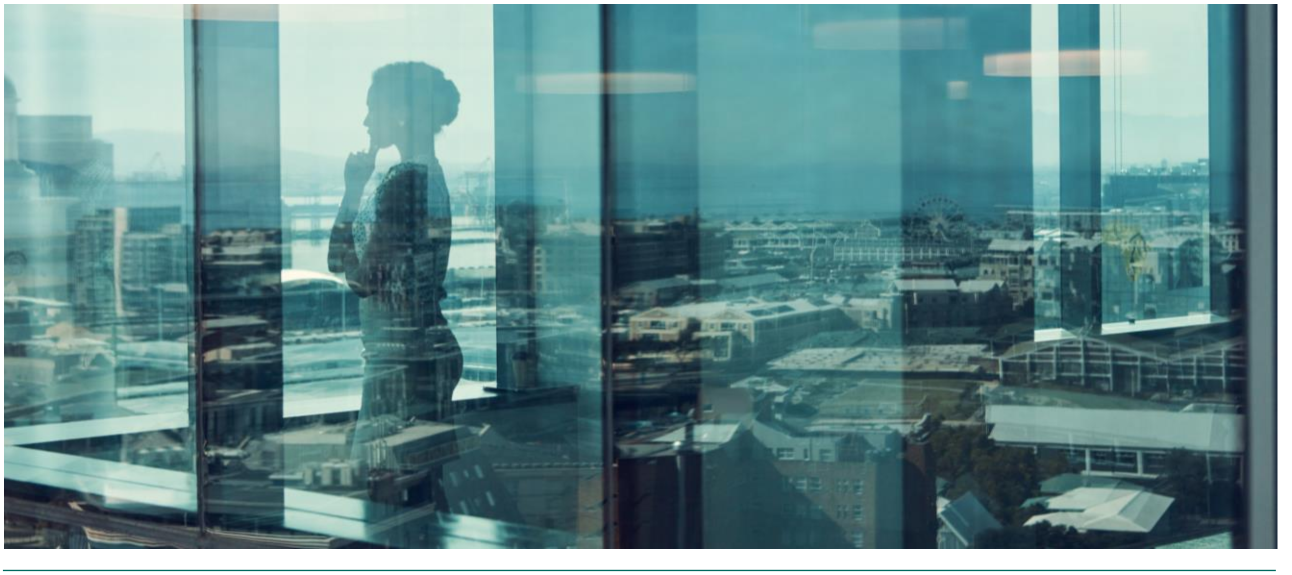
GERMAN REAL ESTATE CLIMATE

For some time, the mood on the real estate market was buoyed by hopes of an imminent improvement. In the meantime, a certain resignation is spreading, which can also be seen in the sentiment barometer. The overall real estate climate has fallen to its lowest point of the year, 64.3 points. Only a few players still expect a noticeable increase in transaction activity or even a year-end rally in 2023.
Meanwhile, the mood on the office markets has reached the bottom. 47.9 points represent the lowest value since 2009 at the height of the global financial crisis.
To classify the current sentiment values, it is worth taking a look at the beginnings of the real estate climate shortly before the start of and during the financial crisis.

Even 15 years ago, the residential market was significantly less affected by sentiment slumps and was able to recover faster than the commercial asset classes. Then as now, housing is perceived as an anchor of stability. This perception is further reinforced by a decline in construction activity, which is expected to lead to excess in demand for existing housing in the coming years. This perspective has led to housing regaining the top position from logistics in July. Against the backdrop of high regulatory requirements in terms of tenant protection and energy efficiency upgrades, however, it remains to be seen whether the housing markets will be able to meet the high expectations of market players.



Source: Primonial REIM Research & Strategy according to Deutsche Hypo

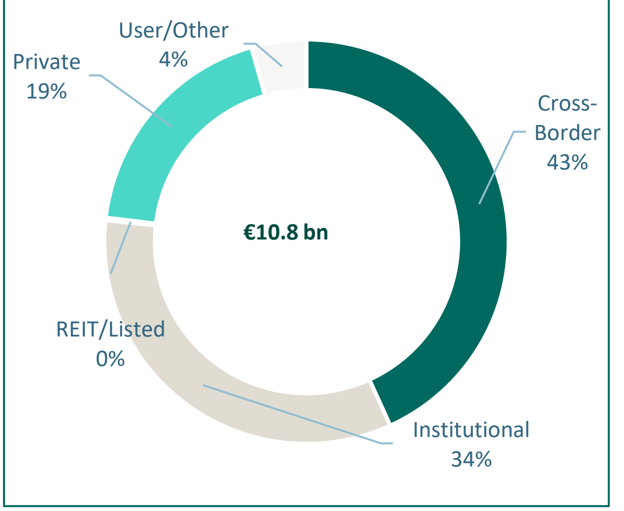


TRANSACTION VOLUME

The first half of 2023 is over and - this much can already be said - the hopes of many real estate market players for a quick market recovery will not be fulfilled. In the first six months of the year, a total of 10.8 billion euros was invested in the largest real estate asset classes. This figure is significantly below the lowest value of the last ten years. Foreign investors have invested around 4.6 billion euros in German real estate so far. Most capital flowed into office properties, followed by retail and residential. The three most established asset classes are thus at the top, albeit far from the transaction volumes of the last ten years. The only asset class with an investment volume comparable to previous years is healthcare. Here, despite the financial difficulties of some operators, the level of the previous years was roughly reached at €0.7 billion.

The much-discussed question remains when the price declines will have reached their plateau and real estate investment will be worthwhile "again". One of the most important parameters is the risk premium, which indicates the difference in yield between real estate investments and almost risk-free government bonds. However, especially when it comes to determining current real estate yields, many market players are groping in the dark due to a lack of comparable transactions. In order to actually be able to profit from the fallen prices, it requires not only a clear asset management strategy, but above all the courage to invest anti-cyclically.

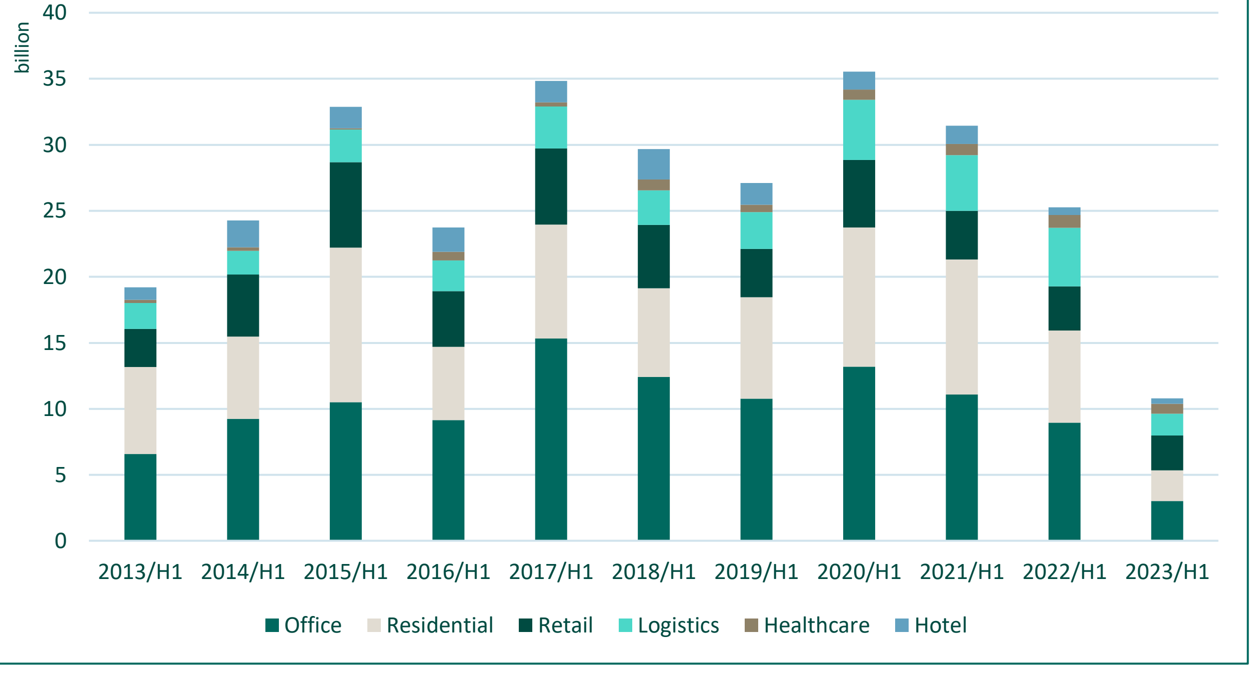
Investors composition H1/2023



OUTLOOK

Investors continue to give real estate as an asset class a wide berth and are waiting for what they consider to be a good time to enter the market. Against the backdrop of significantly declining inflation rates in the USA and Great Britain, an end to the central banks' interest rate hikes is coming into sight. Interest-rate-induced property devaluations could therefore come to an end more quickly than some market participants currently expect. The situation is different for devaluations due to poor energy performance. Here, a large part of the necessary investment costs are still not adequately reflected in the valuation level.

Transaction volume per asset class



Source: Primonial REIM Research & Strategy according to RCA

SUMMARY ASSET CLASSES

Asset Class	Transaction Volume H1/2023	Transaction Volume 5-year-average H1	Cross-Border Volume H1/2023	Prime Yields Q2/2023	Trend Transaction Volume Previous Half Year
Office	€3.0 bn	€11.2 bn	€0.7 bn (23 %)	4.1 %	➘
Residential	€2.3 bn	€8.4 bn	€1.2 bn (54 %)	3.0 %	➘
Retail	€2.6 bn	€4.1 bn	€1.1 bn (42%)	4.2 % (High-Street-Shops)	➘
Healthcare	€0.7 bn	€0.8 bn	€0.3 bn (46 %)	4.9 %	➘
Hotel	€0.4 bn	€1.4 bn	€0.25 bn (59 %)	4.9 %	➘
Logistics	€1.7 bn	€3.7 bn	€0.9 bn (53 %)	4.0 %	➘

Source: Primonial REIM Research & Strategy according to CBRE, RCA

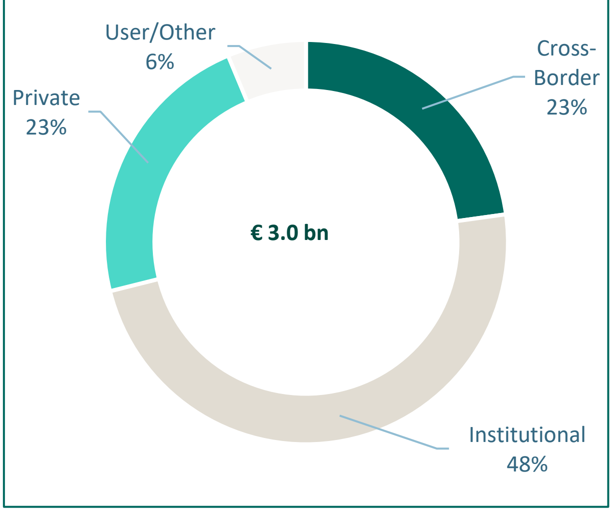
OFFICE

OFFICE TRANSACTION VOLUME H1/2023	€3.0 bn
THEREOF CROSS-BORDER TRANSACTION VOLUME H1/2023	€0.7 bn
PRIME YIELDS OFFICE A-CITIES Q2/2023	4.1 %
PRIME YIELDS OFFICE SECONDARY-CITIES Q2/2023	4.4 %
TREND TRANSACTION VOLUME COMPARED TO THE PREVIOUS HALF YEAR	↘

No other asset class is currently viewed with as much scepticism by investors as office. In addition to the now rather ideological home office debates, concerns about a prolonged recession and the associated effects on the demand for office space are playing a major role. It is becoming increasingly apparent that many companies have rented too much space in the past, especially if it is in rather decentralised locations. The labour market, on the other hand, continues to have a stabilising effect on the office sector. Even though the unemployment rate rose slightly in June, employment figures are still very stable. Similarities with the years before and during the financial crisis are therefore hardly discernible, even if the sentiment barometers point in that direction.

The ongoing restraint has led to office transaction volumes of only €3bn in the first half of 2023. This volume is not even half as large as the lowest value of the last ten years in the comparable period. The bull market is thus finally over. Foreign investors are also currently giving German office properties a wide berth. Due to the rather static German valuation methodology and the lack of comparable transactions, many book values of large office portfolio holders have not yet been adjusted to the current market level. As soon as these interest-related value adjustments have taken place, higher market activity can be expected. The current prime yield reported by CBRE is now 4.1% for A-cities and 4.4% in secondary cities.

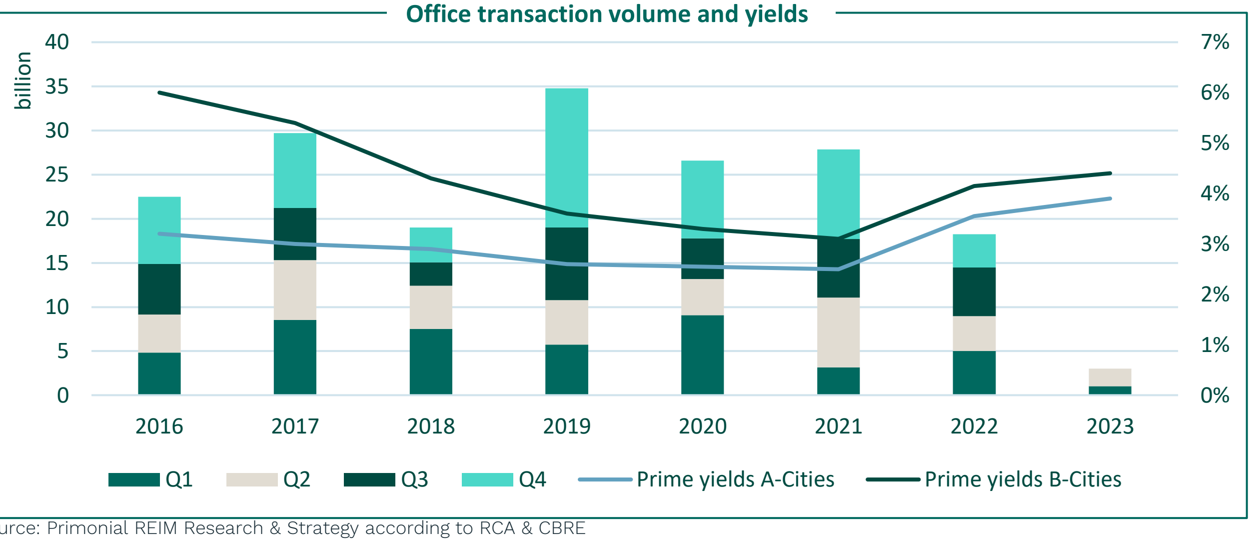
Investors composition office H1/2023



OUTLOOK

Price discovery continues, even if it is noticeable that sellers are now accepting larger price reductions compared to the peak levels of previous years. The labour market continues to have a stabilising effect. As soon as the book values of the portfolio holders have also been adjusted to the new price level, purchasing opportunities will arise. The extent to which prices for office properties will continue to fall depends to a large extent on the development of interest rates and the economy in the coming months.

Office transaction volume and yields



Source: Primonial REIM Research & Strategy according to RCA & CBRE

RESIDENTIAL

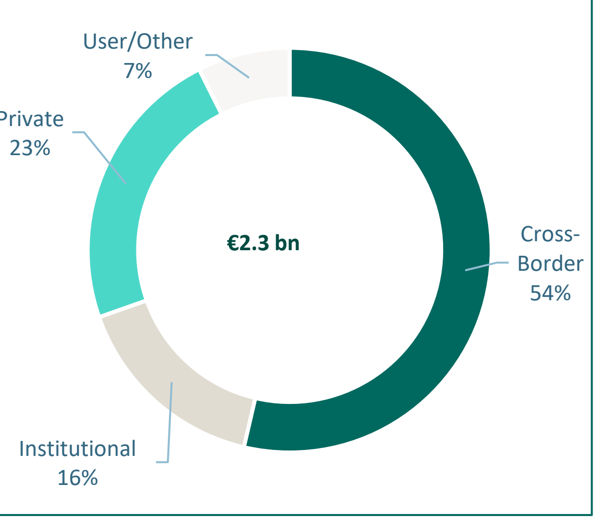
TRANSACTION VOLUME RESIDENTIAL H1/2023	€2.3 bn
THEREOF CROSS-BORDER TRANSACTION VOLUME H1/2023	€1.3 bn
PRIME YIELDS RESIDENTIAL Q2/2023	3.0 %
TREND TRANSACTION VOLUME COMPARED TO THE PREVIOUS HALF YEAR	↘

In the first half of 2023, around 2.3 billion euros were invested in German residential real estate. More than half of the invested capital came from abroad. The residential investment market, like the office sector, has thus slowed down considerably in terms of transaction volume. Nevertheless, against the background of declining approval and completion figures, many investors are looking with great interest at the German residential market. The simple formula is: less construction activity in the next few years will lead to higher demand for existing flats and thus to significantly rising rents. However, three things should not be ignored in the supposedly convincing argumentation:

1. In Germany, tenants are very strongly protected by law and rent increases are not always enforceable.
2. Demographic developments should ease the supply situation in the medium term, especially in the owner-occupied housing sector, as the age of flat and home owners will increase significantly, bringing more living space onto the markets.
3. The new EU building directives will further increase the pressure to make the (residential) building stock more energy-efficient.

Especially for the latter aspect, a building age class-specific renovation strategy is essential in order to be able to price in the actual costs of the "green transformation".

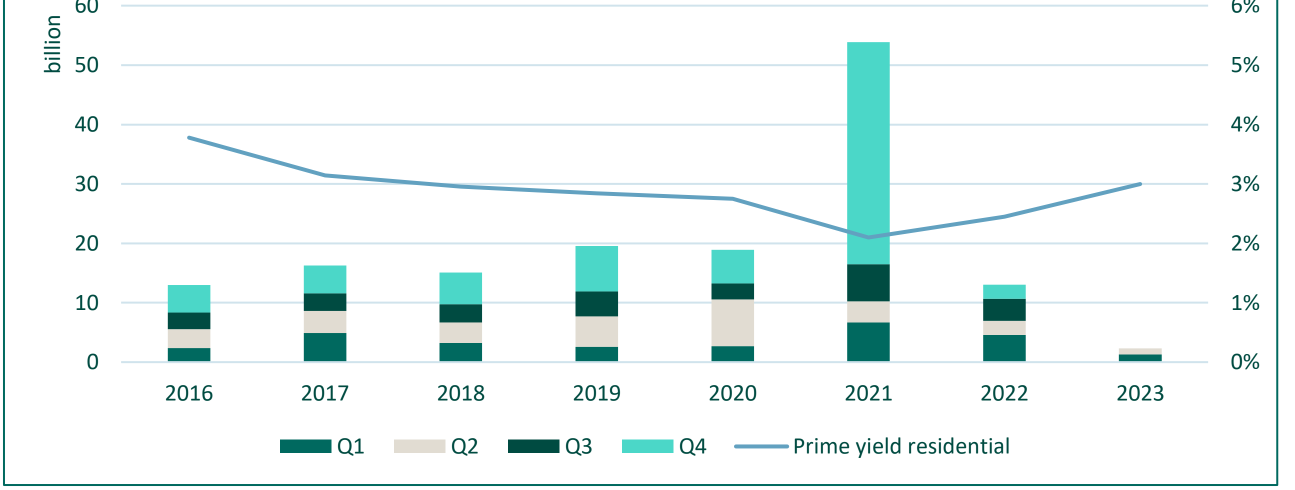
Investors composition residential 2023/H1



OUTLOOK

Residential real estate is, in relative terms, the new darling of investors and promises stability in economically uncertain times. At the same time, neither the interest rate-related devaluations nor the costs of the "green transformation" are sufficiently reflected in the current price level. Whether these "overvaluations" can be fully offset by rising rents in a highly regulated market segment or whether it makes more sense to wait for further price corrections depends largely on the further development of interest rates.

Residential transaction volume and yields



Source: Primonial REIM Research & Strategy according to RCA & CBRE

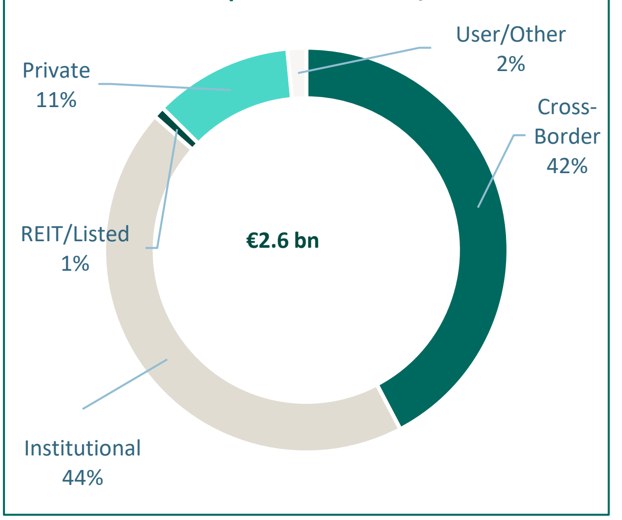
RETAIL

TRANSACTION VOLUME RETAIL H1/2023	€2.6 bn
THEREOF CROSS-BORDER TRANSACTION VOLUME H1/2023	€1.1 bn
PRIME YIELDS HIGH-STREET-SHOPS Q2/2023	4.2 %
PRIME YIELDS SUPERMARKETS Q2/2023	4.6 %
PRIME YIELDS SHOPPING-CENTER Q2/2023	5.1 %
TREND TRANSACTION VOLUME COMPARED TO THE PREVIOUS HALF YEAR	↘

A total of €2.6 billion was invested in retail property in the first six months. Unlike the established asset classes of office and residential, retail real estate thus recorded a smaller slump compared to previous years. However, these figures are significantly influenced by the takeover of some large Karstadt department stores, so that hardly any overriding findings can be derived from the higher transaction volumes. It is not uncommon for the former Karstadt and Kaufhof buildings to be acquired as conversion projects with the aim of marketing them as mixed-use buildings after the completion of extensive conversion measures. For conventional shopping centres and retail parks, on the other hand, the market situation remains complicated, as in many cases the future viability of entire business models is called into question by online retailing and changing consumer habits.

Prime yields for conventional retail properties have continued to rise in the second quarter of 2023 and currently stand at 4.2% for high-street shops, 4.6% for supermarkets and 5.1% for shopping centres.

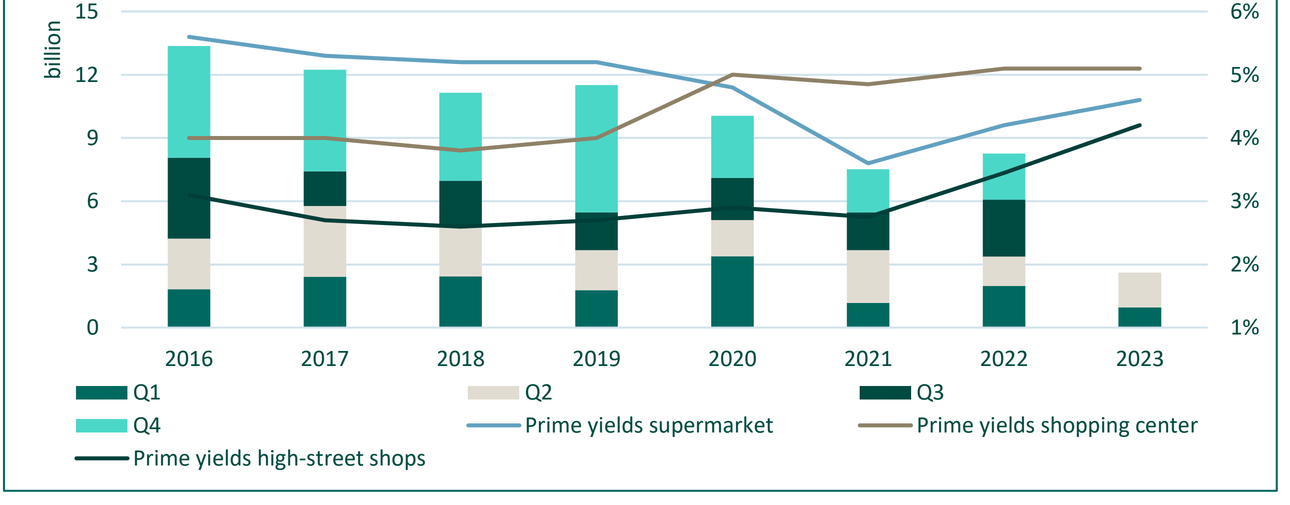
Investors composition retail H1/2023



OUTLOOK

Finding retail properties with solvent tenants and a sustainable business model remains the major challenge outside of supermarkets. Specialised project developers are increasingly looking at the conversion potential of centrally located retail properties.

Retail transaction volume and yields



Source: Primonial REIM Research & Strategy according to RCA & CBRE

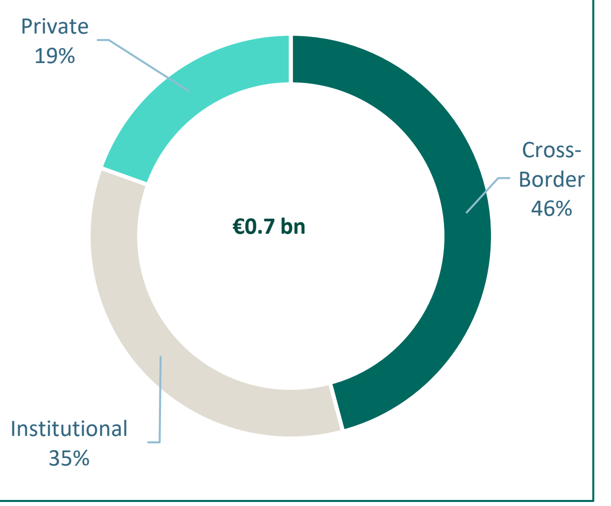
HEALTHCARE

HEALTHCARE TRANSACTION VOLUME H1/2023	**€0.7 bn**
THEREOF CROSS-BORDER INVESTMENT VOLUME H1/2023	**€0.3 bn**
PRIME YIELDS HEALTHCARE Q2/2023 (BRUTTOANFANGSRENDITE)	**4.9 %**
TREND TRANSACTION VOLUME COMPARED TO THE PREVIOUS HALF YEAR	↘

Real estate markets are considered relatively sluggish and inefficient. Against this backdrop, the speed at which prime yields for nursing homes have risen in recent months is quite remarkable: from 3.9% at the end of 2021, 4.4% at the end of 2022 to 4.9% by mid-2023. There are some indications that not all risk factors have been sufficiently priced in, so that further moderate devaluations can be expected by the end of the year. In addition to interest-related value corrections and the financial difficulties of some operating companies, energy-related aspects are increasingly playing a role. From an investor's point of view, the first aspect cannot be influenced. Investors also have only limited influence on the financial situation of the care operators, as the rent to be paid usually accounts for significantly less than 10% of the operators' total costs. In contrast, aspects relating to the energy and CO2 consumption of the buildings can be positively influenced. Significant energy costs can be saved, for example, by installing PV systems, whereby the owner also benefits by reducing the CO2 footprint of the building.

Despite the risks mentioned above, around 0.7 billion was invested in German healthcare real estate in the first half of 2023. This corresponds roughly to the average level of the last five years in the same comparison period. Investor interest thus remains high, even if the transactions carried out are characterised by significantly higher selectivity with regard to operator creditworthiness and energy-related building aspects.

Investors composition healthcare H1/2023

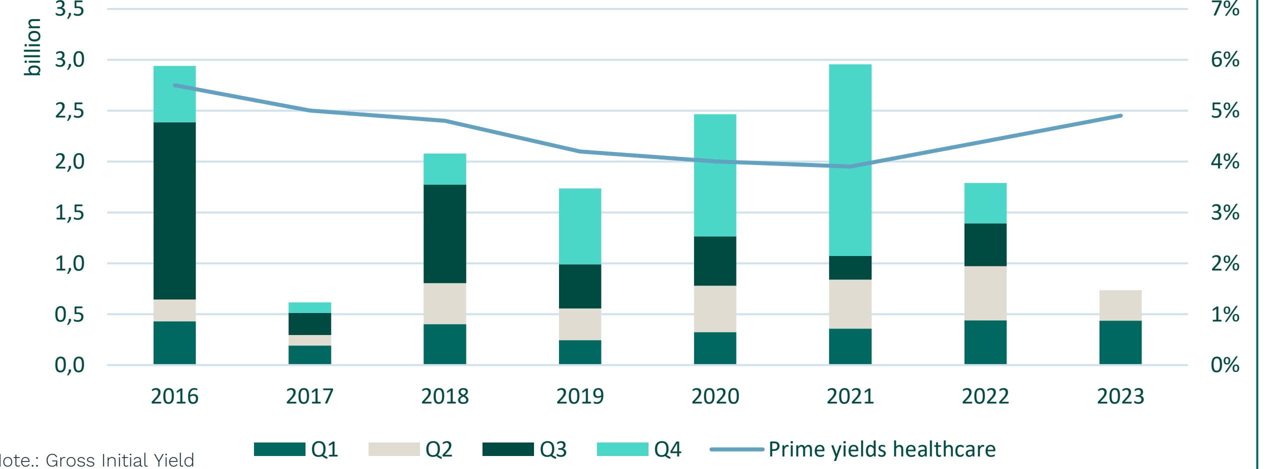


OUTLOOK

The structural problems of the care sector with a lack of staff and resulting low utilisation rates persist and require an overarching state reform.

Provided that the location, operator and building quality are suitable, healthcare real estate can represent an attractive investment against the backdrop of demographic development, even in a complicated market environment. A precise analysis of the financial situation of the respective nursing home operator is more important than ever.

Healthcare transaction volume and yields



Note.: Gross Initial Yield

Source: Primonial REIM Research & Strategy according to RCA & CBRE

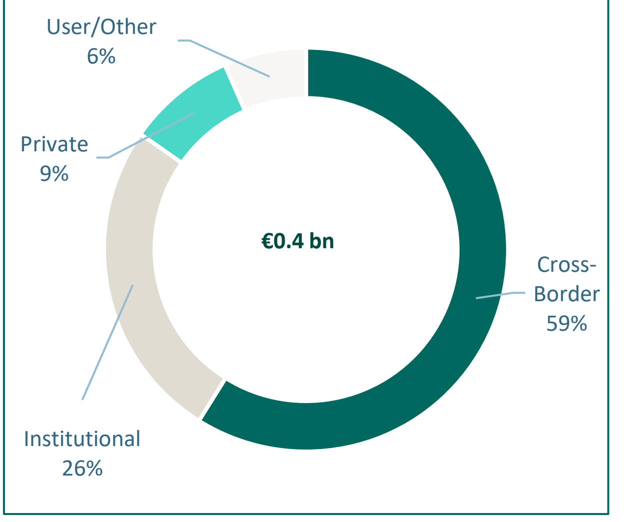
HOTEL

HOTEL TRANSACTION VOLUME H1/2023	€0.4 bn
THEREOF CROSS-BORDER INVESTMENT VOLUME H1/2023	€0.2 bn
PRIME YIELDS HOTEL Q2/2023	4.9 %
TREND TRANSACTION VOLUME COMPARED TO THE PREVIOUS HALF YEAR	↘

Hotel real estate remains the asset class with the least investor interest. Only 400 million euros were invested in German hotel properties in the first half of the year. Prime yields are currently at 4.9%. The increase is thus much less steep than in other asset classes, as there were already noticeable devaluations at the beginning of the pandemic.

Unlike the investment market, the hotel industry in general is currently on the road to recovery. So far this year, the number of overnight stays is significantly higher than in the previous year and in May was even at a higher level than in 2019. Domestic tourism in particular is booming. This is reflected in around 8 % more domestic overnight stays than in 2019. Nevertheless, hotel operators continue to face major challenges. Besides the usually indexed lease contracts, high energy costs and staff shortages play a major role. So far, however, hotel operators seem to be able to pass on the higher costs to the end users through higher prices. In spring, the hotel chain Accor reported a 19 % higher RevPAR compared to 2019, which is currently considered the most important reference year due to the special situation in the Corona years.

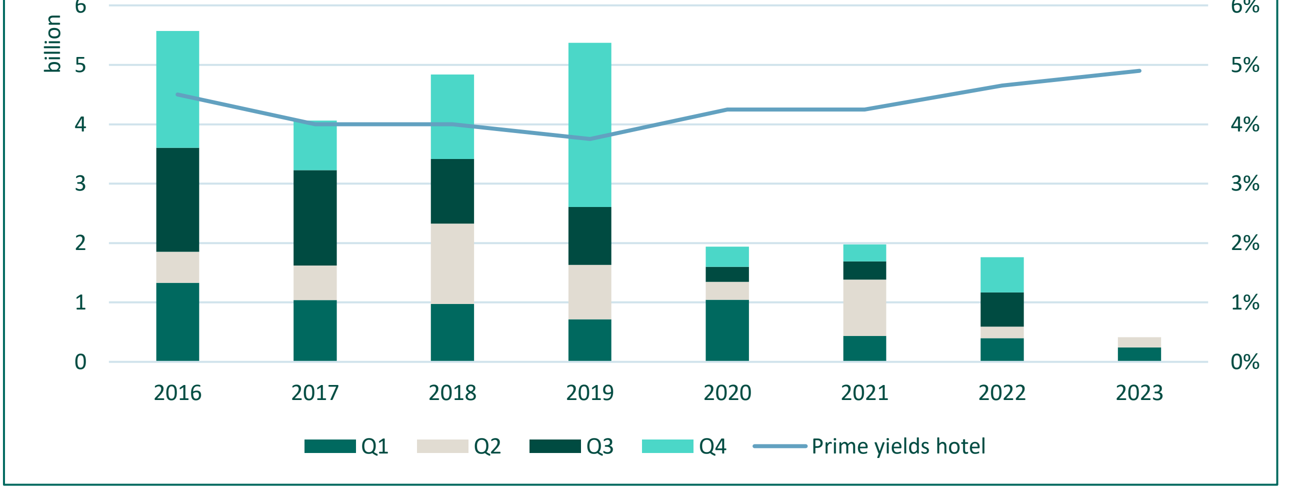
Investors composition hotel H1/2023



OUTLOOK

The number of overnight stays in the first six months is good and is roughly at the same level as in 2019. Nevertheless, investors remain cautious. Investors who bought at high prices in the pre-Corona years are delaying possible sales due to the significant devaluations. The large operator chains are reporting good figures again after a long dry spell, so that attractive purchase opportunities could also arise for real estate investors.

Hotel transaction volume and yields



Source: Primonial REIM Research & Strategy according to RCA & CBRE

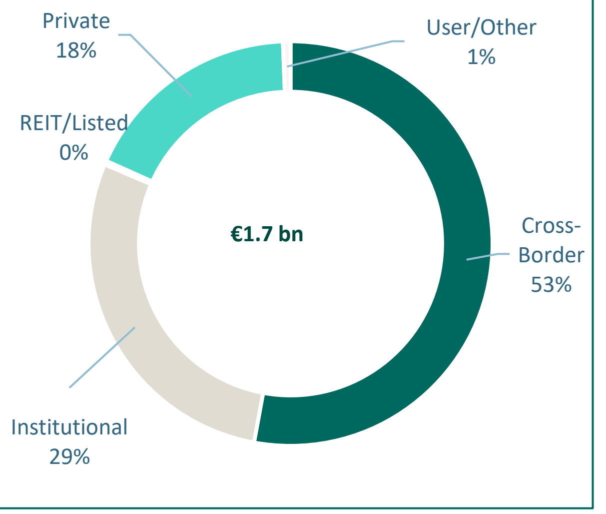
LOGISTICS

LOGISTICS TRANSACTION VOLUME H1/2023	€1.7 bn
THEREOF CROSS-BORDER INVESTMENT VOLUME H1/2023	€0.9 bn
PRIME YIELDS LOGISTICS Q2/2023	4.0 %
TREND TRANSACTION VOLUME COMPARED TO THE PREVIOUS HALF YEAR	↘

The party mood on the logistics markets is over for the time being. Not only is the transaction volume a far cry from the boom years since 2017, but take-up has also slumped significantly. Both investors and occupiers have become more selective and cautious. In addition, there is less supply of new construction space due to the increased construction costs, so that sales of new, modern logistics space in particular have declined. Many users of logistics properties are directly or indirectly dependent on German industry, so that the declining economic growth is also dampening the mood in the logistics sector.

In total, around 1.7 billion euros were invested in logistics properties in the first half of 2023. This is the lowest value in the last ten years. Foreign investors continue to account for a high share (53 %). The prime yield is currently at 4% and thus around 100 basis points below the low at the end of 2021. Compared to other asset classes, the value reductions recorded so far are still relatively low. This means that either further value adjustments are imminent or logistics properties are coming through the crisis particularly well. However, a look at the share price development of listed real estate companies with significant logistics portfolios raises doubts as to whether logistics properties are actually less affected by interest rate and cyclical devaluations.

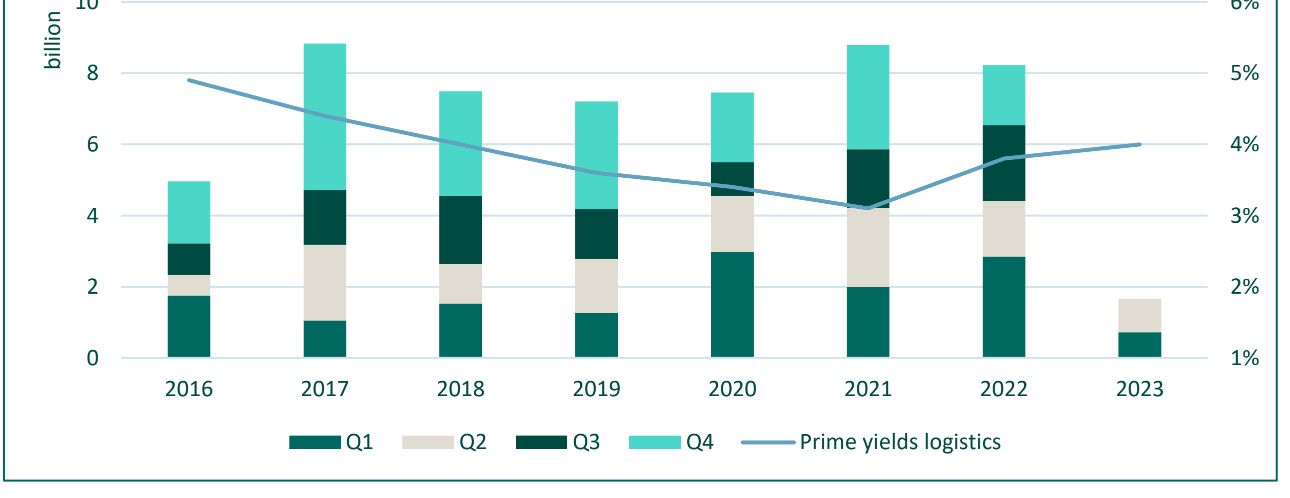
Investors composition logistics H1/2023



OUTLOOK

The interest-related value correction of German logistics properties has so far been lower than in other asset classes. However, investors are becoming much more selective when choosing logistics properties. Demand for space is also far from the record levels of 2021 and 2022. Against the backdrop of high location costs in Germany, a persistently lower demand for logistics is not unlikely. Other European countries could therefore benefit more from possible reshoring to secure supply chains.

Logistics transaction volume and yields



Source: Primonial REIM Research & Strategy according to RCA & CBRE

DEFINITIONS

10-year government bonds: debt securities issued by a state for a period of ten years, generally acknowledged to be a risk-free investment.

Investment volume/transaction volume: total volume of premises acquired in the offices, residential, retail, business premises and warehouses segments by an investor.

Take-up offices: all leases or sales to the occupant (as opposed to sales to investors) for premises to be used as offices. It is expressed as square meters of usable space.

Yield: ratio between the net revenues from the building and the capital committed by the buyer (acquisition price + fees and transfer taxes). All yields quoted follow this definition unless otherwise stated

High-Street-Shops: traditional ground-floor retail premises located in town-center high streets.

Shopping center: a building containing at least 20 retail outlets housed in indoor centers around a large food store that drives customer traffic.

RevPAR: abbreviation for Revenue Per Available Room. It corresponds to the turnover on accommodation of an establishment divided by the total number of rooms RevPAR also corresponds to Occupancy Rate multiplied by ADR.

Hotel Occupancy Rate (OR): ratio of the number of occupied rooms to the total number of rooms in a hotel.

Über Primonial REIM

Primonial REIM has a workforce of 400 employees in France, Germany, Luxembourg, Italy, the UK and Singapore. Its values of conviction and commitment as well as its expertise on a European scale are used to design and manage real estate funds for its national and international clients, whether they are individuals or institutions.
Primonial REIM currently has €42 billion of assets under management. Its conviction-based allocation breaks down into:

- 47 % healthcare/education,
- 35 % offices,
- 8 % residential,
- 5 % retail,
- 4 % hotels
- 1% logistics.

Its pan-European platform manages 61 funds and has more than 80.000 investor clients, 55% of which are individual investors and 45% institutional. Its real estate portfolio consists of more than 1.400 properties (offices, health/education, retail, residential, hotels) located in eleven European countries.

www.primonialreim.com

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The Research & Strategy Department’s role is to formalize Primonial REIM’s real estate investment strategies, based on continuous monitoring of the French and European markets. Although collective real estate accounts for a growing share of institutional portfolios and household savings, it is at the crossroads of financial (hierarchy of rates), economic (tenants’ business models), demographic (the metropolisation phenomenon) and societal (changes in usage) factors. This is why a cross-cutting analysis is needed, which is also long term and therefore in keeping with the horizon of most real estate investors.

Real Estate Convictions Germany offers Primonial REIM’s quarterly view of the most important asset classes: offices, retail, residential, healthcare, hotel and logistics.

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Ref.: Real Estate Convictions Germany Brochure – 022022 - Primonial REIM, a simplified joint-stock company with capital of 10,000 euros, registered with the Business and Company Register, Paris, under number 884 030 842, with its head office at 6-8 rue du Général Foy, 75008 Paris, and with the tax identification number FR18 884 030 842.