pbbIX
Office Property Market Germany
2023 | Q3

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Imprint

Deutsche Pfandbriefbank AG
Parkring 28
85748 Garching, Germany

Germany

Management Board:
Andreas Arndt (CEO), Thomas Köntgen (Deputy CEO),
Andreas Schenk, Marcus Schulte
Chairman of the Supervisory Board: Dr. Louis Hagen
Registered office: Munich
Legal form: Aktiengesellschaft
Companies Register No: Munich District Court, record HRB 41054
International VAT ID code: DE811223976

Supervisory authorities:
Federal Financial Supervisory Authority, Graurheindorfer Str. 108, 53117 Bonn
and Marie-Curie-Straße 24-28, 60439 Frankfurt am Main
European Central Bank, Sonnemannstraße 20, 60314 Frankfurt am Main

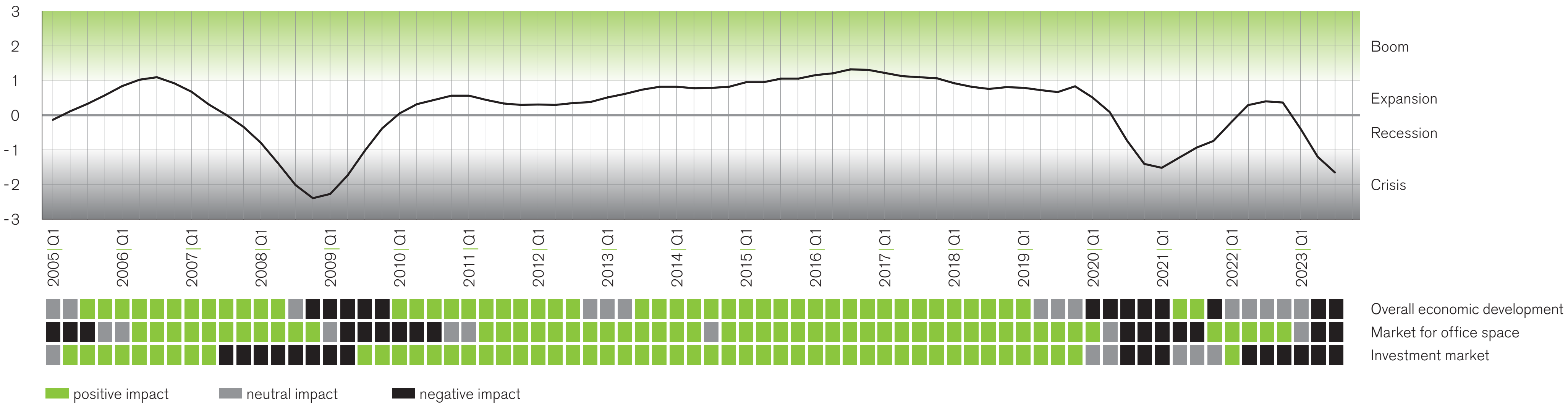
Overview

The pbbIX real estate index continued to decline in the third quarter of 2023. At -1.61, it hit the **lowest level** since the second quarter of 2009. All three components had a negative impact on the index in the summer months: **economic output contracted**, the demand for office space remained low in an environment of economic weakness, and a pronounced slump prevailed on the investment markets.

The overall economy is currently stagnating. Following on from the sideways movement in the first quarter and the slight increase of 0.1 % in the second quarter, third-quarter GDP contracted slightly by 0.1 %. This had a continued impact on the demand for office space, with overall levels in the first three quarters of this year remaining well below those of recent years. Current office space vacancies are therefore significantly higher than one year ago. At the same time, the investment markets remain under the pressure of higher interest rates and the price adjustment process this has triggered, which is reflected in a striking reticence among investors. Following the trend seen in previous quarters, inflows on the investment market were very low, **pushing up initial yields and leading to falling capital values**.

It is reasonable to assume that we have not yet seen the full extent of the downward trend. Although business surveys point to a **tentative economic upturn**, this will not be enough to revive the demand for office space. Investor reticence will also persist this quarter and put pressure on initial yields, even if capital markets rates remain unchanged.

pbbIX BIG 7 | Index



Overall economic outlook

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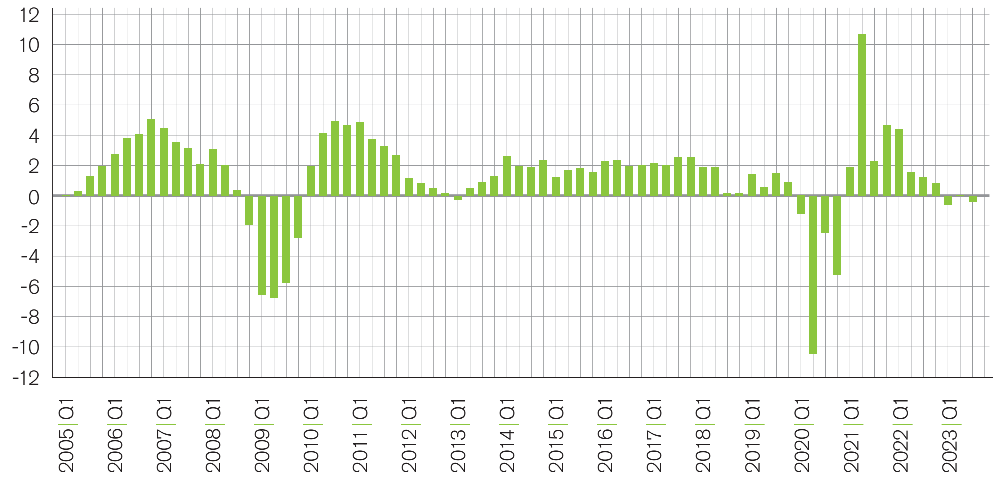
The German economy is stagnating. **Real gross domestic product eased moderately** by -0.1 % in the third quarter, preceded by a slight increase of 0.1 % in the second quarter. High interest rates, an ailing global economy and growing geopolitical risks, combined with weak demand from abroad and domestic consumer reticence, are dampening overall economic activity. According to preliminary figures from the German Federal Statistical Office, private consumption declined most recently despite strong wage increases and a gradually slowdown in inflation.

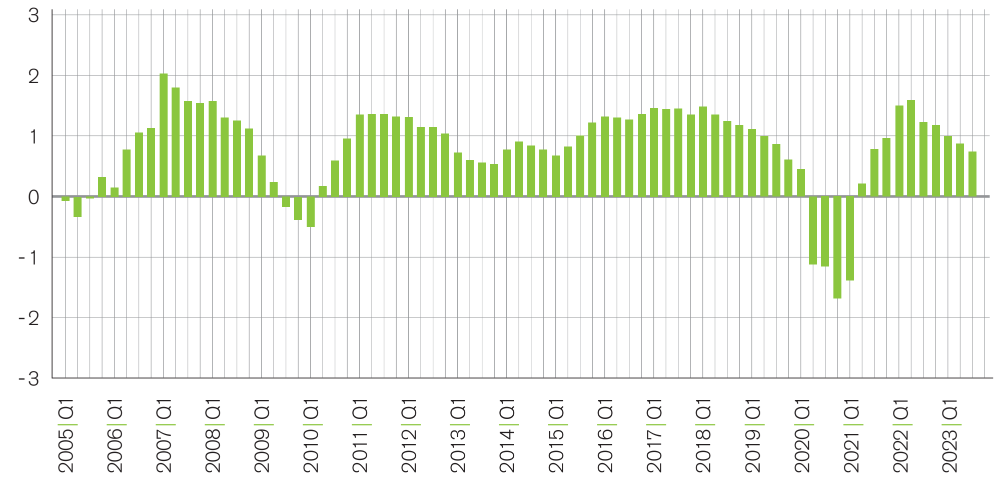
Together with a stable labour market, the latter factor has raised expectations for a slight improvement in the fourth quarter. The current inflation rate has **fallen from a relatively high level to 3.8 %**. Price increases will slow down somewhat by the end of the year, which will benefit the purchasing power of private households. Although the increase in employment in the third quarter was weaker than is otherwise usual for this time of year, it was nonetheless still positive. Compared to the previous year, the number of people in employment rose by 338,000 persons, with new hires especially in the less cyclical service sectors.

The latest confidence surveys also suggest there will be no further slowdown of the German economy. According to the ifo business climate index, businesses assessed their situation in October to be somewhat better than in the two previous months. Expectations were also slightly better but remain plagued by doubts. **The economy is swaying between stagnation and a slight recovery**.

Real gross domestic product | year-on-year change in %



Working population | year-on-year change in %



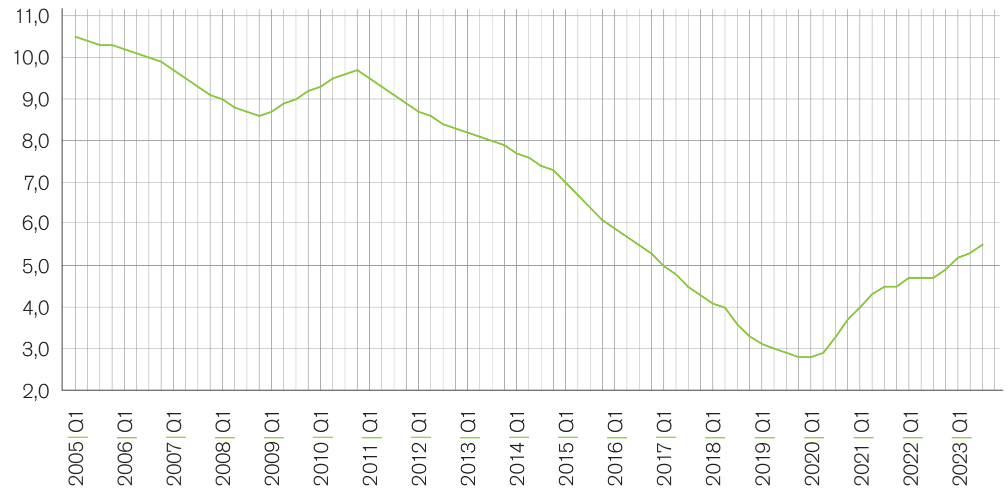
Market for office space

As is the case for the German economy as a whole, the big 7 markets for office space are also suffering from **sluggish demand**, which is evident in rental development. Despite rising slightly in the third quarter compared to the very weak previous quarter, take-up remained low at 630,000 sqm. All in all, only 1.8 million sqm office space was let in the first three quarters of the current year, compared with 2.8 million sqm in the same period of the previous year.

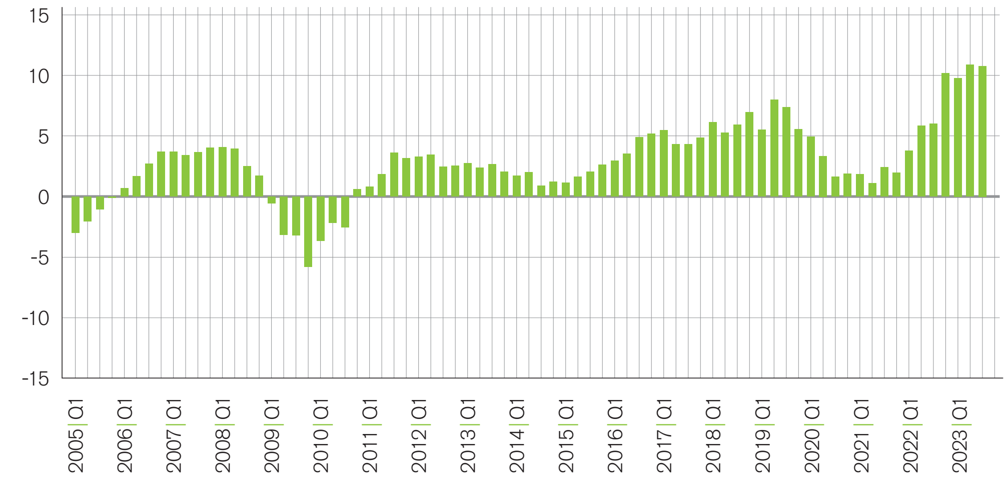
Accordingly, the **vacancy rate is trending upwards**. In the third quarter, 5.5 % of office space was, exceeding the previous quarter by 20 basis points and the same quarter of the previous year by as much as 80 basis points. At the same time, weak demand and uncertainty about the further need for space are putting the brakes on planned and actual new office construction. The sharp rises in construction and financing costs play a role here, too. These factors are increasingly curbing growth in office space. The rise in vacancies is set to slow down in the near future, also because properties that are no longer up to date are being gradually removed from the market. These properties in fact already account for most of the vacant space.

Average and top rents continued to rise in the third quarter. At the peak, the weighted average increase across all markets was up 1.4 % on the previous quarter and up 11 % compared to the previous year's quarter. Due to higher vacancy rates and easing inflation, slower growth is expected for the quarter ahead.

Office space vacancies (BIG 7) | in % of the portfolio



Top rents (BIG 7) | year-on-year change in %

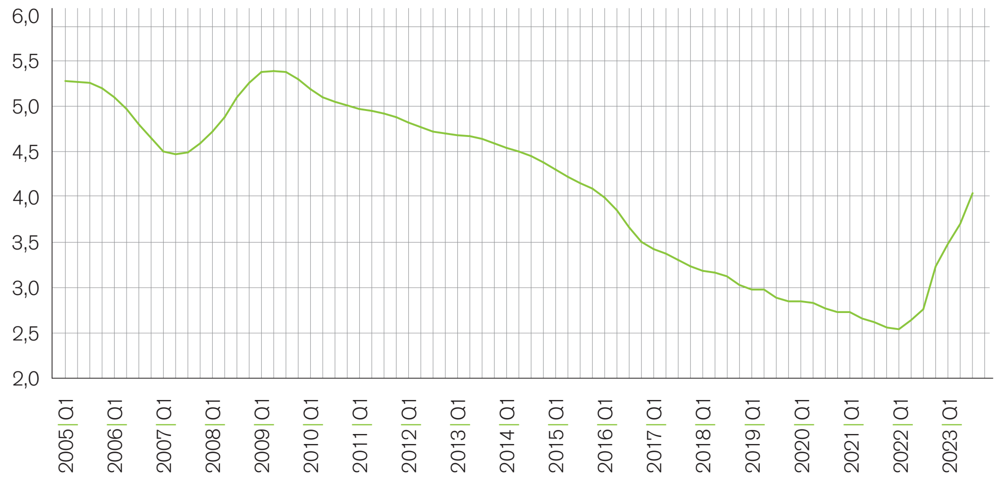


Investment market

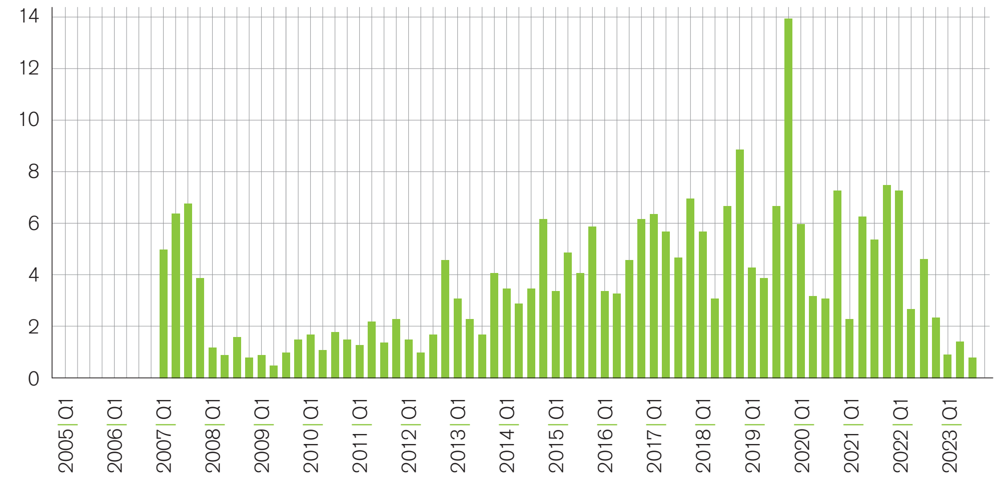
The recessionary development on the office investment markets persisted in the third quarter. Most market participants believe that the **price adjustment process is not over yet**, which burdened investor interest. In conjunction with weak structural and economic demand for office space, investment behaviour was very cautious. Depending on the source consulted, only around €800 million to €1.1 billion worth of office property was purchased in the big 7 markets. In particular, this reflected a lack of large-volume transactions. All in all, transaction volumes across the first nine months of the current year were low, at only €3.1 billion. To put this into perspective, transactions volumes were around €14 billion in the first three quarters of each of the last three years. Such a low level of inflows as in the current year was last seen in 2008 and 2009.

The development of net initial yields for first-class properties (calculated as the ratio of net rental income to the gross purchase price) demonstrates the extent of pressure on purchase prices. These yields have been following an **extremely steep upward trajectory** since the second quarter of 2022, mirroring the development of capital market yields. A further 34 basis points were added in the third quarter of 2023. Nonetheless, the yield spread relative to the current yield for 10-year German government bonds is somewhat lower at present than in mid-2022. This suggests a further increase in net initial yields for the quarter ahead, even though the European Central Bank is not expected to tighten the reins further and interest rates should stabilise at current levels.

Net initial yield (BIG 7) | in %



Investment volume (BIG 7) | in € billion

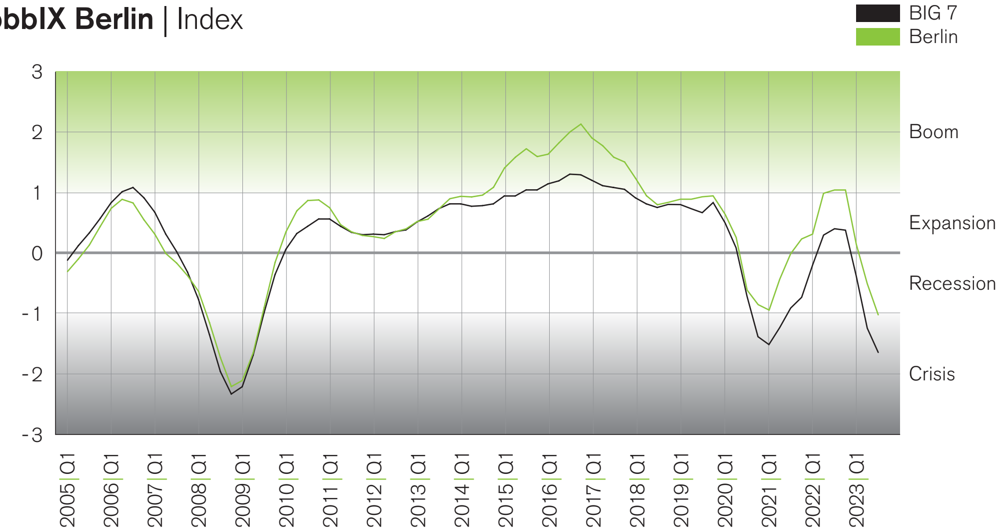


BIG 7

BERLIN

Berlin registered the strongest quarter of the year, with take-up of 152,000 sqm, which was a third more than in the previous quarter. Nevertheless, year-to-date transaction volumes (Q1-Q3) are down by nearly 35 % from the same period of the previous year. The persistent difficulty of office space marketing is driving up the vacancy rate, which was up 20 basis points to 5.0 %. Top rents remained unchanged compared to the previous quarter. Uncertainly still prevails on the investment market. Investments for the year to date fell to just short of €1 billion – a decline of 75 % from the same period of the previous year. Net initial yields for first-class properties increased by 35 basis points to 4.05 %.

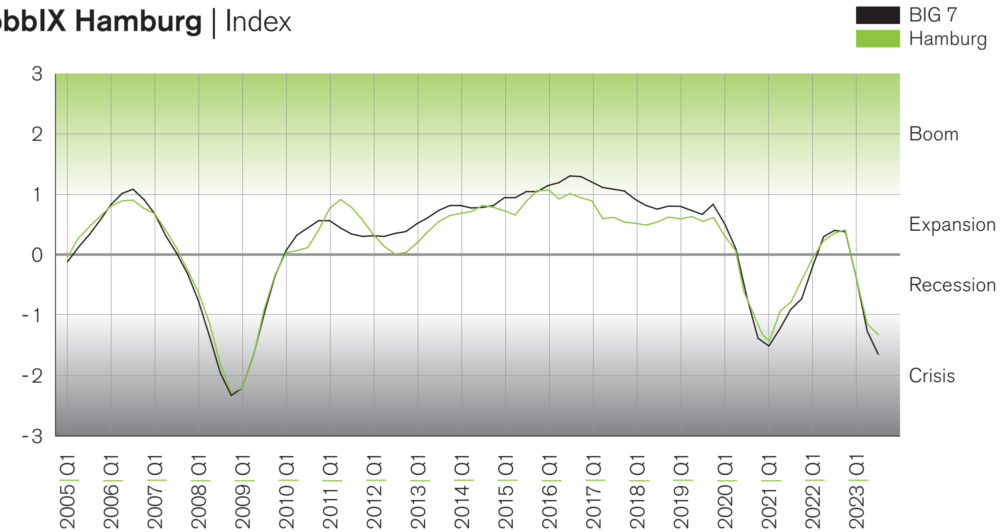
pbbIX Berlin | Index



HAMBURG

Letting performance on the market for office space sank to around 96,000 sqm in the third quarter. This means that a total 330,000 sqm has been transacted for the year to date, which equates to a decline of 30 % compared to the same period of the previous year (Q1-Q3). The largest volume drivers included providers of business services and industrial management, which accounted for around 25 % of office space take-up. The vacancy rate rose marginally to 4.6 %. Top rents increased by 1.5 % over the previous quarter. Investment market participants remained reticent. At €450 million in the first three quarters, the inflow of funds fell to its lowest level since the crisis year of 2009. Net initial yields increased by a further 30 basis points to 4.05 %.

pbbIX Hamburg | Index

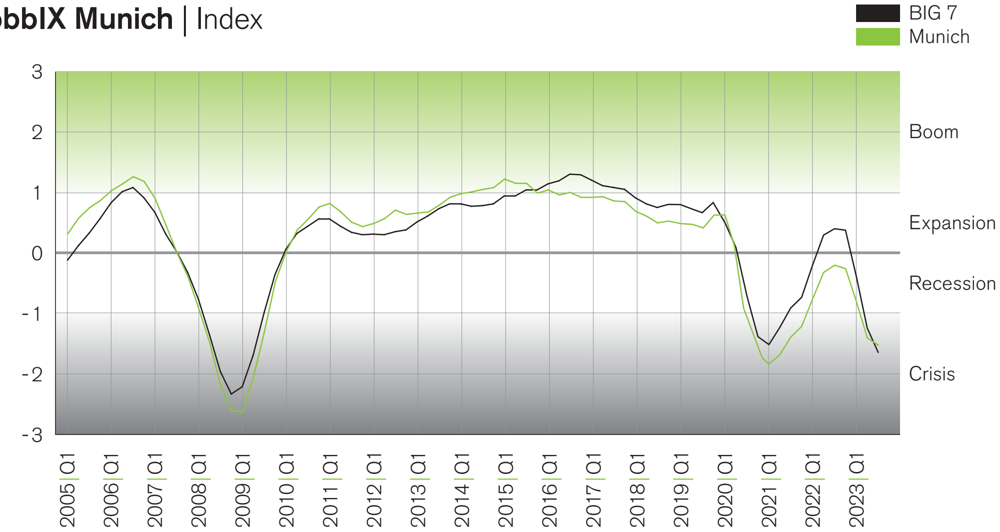


BIG 7

MUNICH

Demand for space in the Munich office market declined, too. Take-up in the first three quarters was only 340,000 sqm, around 45% less than in the previous year. The vacancy rate rose by 10 basis points to 4.8%. The low supply of high-quality space in prime locations led to rising top rents, which increased by 15% in the last twelve months. The third quarter on the Munich office investment market was the most productive this year, with transaction volumes of €350 million. Nonetheless, transaction volumes of €600 million for this year are down by roughly 70% year-on-year. The considerable caution exercised on the investment markets continues to impact net initial yields, which climbed by a further 35 basis points in the third quarter to 4.05%.

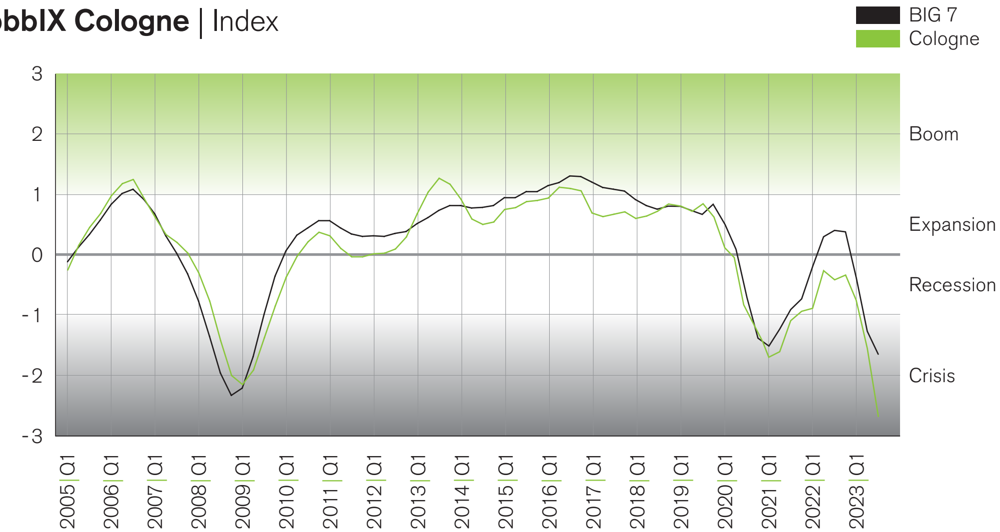
pbbIX Munich | Index



COLOGNE

Demand for office space was below average in the third quarter too: Transaction volumes this year to date amounted to 140,000 sqm, only half as much as in the previous year. With new construction activity slowing, demand weakness has had no real impact on the vacancy rate so far, which remains very low at 3.2%. Top rents were up 1.5% on the previous quarter and by as much as 15% on a 12-month comparison. The Cologne investment market continued to attract very little capital. The inflow of funds was €80 million in the third quarter. This resulted in an investment amount of €220 million this year to date, which is down around two-thirds on the previous year's result. Net initial yields for first-class properties increased by 35 basis points to 4.25%.

pbbIX Cologne | Index

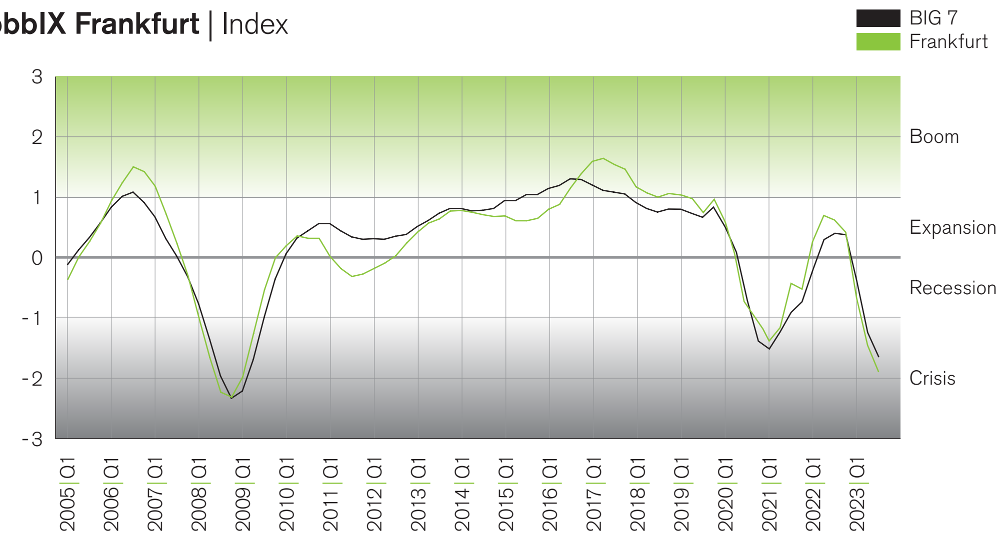


BIG 7

FRANKFURT

Transaction volumes on the Frankfurt office space market remained weak in the third quarter. Around 270,000 sqm was taken up so far this year, which is 16 % less than in the same period of the previous year. Consultancy firms and the financial sector in particular rented less space. The high vacancy rates eased somewhat, while top rents increased slightly. With very few transactions concluded on the investment market, inflows were correspondingly low. Investment volumes of only some €300 million for office properties were raised in the first three quarters of 2023, compared to roughly €3 billion in the same period of the previous year. Net initial yields for first-class properties increased by 35 basis points to 4.25 % at the last count.

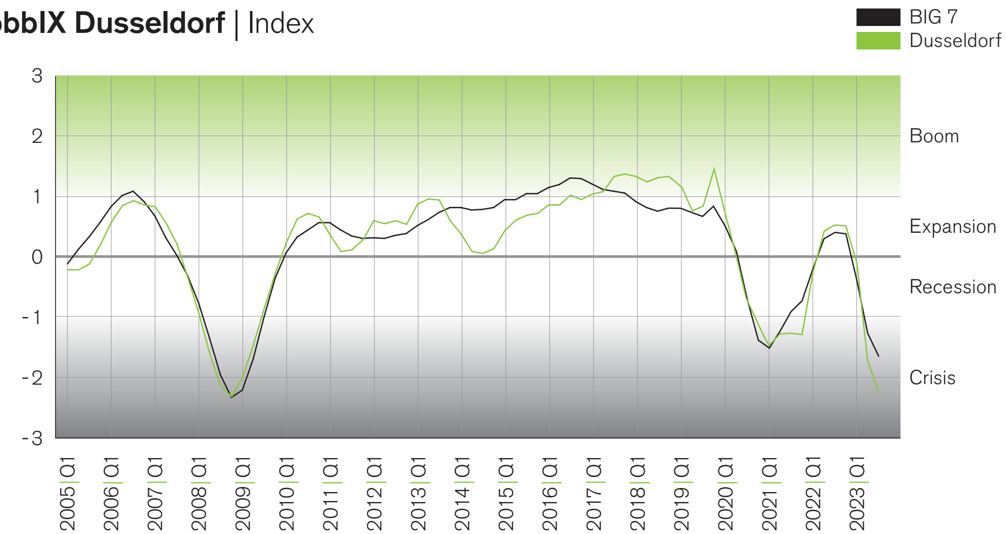
pbbIX Frankfurt | Index



DUSSELDORF

Letting performance in the third quarter increased three-fold over the previous quarter. Transactions volumes in the course of the year were down 13 % on the same period of the previous year. The development was accompanied by rising vacancies, which are currently high at 9.4 %. Rents were unchanged on average compared to the previous quarter. However, top rents increased and reached the €40 level. Inflows on the investment market, which fluctuated strongly, declined to €35 million. €250 million were registered this year to date, 85 % less than in the same period of the previous year. Capital values are under considerable downward pressure in Dusseldorf as well, which is reflected in rising net initial yields. For first-class properties, the latter increased by 35 basis points to 4.25 %.

pbbIX Dusseldorf | Index

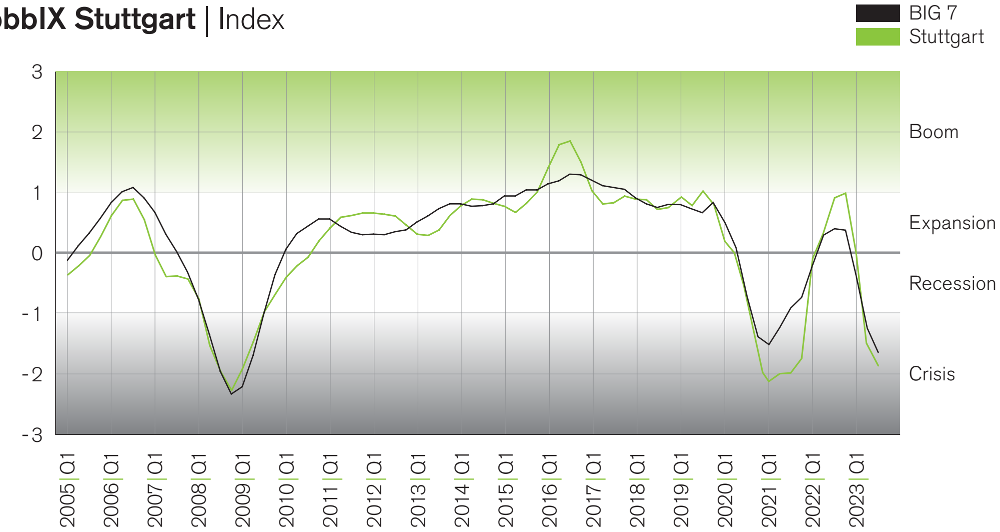


BIG 7

STUTTGART

Rentals on Stuttgart's market for office space increased in the third quarter, but remained down 60 % over the first nine months of 2023 relative to the previous year. Take-up amounted to 42,000 sqm, which leads to a total transaction volume of 107,000 sqm for the year to date. The vacancy rate, which increased by 20 basis points, remains low at 3.8 %. Rents were unchanged in the last few months and reached €35 per sqm for top rents. Inflows on the investment market fell to a minimum in the third quarter. €270 million in property investments has been concluded to date in the course of 2023, down around 60 % compared to the previous year's result. Accordingly, net initial yields for first-class properties increased by further 35 basis points to 3.95 %.

pbbIX Stuttgart | Index



About the pbbIX real estate index

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SCOPE AND METHODOLOGY

As the last two decades have shown very clearly, the development of real estate markets is not a continuous trend that is free of disruption – instead, these markets are characterised by significant cyclical fluctuations. The pbbIX index family tracks economic developments on Germany's key office property markets. The index family comprises a total of eight indices: seven individual indices for the office real estate markets in Berlin, Cologne, Dusseldorf, Frankfurt, Hamburg, Munich and Stuttgart, plus a composite index which tracks overall economic development of the BIG 7 markets.

The indices are based on the results of a dynamic factor model, which brings together eleven variables, using time series to extract the key driving forces for economic trends of office property markets. Specifically, these variables relate to macroeconomic developments, the rental market, and the investment market across the seven office property markets covered. As a preparatory step for the factor analysis, the various market-related indicators are aggregated to form a single market indicator that measures overall development (for example, vacancies or new construction activity). The data list shown below sets out the indicators which were used for the dynamic factor analysis.

Over and above the office real estate market index, the presentation contains assessments regarding the components of 'macroeconomic developments', 'market for office space', and 'market for office investments'. The directional impact of these components on the composite indicator is colour-coded: GREEN indicates a positive, BLACK a negative and GREY a neutral impact.

DATA LIST OF THE DYNAMIC FACTOR MODEL

Overall economic development

- Real gross domestic product (YOY change in %)
- Workforce in the BIG 7 markets (YOY change in %)
- Consumer prices (YOY change in %)
- Current yield (Umlaufrendite) for public-sector bonds with a minimum remaining term of 10 years (in %)

Rental market

- Completed office and administration buildings (in sqm of usable space in the BIG 7 markets)
- Marketing volume (in sqm of rental space in the BIG 7 markets)
- Vacancies (in % of gross available area in the BIG 7 markets)
- Top rent (in € per sqm for the BIG 7 markets)
- Average rent (in € per sqm for the BIG 7 markets)

Investment market

- Initial net yield (in % for the BIG 7 markets)
- Inflow of funds (€ million)