pbbIX
Office Property Market Germany
2024 | Q 1

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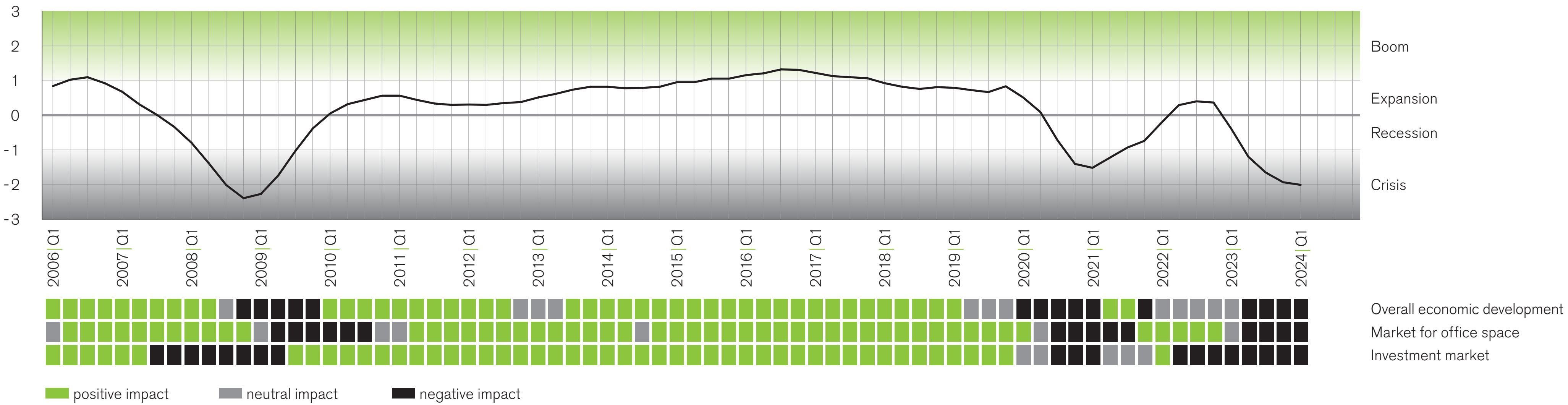
Overview

The pbbIX real estate index continued its decline during the first quarter of 2024, at **- 2.01** points hitting the lowest level since the first quarter of 2009. None of the index's sub-segments drove growth during the first quarter of the year. However, the decline has slowed somewhat, suggesting that office markets have **started to bottom out**. After the economic contraction that dogged 2023, the first quarter of 2024 saw slightly positive growth. Amid the ongoing economic weakness, **demand for office space** remained on a **below-average level. Investment market volumes continued to decline** from already low levels, resulting in rising initial yields and falling capital values. Despite the pause in interest rate movements, office market participants remained cautious given the uncertain timing of the expected first rate cuts.

With a **growth rate of 0.2 %**, the **economy as a whole** picked up slightly at the beginning of the year. The German government's spring projection released in April forecasts GDP growth of 0.3 % for the entire year, which is in line with improved business surveys and expectations at the start of the year. Assuming a slow economic recovery, office markets could stabilise over the course of the year and ultimately embark on an upward trajectory.

Looking at the second quarter, however, office markets are expected to continue their underperformance and demand for office space will remain depressed for the time being. Office space vacancies continue to increase and are significantly higher than a year ago.

pbbIX BIG 7 | Index



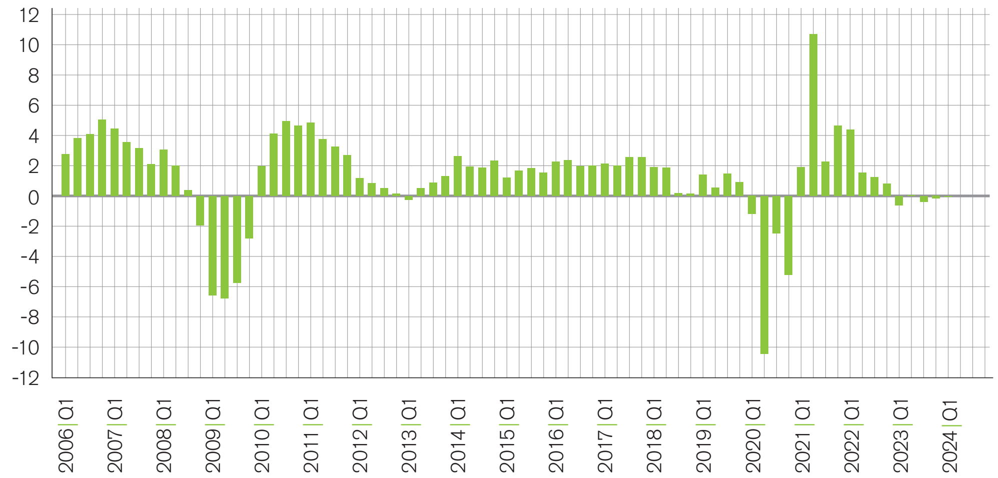
Overall economic outlook

The German economy is moving sideways. After a quarter-on-quarter decline of 0.5 % in the fourth quarter of 2023, real **economic output grew slightly by 0.2 %** at the beginning of 2024, narrowly escaping a technical recession. The slight growth was driven by higher construction investment and exports; private consumption, by contrast, was down.

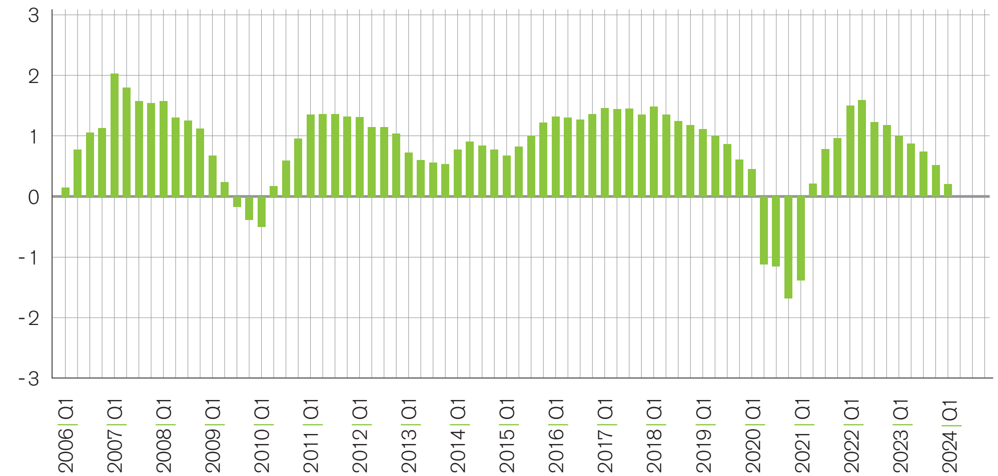
Three factors are fuelling hopes for a slight improvement of the overall economic situation this year: an inflation rate approaching the ECB's 2 % target, the **economic recovery expected for the end of the year** and a stable labour market. Inflation stood at 2.2 % in April 2024 according to preliminary figures, which, combined with substantial wage increases, is benefiting private households and their purchasing power. The **labour market** continues to demonstrate resilience: 90,000 more people were employed in the first quarter of 2024 than in the same quarter of the previous year. Unemployment remains at a modest 6.0 %.

The **macroeconomic outlook** for Germany has improved somewhat over the past months. The latest confidence surveys suggest an economic upturn. At 89.4 points in April 2024, the ifo business climate index reached its highest level since May 2023, with current and expected business situation assessments both improving. Whether the slight economic upturn can stimulate consumption and investment appetite remains to be seen.

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



Working population | year-on-year change in %



Market for office space

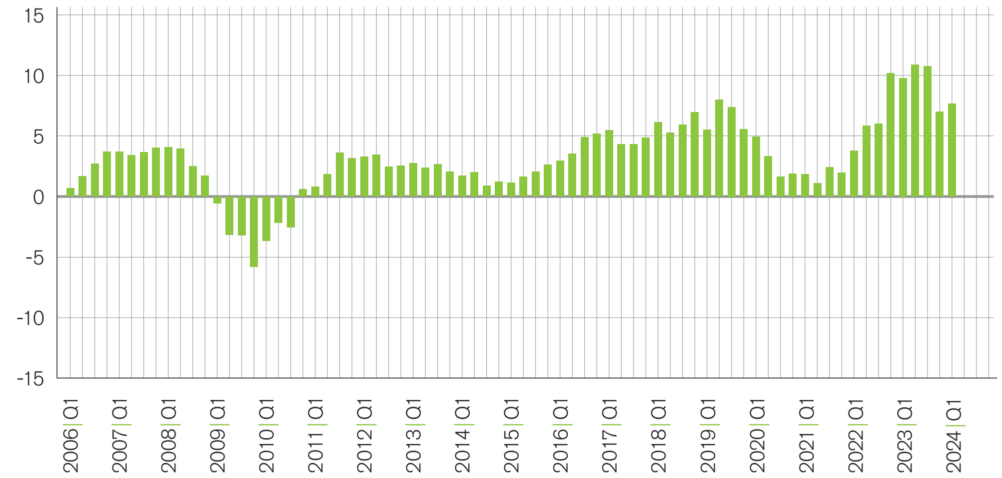
The office space letting market continued to stagnate in the first quarter of 2024. Letting performance of 625,000 sqm was on a similar level to that seen in 2023, but the first quarter saw a downturn of 16% compared to the strong final quarter of 2023, the reasons being a **weak economy** and **transition towards hybrid working practices** connected with a **decreased demand for space. Performance** in the cities showed a **very mixed picture**; while letting performance eased in Hamburg, Dusseldorf and, above all, Cologne, space take-up in Stuttgart increased by around one third on a year-on-year basis.

New construction activity remained more or less unchanged compared with the previous quarter. In a year-on-year comparison, however, the volume of completed new-builds was nearly twice as high as in the weak first quarter of 2023, amounting to 410,000 sqm. By March 2024, the **vacancy rate** saw a significant weighted average increase of 6.0% across all the big 7 markets (+80 basis points compared with twelve months prior). Oversupply of office space is high in Frankfurt and Dusseldorf, but relatively low with vacancy rates of between 3.4% and 5.0% in Cologne, Hamburg and Stuttgart, depending on the source and market definition.

In line with the **demand for high-quality space**, rents for first-class properties in prime locations continued to trend upwards. Top rents were more than 8% above their previous year's level in the first quarter of 2024, whereas average rents edged up by only 0.9%. Competition for prime space in central locations with good accessibility remains strong and will once again drive rental growth upwards in the prime segment during 2024.

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

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



Investment market

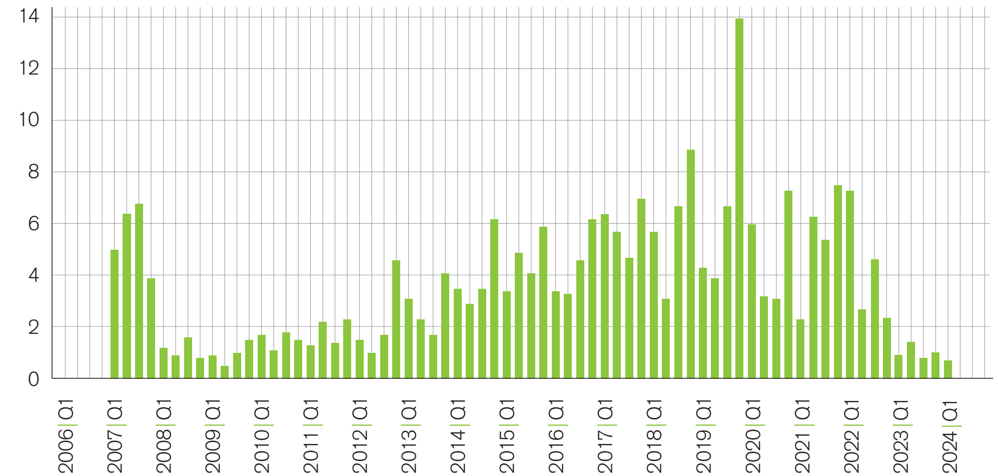
Inflows in the big 7 office investment markets remained on a very low level in the first quarter of 2024. Only approximately €700 million-worth of office property was purchased in the big 7 markets, marking the **lowest level** recorded since the second quarter of 2009, the sector at that time being impacted by the financial markets crisis. To put this into perspective: investments in the first quarter of 2022, i.e. prior to the interest rate hiking phase, amounted to approximately €7.1 billion. Drivers for the current development include the ongoing price discovery process, still high interest rates affecting borrowing costs, the weak performance of office user markets and a stagnant economy at the beginning of the year.

The pressure on purchase prices manifests itself in the **development of net initial yields** for first-class properties (calculated as the ratio of net rental income to the gross purchase price). Capital market yields have remained persistently high since autumn 2023, significantly slowing the yield momentum for first-class properties in the first quarter of 2024: yields increased by a mere 7 basis points compared to a rise of 17 basis points in the previous quarter. By contrast, the yield spread vis-à-vis the current yield for 10-year German government bonds rose to 200 basis points at the beginning of the year, compared to 114 basis points twelve months ago.

What the **investment market** needs is an environment that encompasses stable purchase prices, an adequate risk premium vis-à-vis risk-free investments, plus steady to declining interest rate conditions for borrowing. Some first signs of a positive performance are visible, which will probably result in a **slow recovery** of investment markets from the second half of the year onwards.

Net initial yield (BIG 7) | in %

Investment volume (BIG 7) | in € billion

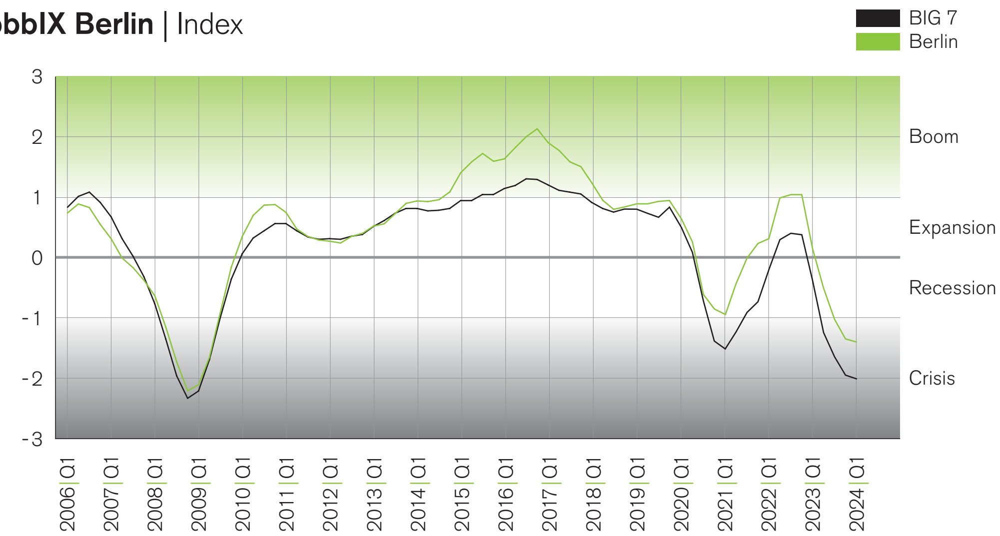


BIG 7

BERLIN

A total of about 145,000 sqm of office space was let in the first quarter of 2024, on a par with the below-average level seen in the same quarter of the previous year. New construction activity reached its highest level since the fourth quarter of 2022, but the vacancy rate rose by 90 basis points to 5.4 % over the last twelve months due to weak letting activity. While the top rent remained stable quarter-on-quarter, at €44 per sqm, it increased by €2 per sqm year-on-year. On the investment market, inflows in the office segment plummeted once again: with a mere €70 million taken up, they were around 75 % lower than in the previous year. At 4.2 %, the net initial yield for first-class properties remained stable in the first quarter compared to the end of 2023.

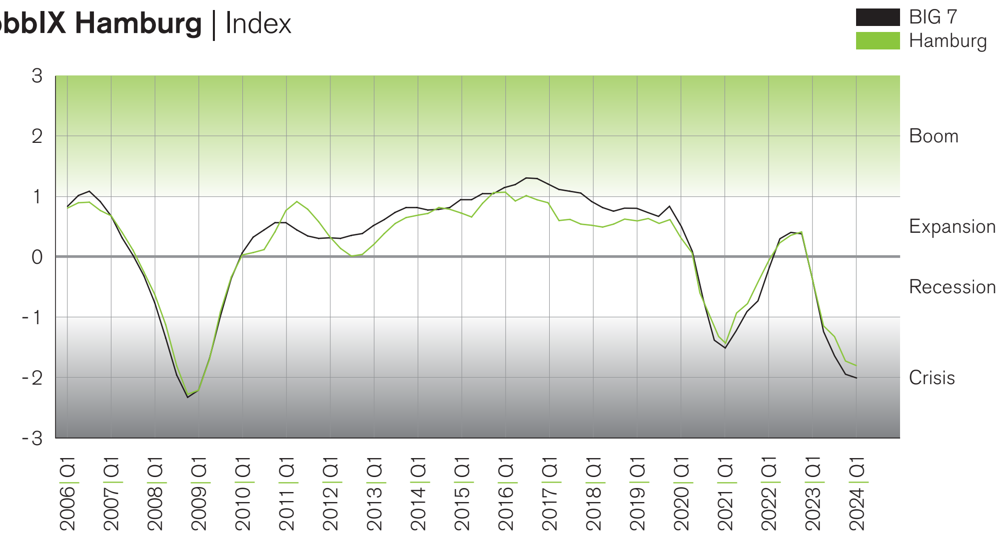
pbbIX Berlin | Index



HAMBURG

Following the trend seen in previous quarters, letting performance declined in the first quarter of 2024, mainly because large-scale lettings failed to materialise. Take-up amounted to just under 90,000 sqm, or approximately 30 % less than in the previous quarter. Business services providers became the main drivers, accounting for around 35 % of space take-up. The vacancy rate remained stable, given the very low new construction activity at the beginning of the year. In a year-on-year comparison, it rose by 40 basis points to 4.8 %. At €34.50 per sqm, the top rent stagnated at a high level versus the previous quarter. On the investment market, office property worth approximately €170 million changed hands in the first quarter, marking a 30 % decline compared to the 10-year average. The net initial yield increased by a further 10 basis points to 4.25 %.

pbbIX Hamburg | Index

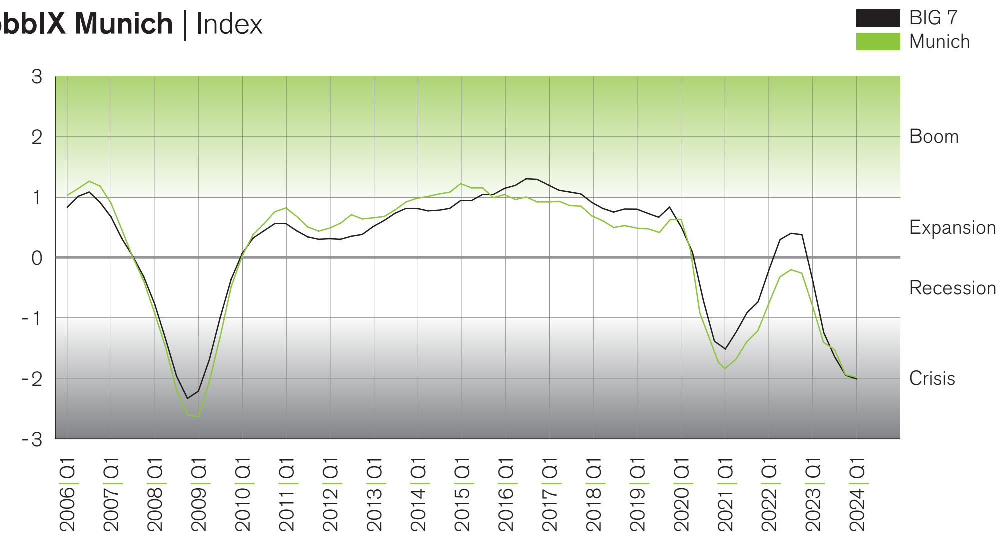


BIG 7

MUNICH

Demand for office space in Munich remained at the previous quarter's level. Space amounting to 140,000 sqm was taken up in the first three months of the year, falling 18% below the average quarterly take-up seen in the past ten years. The vacancy rate rose by 40 basis points in the first quarter, to reach 5.6% at the time of writing. The low supply of high-quality space in prime locations led to a rising top rent, which has meanwhile reached €52 per sqm. The average rent also picked up at the beginning of the year. The investment market continued its weak performance: at approximately €270 million in the first quarter, inflows remained below average. While the initial yield momentum stopped at 4.15%, investor demand was low.

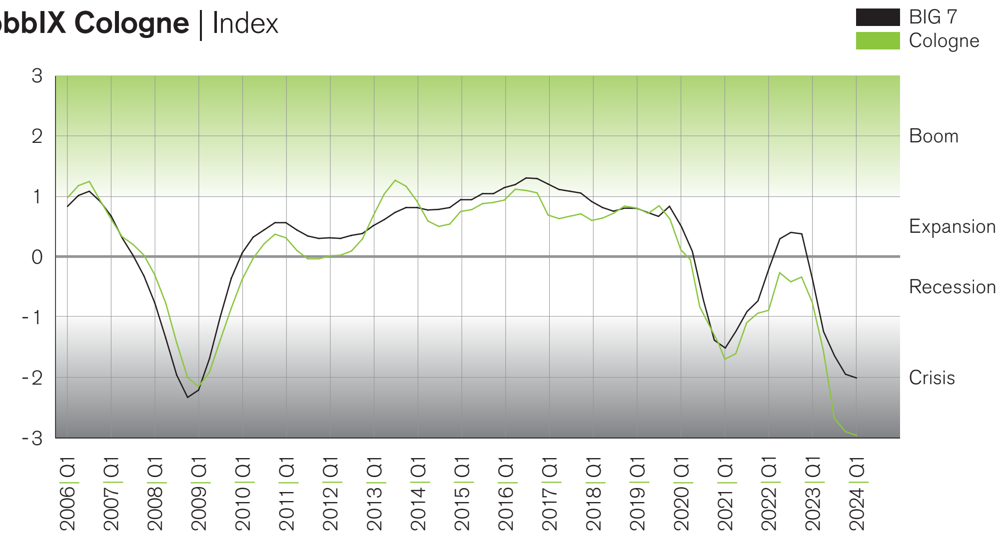
pbbIX Munich | Index



COLOGNE

Cologne saw weaker demand for office space than a year ago: at 33,000 sqm, space take-up fell by 36% year-on-year. Despite muted construction activity, weak demand barely impacted the vacancy rate, which remained very low at 3.4%, up a mere 40 basis points year-on-year. The top rent increased by €0.50 year-on-year, to reach €32.50. The Cologne investment market continues to be challenged. At a mere €50 million, inflows fell by approximately 50% in the first quarter on a year-on-year basis. This reticence translated into a 4.55% increase in the net initial yield for first-class properties during the first quarter (+10 basis points).

pbbIX Cologne | Index

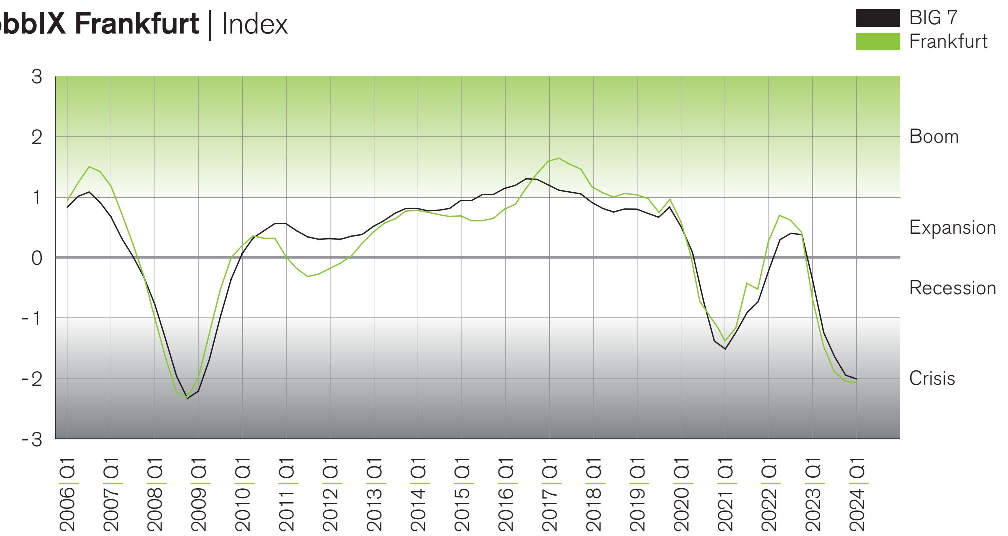


BIG 7

FRANKFURT

A 12 % year-on-year rise in space take-up gave Frankfurt's office market a strong start into 2024. Letting performance was 93,000 sqm. The combination of a low level of new-builds and a higher absorption of space produced a 20 basis point decline in the vacancy rate versus the previous quarter, to 8.6 %. Demand has focused increas-ingly on the prime segment in terms of building quality and location. The top rent saw a slight upward trend over recent quarters, reaching €47 per sqm in the first quarter. At €100 million, inflows on the investment market remained on a low level in the first quarter. The net initial yield for properties in first-class locations increased by 10 basis points to 4.55 %.

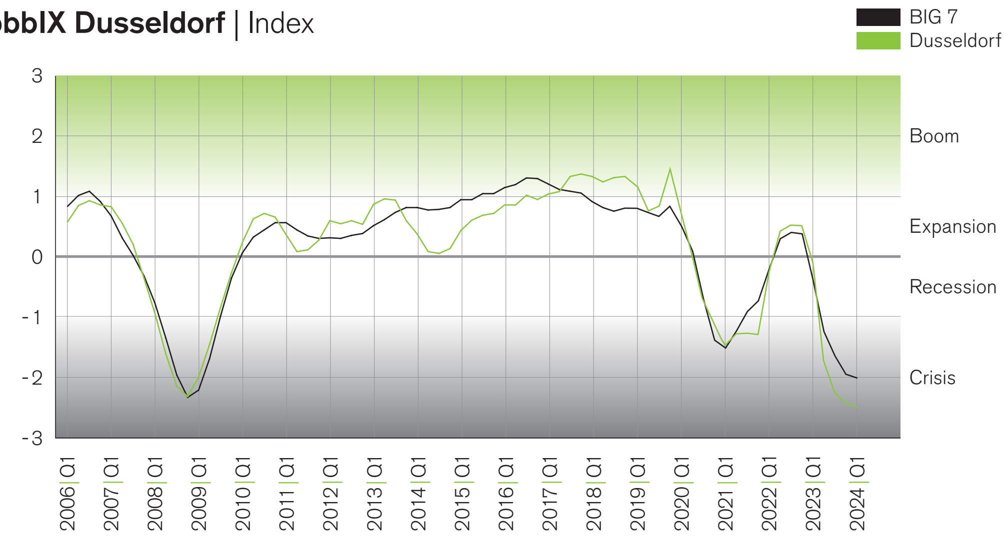
pbbIX Frankfurt | Index



DUSSELDORF

A distinct lack of large-scale lettings meant that the office market in Dusseldorf saw another muted first-quarter development, similar to previous years. A mere 67,000 sqm of office space was newly taken up in the first quarter of 2024 (Q1/2023: 72,000 sqm) and the vacancy rate increased from 9.7 % to 9.9 %, reaching the highest level since early 2015. The top rent, however, which had seen a sharp rise since 2022, increased even further to €42 per sqm. Inflows on the investment market remained very low, at about €40 million. Capital values remained under downward pressure in Dusseldorf as well, which is reflected in rising net initial yields. For first-class properties, the latter increased by 10 basis points to 4.55 % during the first quarter.

pbbIX Dusseldorf | Index

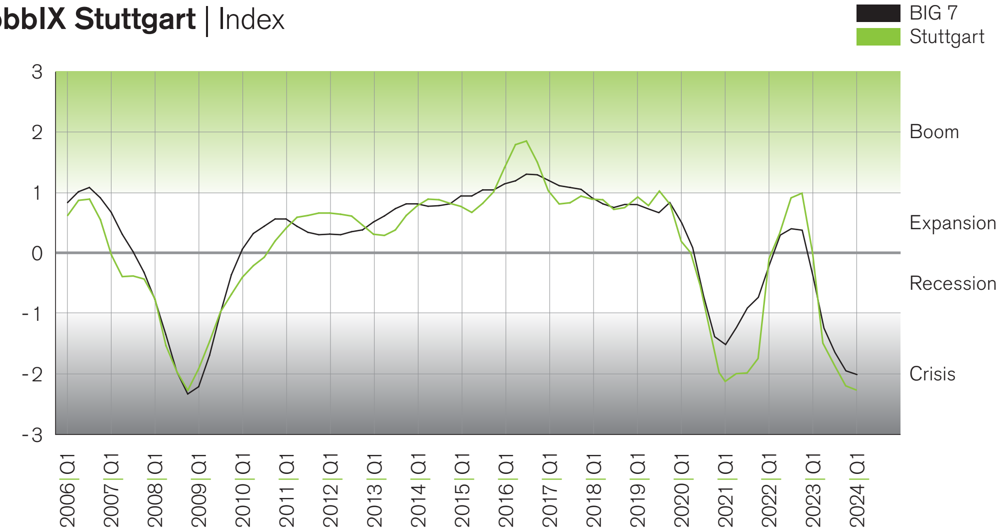


BIG 7

STUTTGART

Office space take-up increased by 30 % compared to the previous year's quarter, amounting to approximately 55,000 sqm in the first quarter. Space take-up has most recently been dominated by the transportation sector, but public-sector institutions and business services providers have also been very active tenants. Vacancies continued to rise in line with the general trend, but Stuttgart's vacancy rate saw above-average year-on-year growth, climbing from 3.5 % to 5.0 %. The top rent increased by €1 to €36 per sqm compared to the previous quarter. No inflows in the office sector were registered in the first quarter, following €60 million in the first quarter of last year. Net initial yield for first-class properties increased by another 10 basis points, to 4.25 %.

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)