

SECTOR UPDATE:

Real estate – the end of a success story?



IMPACT FROM THE COVID-19 PANDEMIC AND EXPECTED FURTHER DEVELOPMENT

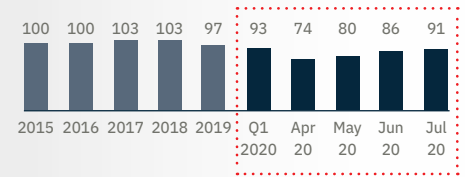
NEGATIVE ECONOMIC IMPACT FROM THE COVID-19 PANDEMIC...

...and high uncertainty with regard to future developments also leave their mark on the real estate sector. The impact varies greatly, however, depending on the market segment. The first negative effects of the pandemic are being perceived in the sector as some tenants, especially retail and catering operations, have started negotiating the deferral of rent payments. This translates into an, at least temporary, halt to the upswing seen in the past ten years, while the further development will largely be determined by how long the restrictions last. Current measures by the German government allow for a cautious economic recovery to a "new normal". At the same time, sentiment is slowly improving (cf. 1 ifo Business Climate Index).

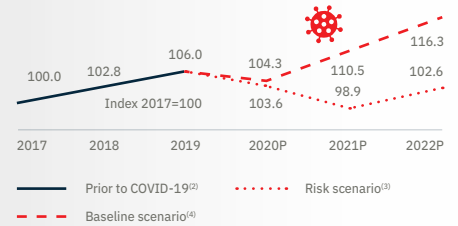
FURTHER DEVELOPMENT DRIVEN BY ECONOMIC SCENARIOS

Crisis mode on the part of consumers and companies as well as related process delays in administration lead to a decline in orders and completion of projects already initiated. A quick (V shaped) economic recovery to pre-crisis levels is considered unlikely in view of the current development of the pandemic. The further course of the national economy will depend on a successful containment of the pandemic. A second wave would push the recovery of the sector out beyond 2022 (risk scenario).

1 IFO BUSINESS CLIMATE INDEX – COMMERCE



2 REAL ESTATE – ADDED VALUE GERMANY⁽¹⁾ (INDEX)



(1) Value-added output of the sector, (2) Forecast prior to COVID-19, (3) Economy recovers in H2 2020 after infections peak and lockdown [as at 8 June 2020], (4) Second pandemic wave including return to lockdown in Q3/Q4 2020 leads to recession with far-reaching consequences [as at 8 June 2020]

HETEROGENEOUS DEVELOPMENT WITHIN THE SECTOR SEGMENTS

STABLE DEVELOPMENT OF RESIDENTIAL MARKET

The residential market tends to react more sluggishly and is less sensitive to exogenous shocks. An increase in unemployment or a decline in household budgets caused by the crisis as well as a potential demise of inner cities would increase the pressure on rents and purchase prices. However, immediate public countermeasures will probably lead to a short-term stabilisation in this segment. The probability of rent defaults has only increased marginally so far, additional inquiries with regard to a deferral of rent payments were only made at around 1% of properties in the first quarter. Especially the continued urbanisation trend is counteracting a decline in prices in the larger cities. However, an increase in unemployment figures and sustained short-time work arrangements may have a negative effect in the medium term. It is possible that purchases of real estate or new rental agreements will be postponed because of uncertainties on the employment market. A marked decline in fluctuation and intra-national migration together with a lack of influx from abroad further weigh on demand in the residential market. Nevertheless, residential real estate continues to be a "safe harbour" with higher growth in demand than in supply in the long term and the corresponding return to a growth course with respect to both rent and purchase price levels.

UNCERTAIN FUTURE OF OFFICE DEMAND

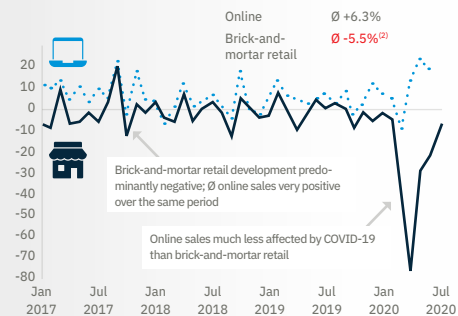
The generally robust office market will be temporarily burdened by corporate uncertainty. This will lead to postponement or cancellation of new rental agreements or expansions. Market participants with short or flexible agreements (such as co-working suppliers) are particularly affected. In the medium term, experiences made during the crisis may lead to a revaluation of decentral work structures. Many large companies such as Siemens, Novartis, PSA etc. are currently in the process of rethinking their office concept in favour of more flexible or even permanent work-at-home arrangements as well as reducing business travel and the corresponding obligation to attend events, which also contributes to cost savings (e.g. at Deutsche Post, Deutsche Tele-

kom, Rheinmetall etc.). This would lead to a reduction in required office space per capita and thus in demand. Together with the increased construction activities in key markets, this could lead to rising vacancy rates and higher pressure on rental prices. In addition, the demand for office work space also depends on the development on the employment market. While unemployment figures were up on the prior-year level by 26% in May 2020 and short-time work arrangements were made for around 12 million people, government measures and corporate crisis intervention prevented any major loss of jobs so far. The further economic development (U shape or L shape) will have a crucial effect on the attractiveness of this market.

DIFFICULT MARKET ENVIRONMENT FOR RETAIL (NON-FOOD)

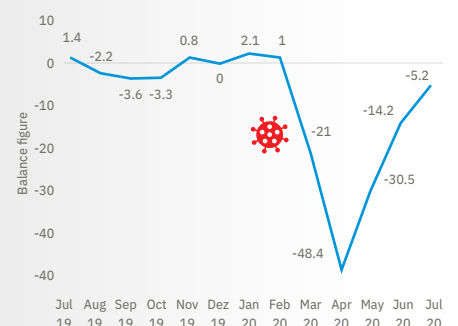
The market, which had already been challenging before the crisis, is further burdened by the effects of the COVID-19 pandemic. Owing to the lockdown and consequent losses, first retail tenants are already asking for rent reductions. The German Retail Federation (Handelsverband) predicts revenue losses resulting from retail closures of € 1.15 billion per day. Despite a gradual reopening, uncertainty remains among consumers, and pedestrian traffic continues to be substantially below the prior-year levels. Especially fashion stores in high street monopoly locations are expected to suffer revenue losses of estimated -25% to -30% in 2020, which will lead to a wave of insolvencies (e.g. Tom Tailor, Appellath-Cüpper). A low propensity to buy, the economic uncertainty of consumers, the lack of events that would prompt purchases such as weddings, christenings etc. and the trend towards e-commerce could lead to a demise of inner cities with up to 50,000 shop closures in the wake of the COVID-19 crisis. Permanent closures, rent defaults and increasing vacancy rates are expected for smaller and medium-sized cities in particular as well as for less attractive locations in major cities. At the moment, contract extensions or new rental contracts are only being concluded for top locations. Key decision makers in the real estate industry are also rather pessimistic with regard to the expected development of purchase prices and rent levels. In the medium to long term, the crisis will accelerate the shift towards online shopping.

3 FASHION – BRICK-AND-MORTAR RETAIL VS. ONLINE: REVENUE⁽¹⁾ (CHANGE IN % VS. PY)



(1) Market for textiles and clothing, online including mail order as well as shoes, leather goods; (2) excl. March 2020 (COVID-19)

4 IFO BUSINESS CLIMATE INDEX FOR TRADE IN GERMANY (ON BALANCE, SEASONALLY ADJUSTED)



(1) Market for textiles and clothing, online including mail order as well as shoes, leather goods; (2) excl. March 2020 (COVID-19)

HETEROGENEOUS DEVELOPMENT WITHIN THE SECTOR SEGMENTS

LOCAL SHOPS SHOW SUSTAINABLE REVENUE GROWTH

As they meet basic needs, food retailers have a unique position in the crisis. The systemic relevance of the sector has also been emphasised time and again by policy makers. All in all, revenues in this market increased significantly. April saw an increase in food and beverage revenue of 6.2% compared to the prior-year period. And this was not only owed to a short-term boost caused by panic buying. The increase in demand is expected to continue in the medium term as restrictions in restaurants and offices continue, and consumers eat at home which shifts consumption into people's homes.

HEALTH CARE, LIKE RESIDENTIAL, CONSIDERED A "SAFE HARBOUR"

Because of the lower correlation with economic output, many investors are now shifting their focus towards the health care segment. The investment volume in health care properties amounted to € 400 million in the first quarter of 2020, which is only 7% below the prior-year period. With long-term rental contracts and sustainable cash flows, health care real estate is also considered a safe harbour in times of crisis. In April 2020, pharmacy revenues declined slightly year-on-year by -1.6%.

STORAGE/LOGISTICS REAL ESTATE TO BENEFIT IN THE MEDIUM TO LONG TERM

Overall, the heterogeneous segment is regarded as the winner of current developments around COVID-19. In the short term, logistic companies face great challenges with regard to maintaining supply chains during lockdown and withstanding other state interventions such as travel limitations. In the medium to long term, the fragility of international supply chains focusing on costs and just-in-time deliveries during the COVID-19 will lead to a paradigm shift with growing demand for larger warehousing solutions and regional supplies. The upswing of the logistics sector is further driven by the trend towards e-commerce, as deliveries to end consumers replace brick-and-mortar retail. The strong increase in product deliveries amid the COVID-19 pandemic led to a temporary surge in growth in online sales, even of products traditionally classed as typical offline retail products such as medicines and products for everyday use. This leads to a sustained positive effect on demand, thus supporting the storage and logistics industry in the longer term. In addition, the supply side is limited by a lack of suitable and available locations and an extremely high utilisation of construction capacity.

IMPLICATIONS FOR THE INVESTMENT MARKET

As a result of the pandemic, the investment market suffers uncertainty and state interventions leading to delays in decision-making and review processes, renegotiation or complete cancellations of investments. Investors are currently adopting a wait-and-see stance. However, due to a low level of liquidity and higher risk premiums, dynamics on the market will pick up again from Q2 2020. In the hotel, catering and retail trade in particular, owners will have to draw on the support of investors, as banks are currently hesitant to provide financing, especially for hotel properties.

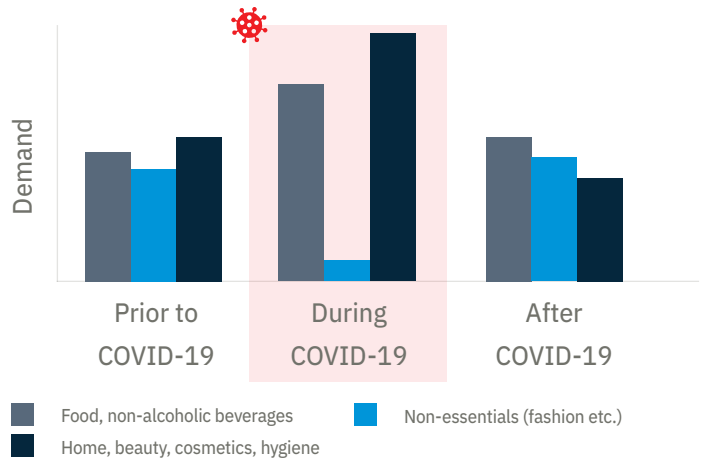
Are you interested in market trends in the real estate industry? Please get in touch and arrange a meeting for an informal chat without any obligation. We look forward to hearing from you.

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THE RIPPLE EFFECT OF THE PANDEMIC AFFECTS THE ENTIRE RETAIL SECTOR

Change in consumer spending because of COVID-19, indicative representation



HIGH LOSSES IN HOTEL AND CATERING SECTOR

This area is particularly hard-hit by the negative impact of the pandemic. Travel warnings and low travel as well as general restrictions in public life weigh on the sector. This is further aggravated by the cancellation of large events as well as measures to restrict the number of participants. The risk of rent defaults is particularly expected to increase in the final quarter. The employment situation in this segment is also extremely strained. Nine out of ten employees in short-time work arrangements, more than half of the businesses reducing their number of employees and an expected increase in insolvencies make this segment particularly dependent on government measures. While regional travel and leisure sales have benefited from catch-up effects due to increased domestic travel activities during the summer holidays, negative effects are being felt in the business travel segment. The digitalisation of work processes in the corporate sphere with the help of online applications is now an important factor to reduce costs. The expected decline in business travel will be felt by hotels, also in the long run. International trade show locations are even more affected, and first catch-up effects are not expected before 2021. Key decision makers in the real estate industry expect a pronounced decline in purchase prices and rent levels.

In the second half-year, demand is expected to increase again, especially for residential real estate, because of the high level of liquidity in the market. In the long term, the transaction volume for commercial real estate is also expected to rise again, as the sustained low interest rate provides for a limited choice of "safe" investment options with attractive expected returns.

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