

The impact of Brexit on the Frankfurt real estate market

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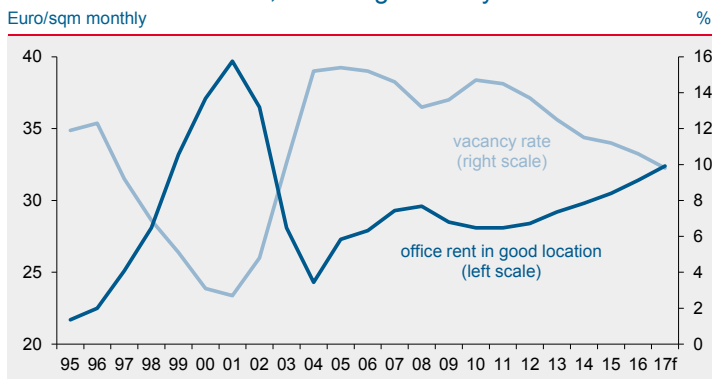
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- The Exit of the United Kingdom from the European Union will have significant consequences for the Frankfurt real estate market. In the medium term, we expect that a minimum of 8,000 bank employees will be relocated from London to Frankfurt.
- In view of a still ample vacancy rate and a number of construction projects underway or in the pipeline, satisfying additional demand should be possible without any difficulty on the office market.
- On the residential market there is no appreciable vacancy rate. However, the considerable rise in new construction activity, projects planned for the next few years as well as the abundant land reserves available in the surrounding area suggest that there will not be any significant tightening on Frankfurt's housing market as a result of Brexit.¹

The effects of Brexit on the Frankfurt office market

With the starting gun having been fired for Brexit negotiations, the situation on Frankfurt's office market is positive. Despite modest rises in average office rents, they are still significantly below their all-time highs at the turn of the millennium. In comparison to the leading German office markets, rents in Frankfurt are by far and away the highest of all. However, it seems rather affordable compared to other European financial centres: rents in Frankfurt are significantly lower than those in London and noticeably below levels in Paris and Dublin. This is most definitely an advantage in terms of competition between financial centres that should not be underestimated.

Modest rent increases; declining vacancy rate



Sources: Scope, Helaba Research

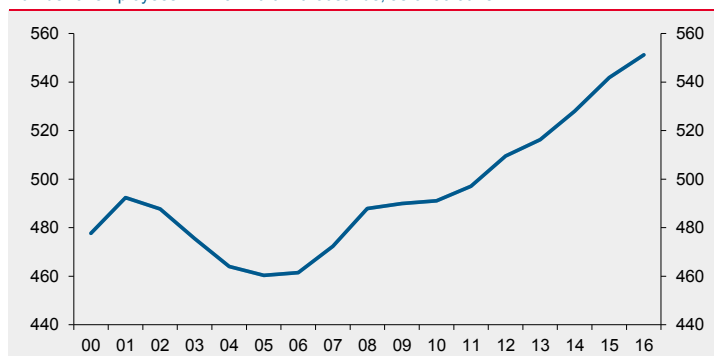
At first glance, the amount of available office space in Frankfurt should mean that the relocation of thousands of additional bank employees will be easy to manage. Over the last few years, the vacancy rate has fallen considerably from over 15 % to around 10 %. A boom in employment, which was already underway before the Brexit vote, contributed to this: In the five years from 2012 to 2016 alone, the number of employees subject to social insurance contributions rose by 54,000 (of which around a half are estimated to be office jobs).

¹ This Real Estate Report is an excerpt from our latest special publication "Financial Centre of Frankfurt: In Pole Position for Brexit Bankers" of 31 August 2017 (English version of the study will shortly be available)

This publication was very carefully researched and prepared. However, it contains analyses and forecasts regarding current and future market conditions that are for informational purposes only. The data are based on sources that we consider reliable, though we cannot assume any responsibility for the sources being accurate, complete, and up-to-date. All statements in this publication are for informational purposes. They must not be taken as an offer or recommendation for investment decisions.

Demand for office space mirrors growth in employment

Number of employees* in Frankfurt in thousands, as of 30 June



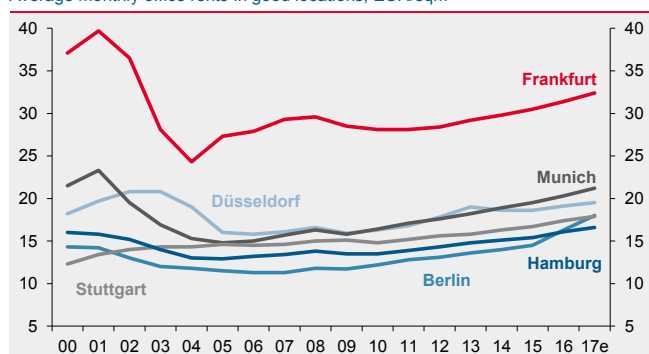
*subject to social insurance contributions
Sources: Federal Employment Agency, Helaba Research

Significant vacancy rate in Frankfurt an opportunity

However, Frankfurt still has the highest vacancy rate anywhere in Germany, while in other top locations there is already a scarcity of office space. What was seen as a weakness for a long time is now proving to be a locational advantage. Of the total office space of approximately 12.5 million sqm, around 1.2 million sqm is vacant. This is fortuitous because the Frankfurt office market is now clearly moving up a gear thanks to Brexit.

Office rents highest in Germany...

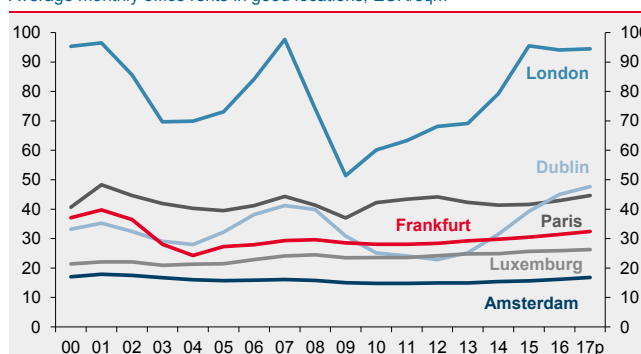
Average monthly office rents in good locations, EUR/sqm



Sources: Scope, Helaba Research

... but only moderate among financial centres

Average monthly office rents in good locations, EUR/sqm



Sources: Scope, Helaba Research

On closer inspection, the Frankfurt office market appears somewhat more diverse: a large proportion of vacant space is not in the central locations preferred by the financial sector and of the high quality that Brexit newcomers expect. Nevertheless, in principle around half of the current vacant office space should satisfy the high demands of the banks, of which at least 250,000 sqm is located in the favoured Central Business District (CBD).

Increased number of office leases soon expected to be signed

A whole host of banks aiming to relocate from the river Thames to the river Main will probably be looking for larger, interconnected spaces in central locations. If many institutions show a simultaneous interest for this market segment, it may not be possible for all of them to find suitable space at short notice. However, some banks will be able to accommodate additional employees at their existing offices, while others will be dependent on renting new properties. If the customary lead times for property searches, lease negotiations, adequate refurbishment or upgrading work as well as, finally, moving into the new office space are factored in, only limited time remains before Brexit proper takes place in the spring of 2019. For this reason, with companies having already reserved options on office space, it is likely that the first leases will soon be signed.

First of all, individual banks will come to Frankfurt with a limited number of employees in order to gain a foothold in the EU. It will take some time before they increase their workforces. This means that not all institutions will necessarily require the perfect office space, at least not initially, and the demand for space by some new banks will be modest to begin with. The Brexit-induced gain of at

least 8,000 office workers in Frankfurt will thus not happen overnight but will instead be a process lasting several years, as described above. Furthermore, Frankfurt’s major banks are currently implementing large-scale reductions to their staffing levels with the consequence that, when taking these consolidation measures into account, the net effect will probably be less pronounced.

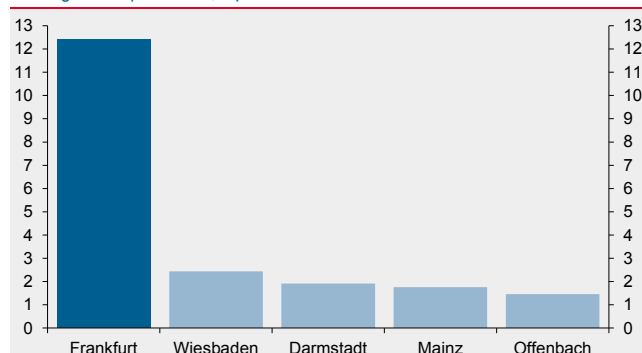
Selected office property developments in Frankfurt

Project	office space, sqm	completion
Winx Tower	32.000	end 2017
Marienforum	12.000	early 2018
Omniturm	44.000	end 2018
Marienturm	44.500	early 2019
Grand Central	45.000	2020
Four Frankfurt	100.000	2021/2022
Tower One	42.000	2021
Honsell-Dreieck	55.000	2023

Sources: Press releases, Helaba Research

Frankfurt dominates office market in Rhine-Main area

Existing office space 2016, sqm million



Sources: Scope, Helaba Research

Well-stocked pipeline to prevent shortages on office market

Assuming an average per capita office space of around 20 sqm (more seems unrealistic since London bankers are used to a rather “efficient” use of office space) results in additional, purely Brexit-related, demand of as little as approximately 100,000 sqm by the end of 2019. This would not even correspond to half of the current vacant office space in the CBD. Furthermore, until the Brexit effect unfurls more strongly, new space will expand supply on Frankfurt’s office market (see table above). For instance, the Winx Tower, the Omniturm as well as the Marienforum/Marienturm developments, which are nearing completion, will increase office space in central locations by more than 130,000 sqm. This will be complemented by a range of smaller projects. However, until the largest project known as “Four Frankfurt”, which will provide around 100,000 sqm of office space on a plot previously occupied by Deutsche Bank, is realised, prospective tenants will have to wait another four years.

Many additional office jobs in other sectors

However, even Frankfurt does not consist exclusively of banks. Additional demand as a result of Brexit comes during a period of strong economic activity in which numerous jobs are being created in other industries, too, especially in the dynamic Rhine-Main region. Over the last few years, employment growth in the city has occurred almost entirely in non-financial sectors. In the context of banks relocating to Frankfurt, it can safely be assumed that other service sector companies will also raise their staffing levels in the German financial centre. The upshot of this is that the total number of office workers should rise at least twice as fast as would otherwise be expected with an isolated Brexit effect. Even this additional demand could be satisfied with the existing stock of office space in central locations as well as completions of new properties in the next couple of years without any major problems.

New construction activity to limit potential for rent increases

Therefore, in the years to come Brexit will amplify an already positive development on the Frankfurt office market and contribute to a continued fall in the vacancy rate. However, in view of a well-stocked pipeline of projects, we do not expect the vacancy rate in Frankfurt to approach the very low levels of other top German locations (such as Munich or Berlin, with 3 % to 4 %). Thanks to the Brexit effect, rent increases in good locations will probably be somewhat higher over the next one to two years. Before rents pick up more rapidly, though, incentives such as rent-free periods or the assumption of refurbishment costs will be reduced, which indications suggest is already happening. In light of new construction projects either currently underway or in the planning stages and the possible revitalisation of existing properties, however, there will not be any real shortage of space with continuing higher rent growth. Frankfurt remains Germany’s most expensive office location but is still affordable in comparison to other European centres. In terms of letting turnover, at least, Brexit may lead to new record highs.

Boost for secondary locations also likely

Since interest from established as well as new banks in the financial centre will continue to focus on downtown locations, the question arises as to whether Frankfurt's secondary locations or even neighbouring office locations in the Rhine-Main area will benefit from Brexit, too. Banks willing to relocate that are not (initially) able to find any suitable space in the CBD will presumably fall back on neighbouring locations or, to start with, distribute their workforces among different locations. This could have positive effects for secondary locations that, for example, had previously been used for the banks' back-office activities. Moreover, companies from other industries that are not prepared to meet the costs of more strongly rising rents in the banking district might turn to alternative inner-city locations instead. This should benefit Niederrad, Mertonviertel or the Kaiserlei area, which is part of the neighbouring city of Offenbach. A less likely scenario would involve Brexit having a direct impact on office space in other cities in the Rhine-Main conurbation, because in choosing a location for their back-office operations, banks will also consider its vicinity to the banking district in Frankfurt. Kaiserlei, which is easily accessible from Frankfurt's city centre in around ten minutes, will likely be acceptable; but travelling times of 40 minutes by public transport to Darmstadt, Mainz or Wiesbaden probably makes these cities a less attractive option.

Consequences for the regional housing market

Very different situation on the housing market

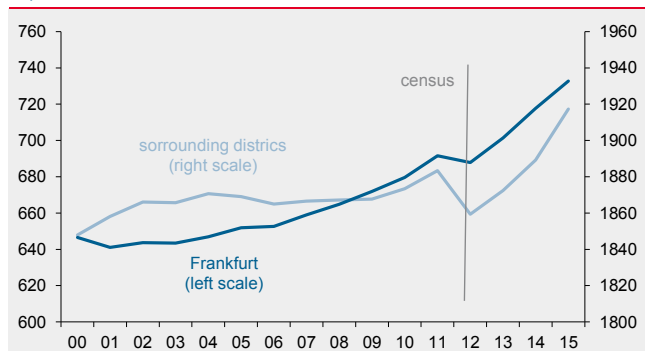
In contrast to the ample volume of available office space, vacancy rates on Frankfurt's housing market are currently negligible. The starting situation in both segments of the real estate market in the run-up to Brexit is therefore very different. The city of Frankfurt has been experiencing a major population surge for many years. From 2012 to 2015, the number of residents grew by an average of 15,000 per year. Although data for 2016 are not available yet, they are likely to show a similar increase. Since 2010, the number of inhabitants will thus have risen by more than 60,000 and is projected to exceed the 750,000 mark this year. The populations of neighbouring districts have increased by a similar magnitude.

Considerably higher new construction activity – but still too little

The influx of new residents from inside and outside Germany has been accompanied by increasing construction activity over the last few years. However, it has not been strong enough to keep up with the additional demand, with the result that the gap between supply and demand on the Frankfurt housing market has widened. There has been a similar development in other German cities, too. This is leading to a significant rise in house prices. Considerable efforts have therefore been made in Frankfurt in recent years to stimulate new construction activity. While an annual average of 2,400 apartments were completed within city limits from 2010 to 2013, this had risen to as much as 4,300 over the following three years (cf. chart on next page). Assuming a household size of less than two persons in a city such as Frankfurt, significantly higher demand forecasts would seem reasonable in view of the most recent increases in population. Brexit newcomers will make this situation more acute in the next couple of years and could – at least in certain inner-city market segments – increase the growth rates of residential property prices and rents.

Increasing populations – even in surrounding districts

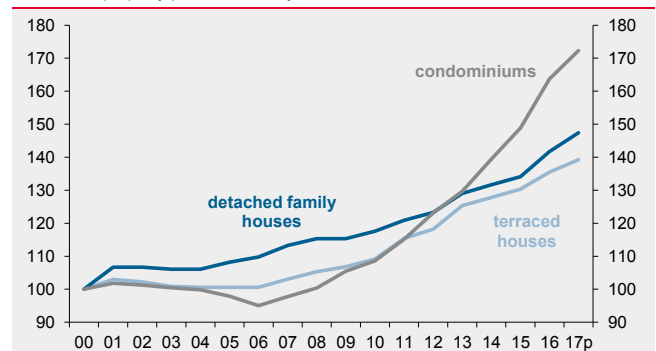
Population as of 31 December, thousands *



* Data for 2016 not expected to be published until the beginning of 2018
Sources: Federal Statistical Office, Helaba Research

They just keep rising and rising...

Residential property prices in the city of Frankfurt, 2000 = 100



Sources: Scope, Helaba Research

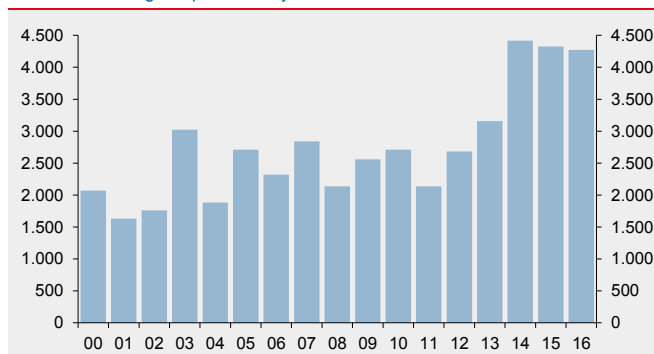
Different approaches to creating new living space

Efforts to mobilise additional building land include urban infill, vertical construction with a range of planned residential high-rises and converting office premises to living space. However, these possibilities are limited and will most likely not be adequate in order to meet the high level of demand for accommodation. Even without the additional effect of thousands of Brexit newcomers, the city and its surrounding districts face a challenge on the housing market. For this reason, there must be an “internal development” by establishing new residential areas in Frankfurt’s periphery on land that has previously been used for agricultural or recreational purposes.

In this regard, the recent political decision to develop a new urban district on a site spanning almost 550 hectares has come at an opportune moment. There is potential here for up to 12,000 apartments accommodating as many as 30,000 residents. However, the example of the “Riedberg” area shows that this can only be realised in the long term – planning commenced around 25 years ago and development is only now approaching completion. It will probably take seven to ten years before the first completed apartments are expected to be available. Yet, a new residential area of this size (which is significantly larger than even Riedberg) has the calibre to provide substantial relief to the city’s housing market for years to come.

Significant expansion in residential construction activity

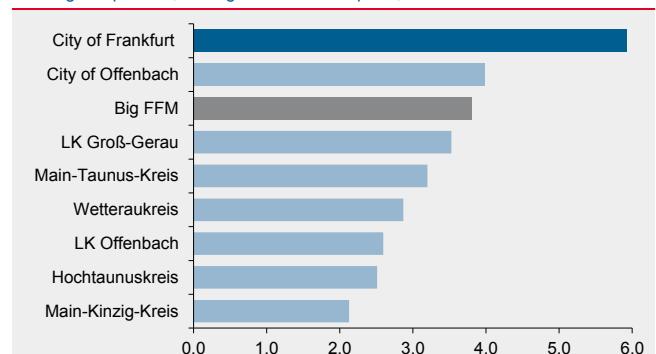
Number of housing completions* city of Frankfurt



*all buildings including completions in existing properties
Sources: Federal Statistical Office, Helaba Research

Residential construction activity per resident

Housing completions, average of 2014-2016 per 1,000 residents*



* based on the population at the end of 2015
Sources: Federal Statistical Office, Helaba Research

In respect of providing various qualities of living space, however, it is not only down to the city itself to take action but also to its surrounding areas. The average number of completed dwellings in relation to population size over the last three years demonstrates that, within the region, Frankfurt has recently made by far the largest contribution to improving the supply of living space. While Frankfurt had recently managed around six completed dwellings per 1,000 residents, the comparable figure in most neighbouring districts was only two to three (with the positive exception of the nearby city of Offenbach that boasts a figure of four). The available land exceeds the possibilities that Frankfurt offers with its strictly limited boundaries by a large margin. However, if construction is intensified in outlying areas, it will be vital to expand the (transport) infrastructure in order to ensure that commuting times remain bearable.

Uncomplicated housing market from the perspective of Brexit bankers

The situation in terms of the availability of properties on Frankfurt's housing market, which is not exactly abundant, is unlikely to perturb any Brexit émigrés. The prices of residential properties and rents in London are as much as three times higher than those in Frankfurt. The strong price rises seen over the last few years on the Frankfurt housing market do not even come close to those in the British capital. Due to the significantly higher cost of living there, many people are used to living on the edges of Greater London. In view of the “inexpensive” prices, at least from their perspective, and incomes that are usually above average, even residential areas in the city centre of Frankfurt would be acceptable and affordable for them. Finally, even the supposedly low level of residential construction in the Frankfurt region is relative when compared to that of Greater London. While the Greater London area registered as few as 2.6 completed dwellings per 1,000 residents on average over the last three years, during the same period this figure was as high as 3.8 completions in the comparative area of land that we have termed BIG FFM (created by transposing Greater London

onto the area around Frankfurt). Furthermore, the fact that around 2.8 million people live in this region equivalent in size to Greater London, which has 8.5 million inhabitants, suggests that the potential for growth in housing in the Rhine-Main financial centre market is considerably higher.

Presumably, many bankers from London will initially commute to Frankfurt for a while before moving their families or settling here permanently. In the short term, this may lead to higher demand for furnished serviced apartments in central inner-city locations. A range of existing and planned residential towers in the premium segment, micro-apartments and boarding houses indicates that the German financial centre is well-positioned in this respect. These new Frankfurt residents will not consider renting an apartment or purchasing a property until they have decided to remain for a longer time. Their elevated purchasing power will enable them to choose between central, inner-city residential locations with very short distances to work or the attractive surrounding areas with acceptable commuting times. Nevertheless, the displacement of lower income groups being priced out of the city's increasingly unaffordable urban districts remains a serious issue. ■