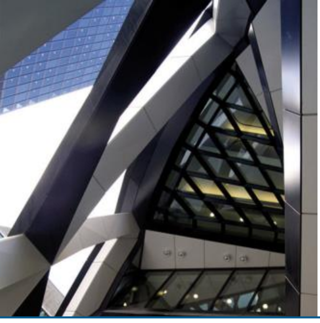
Helaba Research

REAL ESTATE REPORT

9 March 2018



Upswing

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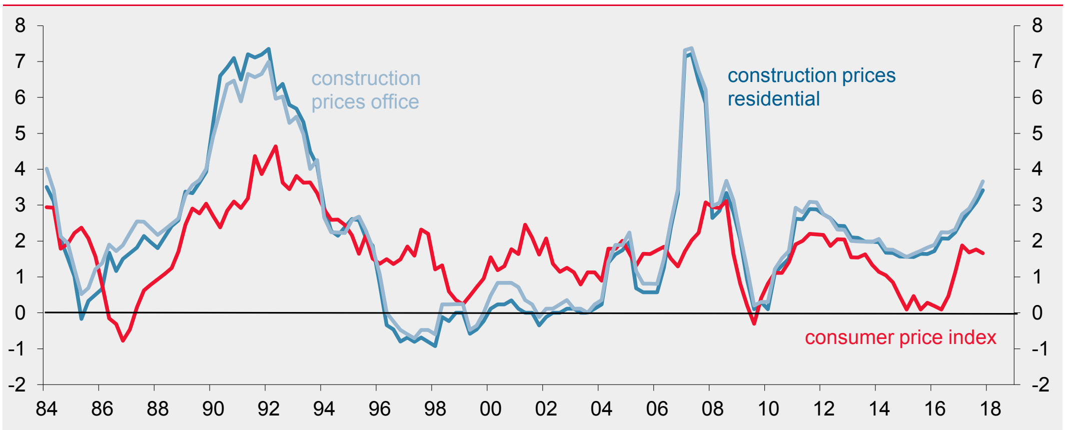
- The plans by Germany's Grand Coalition on housing policy are not persuasive in all respects (p. 2).
- Office markets in the Central European capitals are benefitting from robust economic growth in the region (p. 3).
- The office market in the Paris metropolitan area is continuing its recovery. The higher economic dynamism most recently promises to provide an additional boost (p. 4).

1 At a glance

German construction industry: construction prices moving up

Construction price index Germany, % y/y



Sources: Datastream, Helaba Research

The German construction industry is booming. Capacity utilization is at a multi-year high, the volume of orders is higher than it has been in twenty years, and the market for skilled workers is largely depleted. And this even though there is so much to do: this year housing construction is likely to remain well below demand, and with vacancy rates between 3 % and 5 % in leading office centres like Berlin, Hamburg, Stuttgart, or Munich, office space is becoming increasingly tight. The boom in the construction industry is taking its toll: it is no surprise that construction prices are now moving up sharply.

2 Selected real estate analyses

2.1 German housing policy: ambitious goals

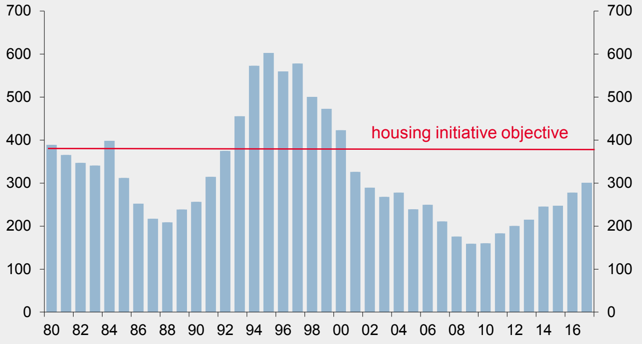
The Grand Coalition is getting to work. In addition to a few new housing policy measures, the coalition agreement contains familiar concepts that have not proved very successful.

Housing policy in the coalition agreement

Given the growing shortage of housing and prices and rents that have been rising robustly for years, it is no surprise that housing policy was an important issue in the election campaign. However, once again it was not enough for a separate ministry, which is something the sector has wanted for a long time. Instead of the Minister of the Environment, the Minister of the Interior will take on this task as a side job. But at least the coalition agreement does contain seven pages on the issue of housing policy, while last time around it was only three pages.[1] Even taking into account that the coalition document is now much longer (177 versus 116 pages), the section on housing policy has gained in importance, at least with respect to the space devoted to it.

Ambitious goals for housing construction

Housing completions Germany*, '000s

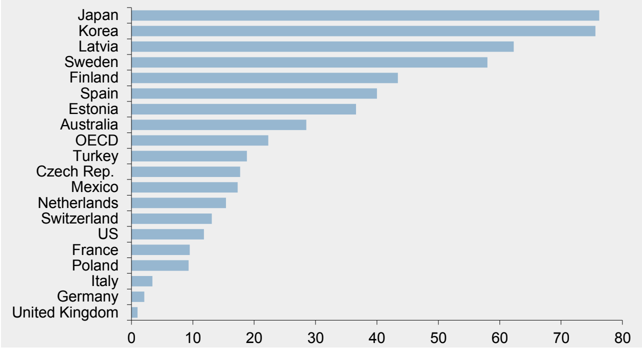


*before 1993: Western Germany

Sources: Federal statistical office, Helaba Research

Slow Internet as a location disadvantage

Glass fibre connections in total broadband (June 2017), %



Sources: OECD, Helaba Research

Digitalization in rural areas can take pressure off the housing market

The overarching goal of housing policy is the construction of 1.5 million housing units, that is, an average of 375,000 per year. Against the backdrop of annual completions of around 270,000 p.a. during the last legislative period, this is ambitious. Old stalwarts that show up in the coalition agreement are a revival of subsidised housing and the introduction of a construction child allowance ("Baukindergeld"). More funds for subsidized housing seem sensible in principle, since the number of public housing units has been declining for years. However, this is an expensive instrument to promote housing construction, since the "minimum of two billion euro in the years 2020/21" will hardly be able to boost completions in any meaningful way. We believe that supporting individuals rather than housing units is more efficient, especially since the problem of misallocation remains unsolved. With the construction child allowance, the former subsidy monster known as the homeowner's allowance ("Eigenheimzulage") is returning in miniature – with an uncertain effect, as the millions spent are more likely, in the current market environment, to lead to windfall effects or benefit developers via higher purchase prices. With the respect to rent control ("Mietpreisbremse"), its "suitability and effectiveness" is supposed to be examined by the end of the year, and a tightening (for example, through the obligation to reveal the previous rent) cannot be ruled out. However, heartening in the coalition agreement are passages aimed at lower construction costs and the elimination of superfluous regulations. Perhaps the most important aspect for the housing market is found somewhere else entirely in the coalition agreement: the long-overdue expansion of broadband networks through billions of Euro in additional investment by 2021. That could upgrade places to live beyond the large cities and take considerable settlement pressure off the conurbations. By international standards, Germany lags far behind in this area. We will continue to take a critical look at the individual measures in the next Real Estate Reports.

[1] Coalition Agreement of 7 February 2018, Chapter IX, vom 7. Februar 2018, Kapitel IX. Liveable cities, attractive regions, and affordable living, pp. 109-116.

2.2 Central European office markets in an upswing

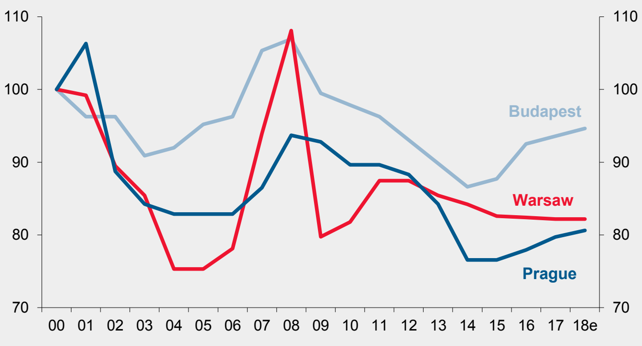
The robust economic growth and the continuous improvement in the labour markets are having a positive effect on the office markets in the Central European capitals. The demand for space has grown noticeably, with the result that the sometimes high volumes of completions in earlier years are being absorbed and vacancy rates have declined.

Demand for office space benefitting from strong economic growth

Recently Central European countries have attracted attention chiefly with their politics critical of Europe. In spite of the political quarrels with the EU, which in the case of Poland have even led to sanction procedures over the rule of law in that country, the region continues to enjoy great popularity among real estate investors. With an investment volume of 13 billion euro, a new record high was posted last year. The economic background conditions remain excellent. With economic growth of 4 % in Hungary and even 4 ½ % in the Czech Republic and Poland, the rise in real GDP in 2017 was much stronger than in the euro zone (2.5 %). While the pace of economic growth will ease somewhat over the course of this year, at a projected rate of around 3-4 % it will still be very high. The labour markets are benefitting from the good economic performance. The harmonized unemployment rate in the Czech Republic, at 2.3 % at the end of last year, was the lowest ahead of Germany within the entire EU, and Poland and Hungary were also very positive with rates of around 4 %. This is linked to a robust growth in jobs, especially in the capital city regions, and correspondingly high rental volumes in the office market. The flipside is the growing shortage of skilled workers, which could retard future growth.

Rents have now stabilized also in Warsaw

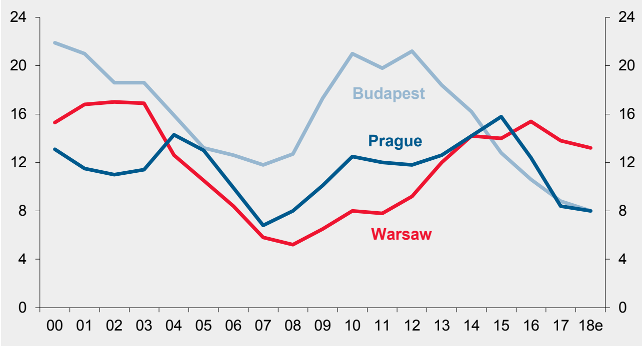
Average office rent in good location, Euro/m² monthly



Sources: Scope, Helaba Research

Noticeable decline in vacancies

Office vacancy rate, %



Sources: Scope, Helaba Research

With nearly 7 million m², Warsaw is the largest office location in the region. In 2017, less new space was completed here than in the record year of 2016, though relative to the existing stock it was still much more than in Prague or Budapest. Thanks to the high absorption and a continuing decline in new construction activity, office rents in good locations in Warsaw can stabilize in the current year. The two other office centres saw a more favourable development in recent years. While the long slump in office rents in Budapest (with around 3 million m² office space) came to an end already in 2014, it took a little longer in the Czech capital (4.2 million m²), not least because of the higher level of completions. New space declined strongly in Prague in 2016, which contributed to the recovery of the market. Thanks to the robust rise in demand, it should be possible to absorb the now higher volumes of completions without any problems.

Office vacancies declining in all three capitals

As a result of persistent high completions, the office vacancy rate in Warsaw rose from the low in 2008 to more than 15 % by 2016. By the end of this year, the rate should continue to decline in the direction of 13 %. That would still put it much higher than in the two other office centres, with an estimated 8 %. The situation will continue to improve in 2018 in all three Central European office markets. However, the rise in rents should remain moderate, and the decline in vacancies should slow down.

2.3 Paris office market: healthy trend

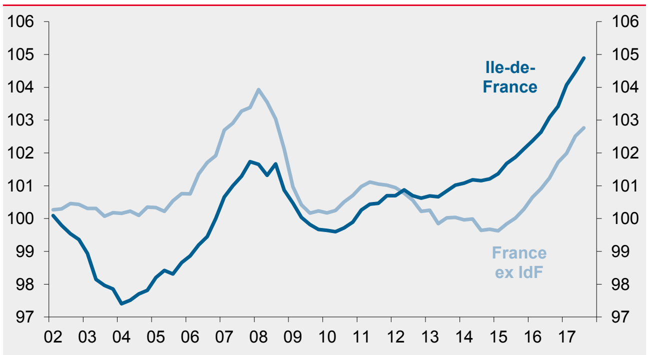
The French economy has gained momentum. Even the labour market, weak for so long, is improving. The office market in the capital region is benefitting from this trend.

New president on a path of reform

The mood in France has improved noticeably since the elections last year. The new president commands a stable majority in parliament and has begun to implement the course of reform he had announced. The first measures have already been taken in the labour market and in tax law. Given the high unemployment last year (9.5 % on average), the need for change remains high. However, the economic momentum is drawing close to that in the euro zone. While growth in France last year, at an inflation-adjusted 2.0 %, was still noticeably lower than the average of 2.5 % for the euro zone, the pace of growth was on a par in the fourth quarter (+0.6 % over the previous quarter in both France and the euro zone). With that, the economic background conditions for the office market in Paris and the Ile-de-France have continued to improve. As it is, the dominant capital region is developing in an especially favourable way. This is confirmed by the above-average employment growth in the Ile-de-France: here the employment figure has been on the rise already since 2010, while the trend turned around in the rest of the country only in 2015.

Robust employment rise in the greater Paris region

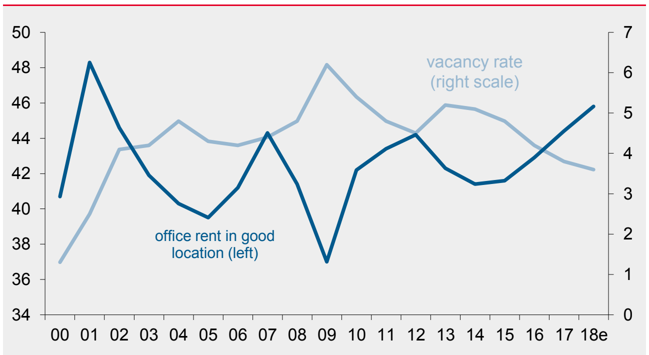
Number of employed workers, Q1/2001 = 100



Sources: INSEE, Helaba Research

Positive development of office rents in the city area

Average office rent in good location, Euro/m² vacancy rate, %



Sources: Scope, Helaba Research

Low vacancy rate in centre provides impulse to other locations

In line with the positive economic development, the office market in the French capital region has been recovering since about 2014. With total office space of around 55 million m² (a good 30 % of which is in the city area of Paris), this is the largest European office market. Rental results indicate a strong demand for office space. With 2.6 million m² in 2017 as a whole, the high level from the previous year was surpassed still and the best result recorded since 2007 – thanks to many large rentals and an intensified activity in the final quarter. With a vacancy rate below 4 %, there is already a shortage in the city area of Paris, which the result that interested parties are increasingly moving (by necessity) to less central locations. In the greater metropolitan area as a whole, the vacancy rate is moving in the direction of 6 %, though in some peripheral locations it is still in the double-digit range. Especially in the Western Business District (Croissant Ouest), the comparatively high availability of office space has most recently allowed for a noticeable rise in rental turnover.

The uptrend in the office market will continue thanks to the good economic development. At around 1 million m² of new or revitalized office space, completions in the capital region in 2018 should be roughly equal to last year's figure. A high proportion of pre-rentals suggests that the additional supply will be readily absorbed and that the vacancy rate could decline a little more still. The moderate rise in rents continues above all in the desirable locations and could broaden for high-quality properties in other areas. A net initial return in the Central Business District of 3 % should still guarantee an adequate risk premium. However, this historically low level is generating a growing interest in real estate investments beyond the core segment. ■