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Equity Research European Real Estate

Market Insight: Germany

September 2018

Presented by Marios Pastou

Agenda

- Summary and introduction
- Market update - Germany: the “Bull” and “Bear” case
- Berlin: priced for further growth
- Commercial property
- Property tours to follow

1. The Bull case

Our strategy team remain bullish

- Bullish for 8 years on German residential
- Powerful mix of economics, European politics and demographics
- EU monetary policy is too loose for Germany's growing economy and low unemployment. This should put upward pressure on wages and real asset prices
- Added hedge that if the Eurozone were ever to be abandoned, German assets would outperform
- Rental growth prospects are enduring in residential and Germany's polycentric city structure brings balance

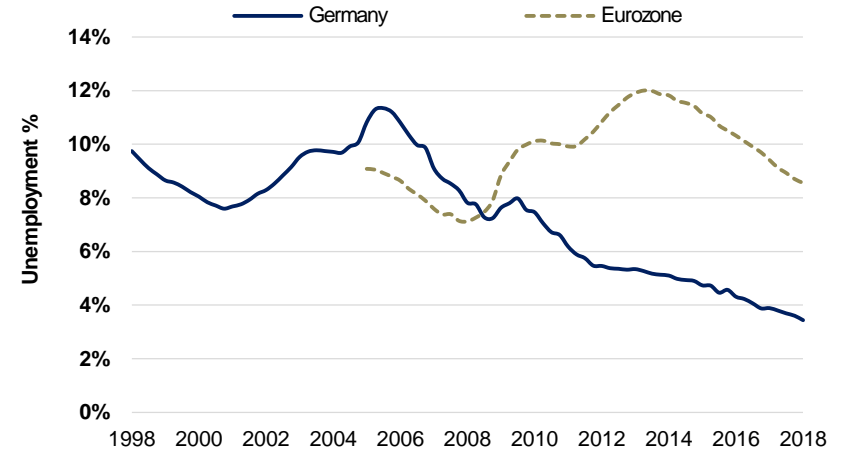
Real wage growth and asset prices are the by-products of a strong economy locked into the Euro

Germany's current account surplus is 8% of GDP



Source: Thomson Reuters, Deutsche Bundesbank

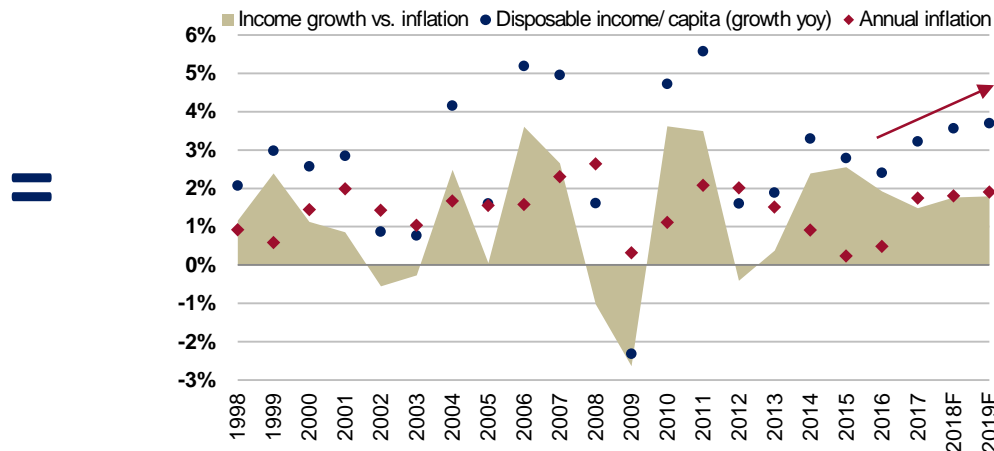
Unemployment levels have reached historic lows



Source: OECD

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Disposable incomes are increasing ahead of inflation

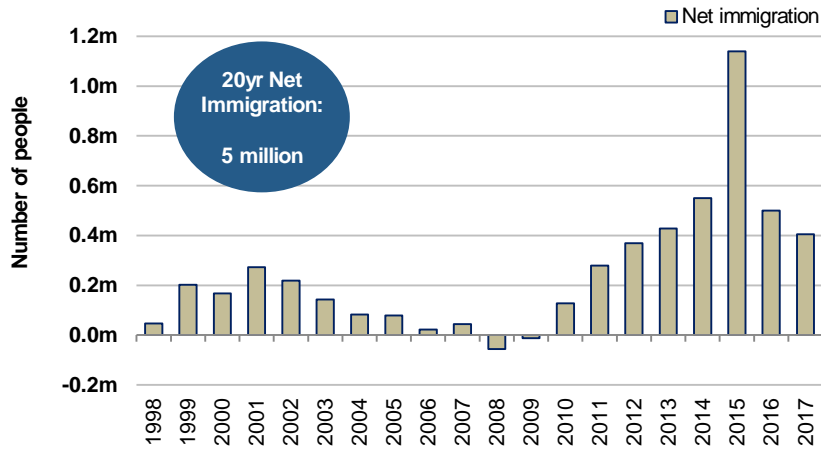


Source: Thomson Reuters, Destatis, CS Global Economics (inflation forecasts)

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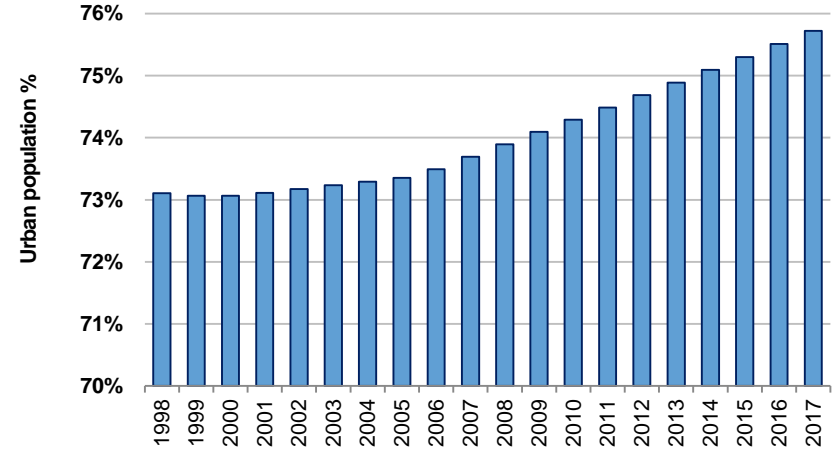
Immigration and urbanisation stimulate demand in major cities; household size is set to shrink

Immigration has boosted demand for affordable housing



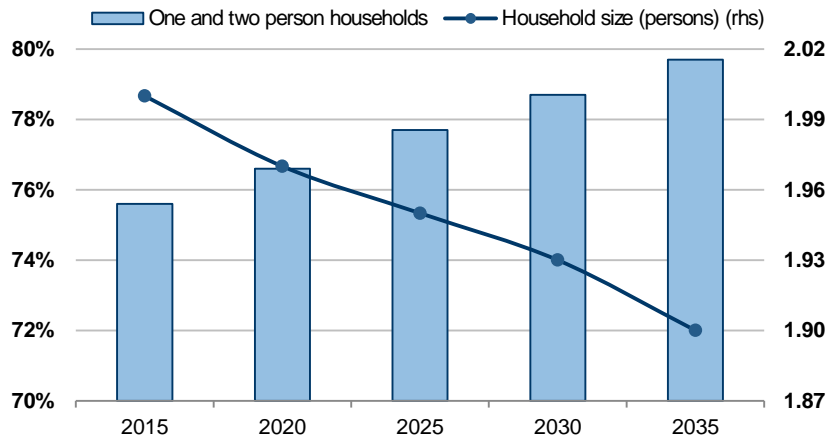
Source: Destatis

Migration has been towards cities for work and lifestyle



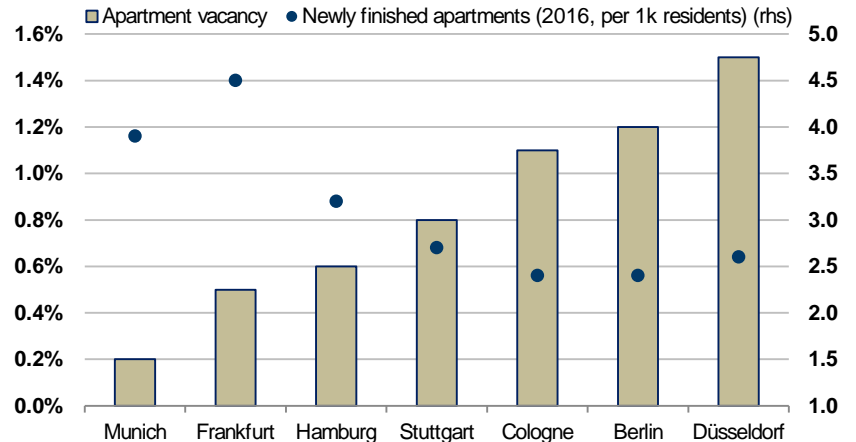
Source: World Bank

The trend towards smaller households is set to continue



Source: Destatis

Low resi supply has caused city vacancy to fall below 2%

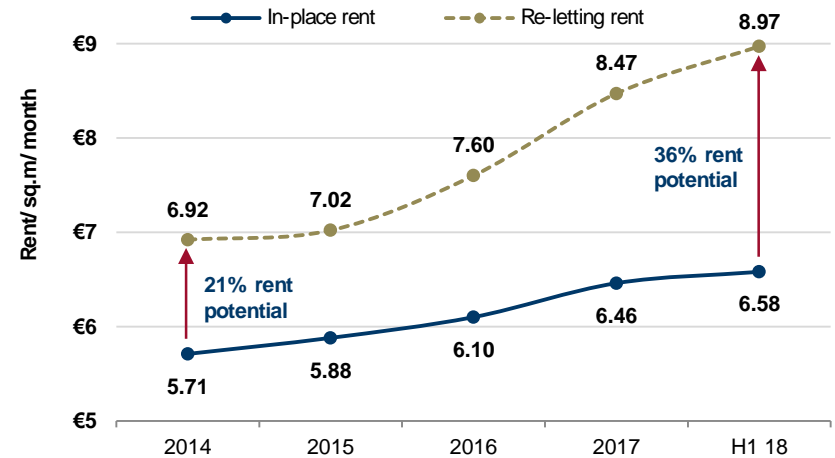


Source: CBRE

Residential capital value lag and rental growth has long-term support

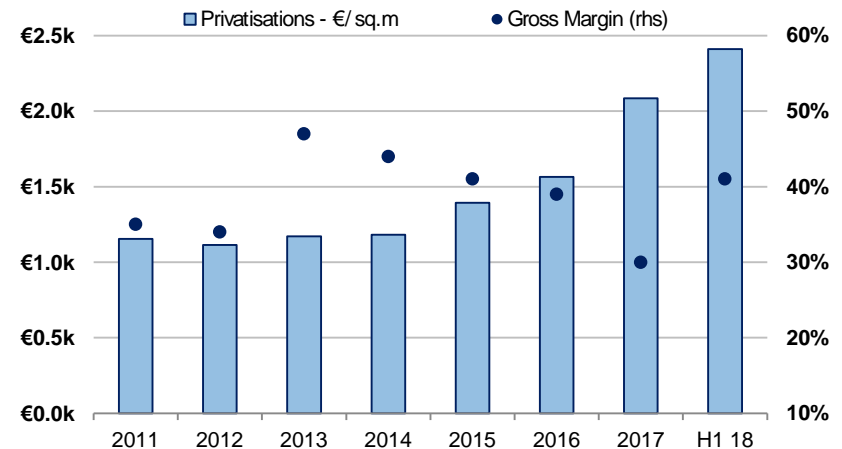
- German residential valuers mark *to model* not *to market*
- In-place rents are restricted by tight regulations
- Capital values are well below market levels and replacement costs (Deutsche Wohnen's average is €2.2k/sq.m in Berlin, whereas the market average is €3.3k/sq.m and replacement cost is 1.7x book value)
- Privatisations (sales of individual units) continue to attract premium prices over appraised values
- Arguably blocks should attract a premium, especially given synergies available from managing in scale

Rent controls have enhanced the gap between in-place rents and re-letting levels in Berlin...



Source: Deutsche Wohnen (both charts)

... and privatisations achieve considerable margins



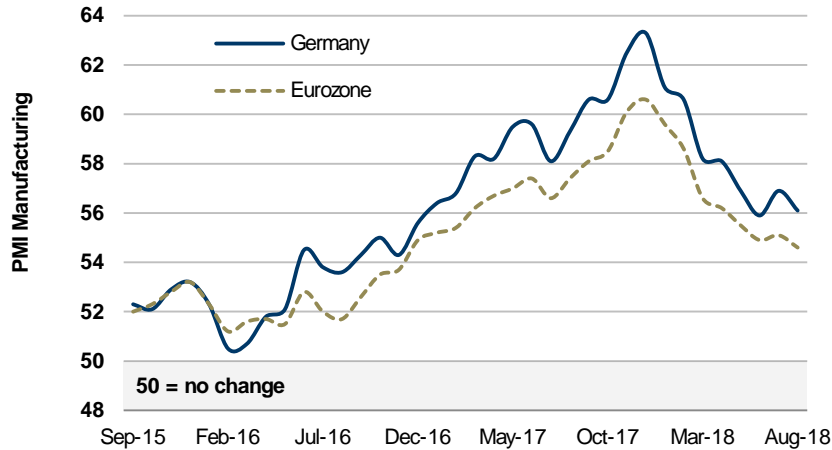
2. The Bear case

The bears worry that valuations are stretched

- Several economic indicators appear to have turned over
- Ongoing concern over rise in Bund yield, but decoupled recently
- Immigration surge has subsided and low birth rate is a longer-term challenge
- High average total returns from German resi are above long-term expectations
- Residential rent multiples have expanded significantly, i.e. yield compression
- Efficiency gains have largely been captured through scale
- Listed German resi companies are seeking value elsewhere

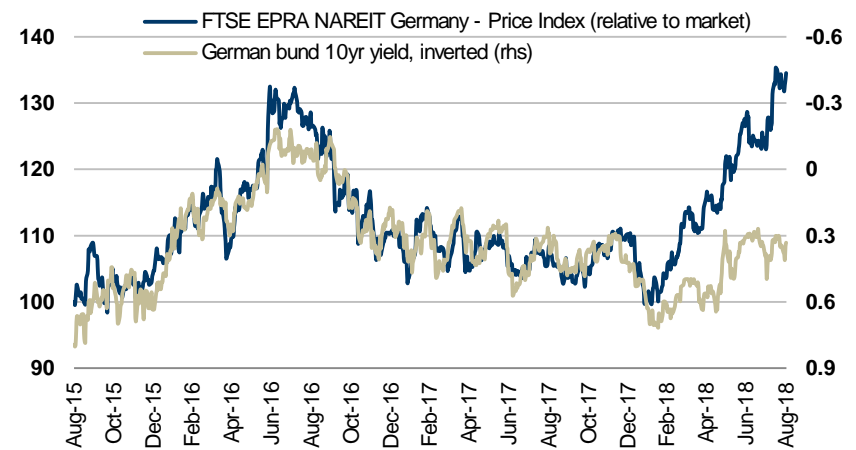
Some macro indicators reflect Europe's ongoing structural/political instability

PMIs have turned down, along with the European average



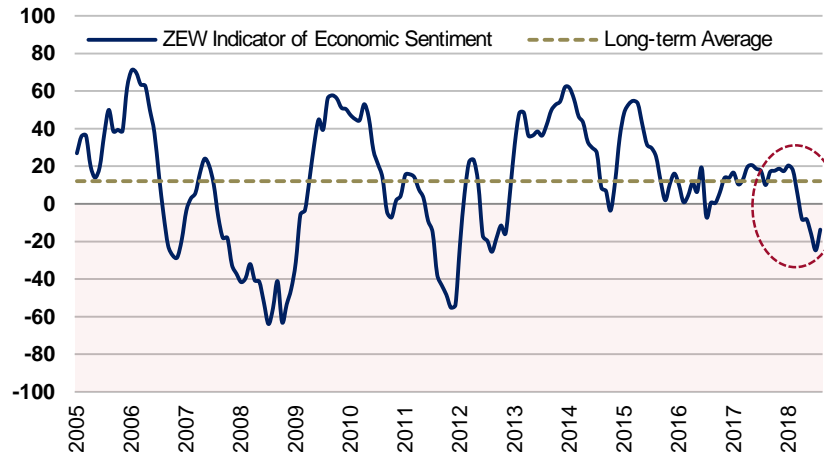
Source: Thomson Reuters, Markit

Recent outperformance is not justified by the Bund yield



Source: Thomson Reuters, EPRA, MSCI

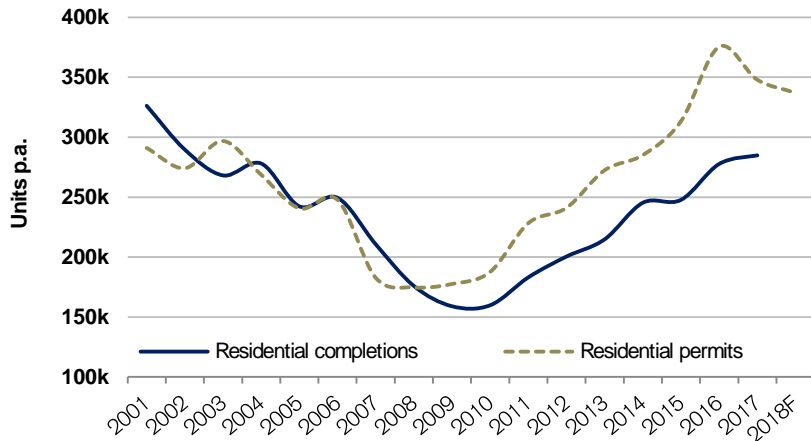
Economic Sentiment in Germany is negative



Source: Thomson Reuters, ZEW

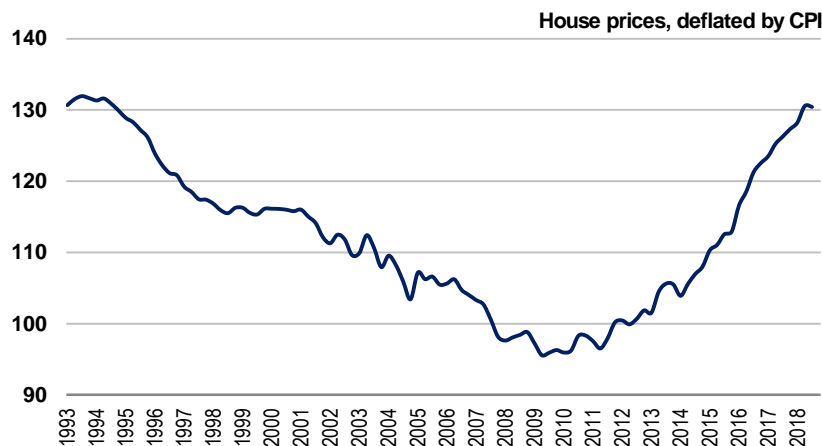
New supply of residential has increased and regulations restrict reversion capture. Prices have risen sharply

Residential completions have picked up



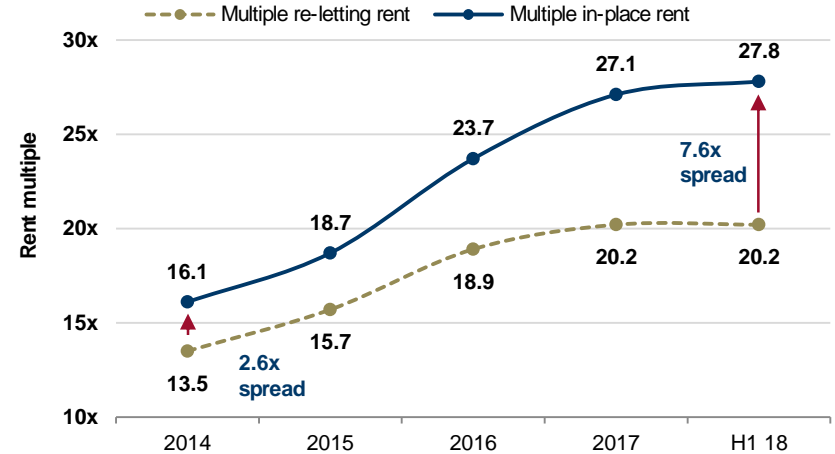
Source: Destatis (2018 forecast based on annualised H1 2018 permits)

Prices have increased to early-90's levels on a real basis



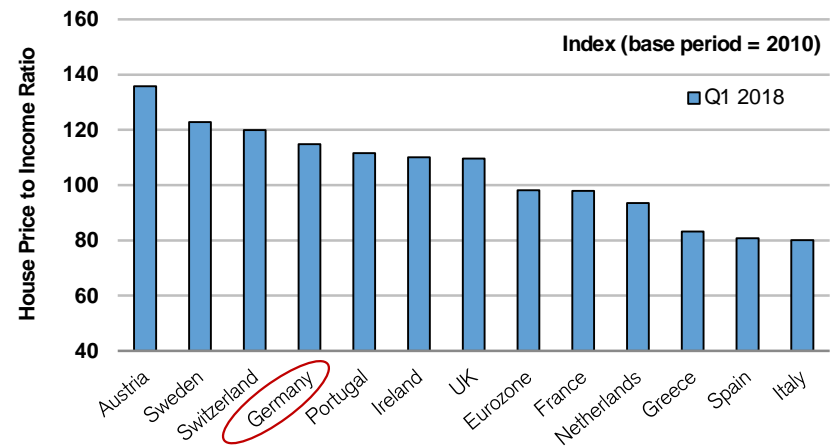
Source: Thomson Reuters, Oxford Economics, Credit Suisse estimates

Berlin's resi rent multiples have expanded significantly



Source: Deutsche Wohnen – Berlin portfolio

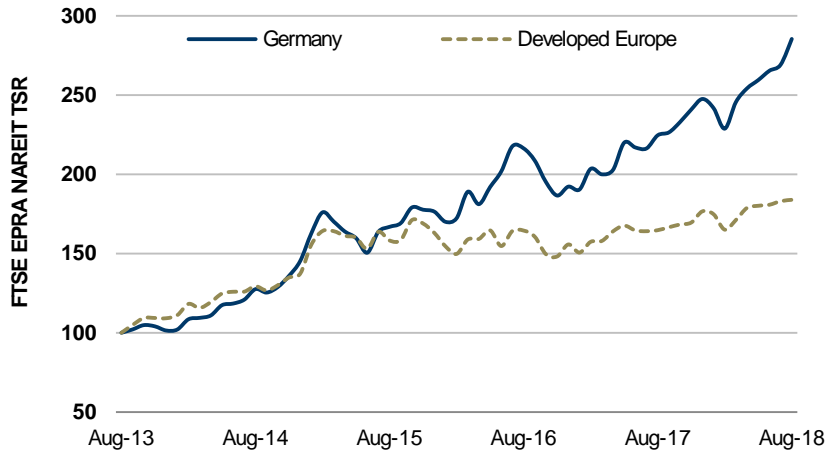
Housing is less affordable than the European average



Source: OECD

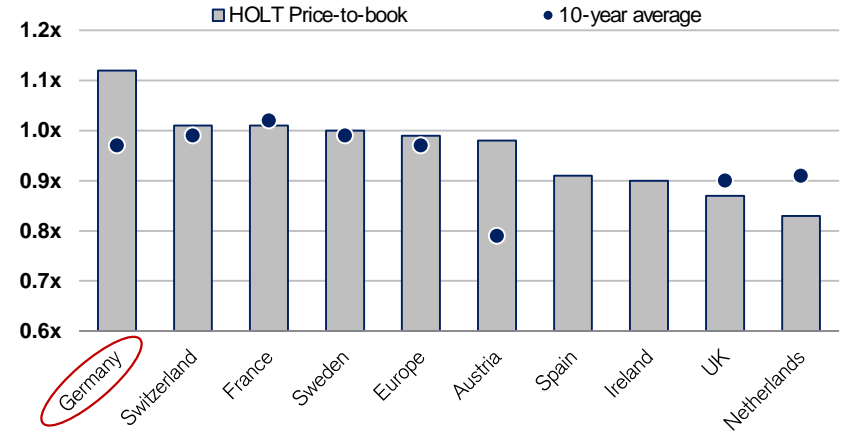
The listed resi companies are seeking new areas of growth following many years of strong performance

German real estate has outperformed in Europe



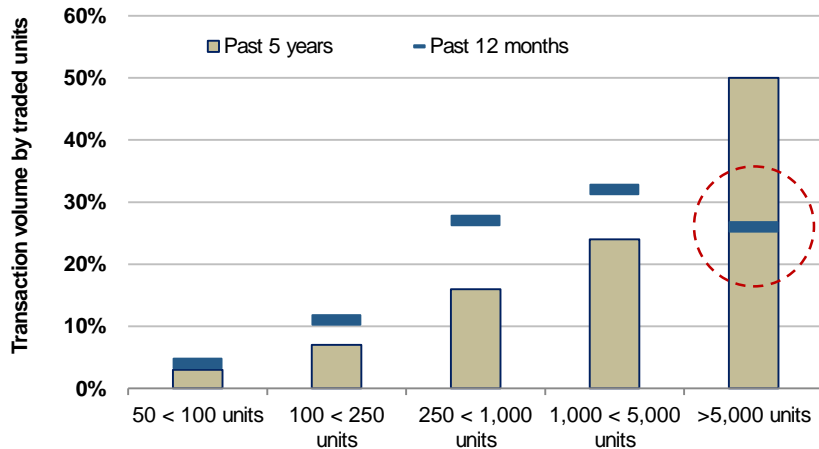
Source: Thomson Reuters, EPRA

Share price premiums to book values are high



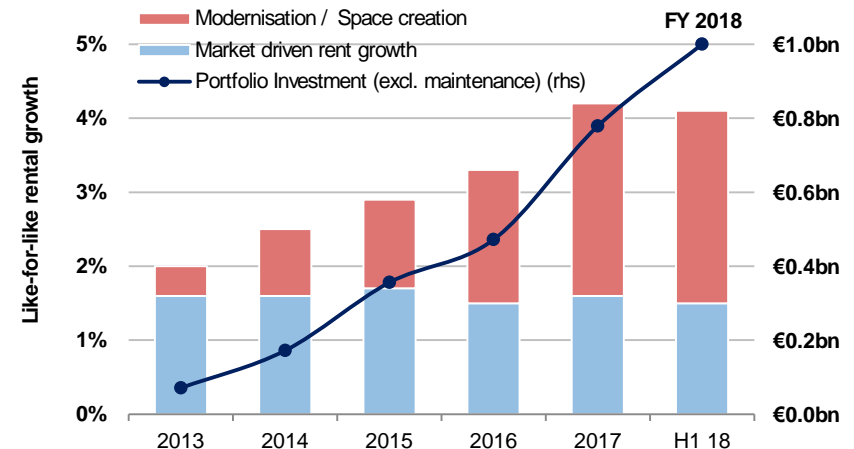
Source: Credit Suisse HOLT®

Large portfolio acquisition opportunities have fallen



Source: Savills

Residential landlords are ramping up capex spend

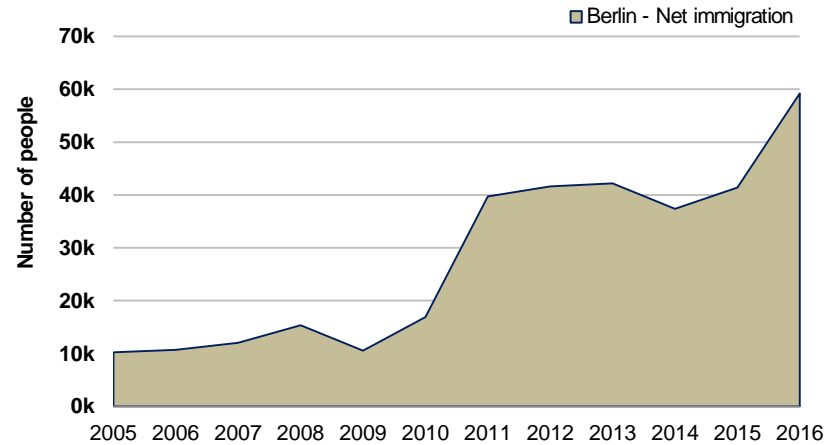


Source: Vonovia

3. Berlin – priced for further growth

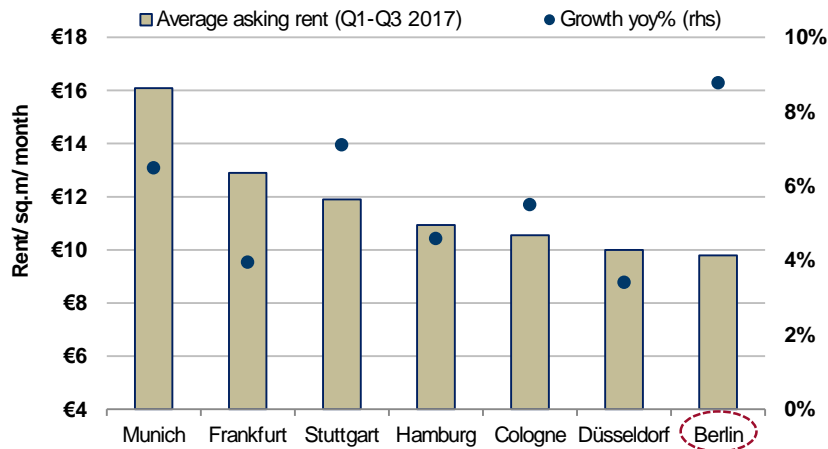
Berlin's draw is no secret, but difficult to bet against

Berlin continues to attract a steady flow of immigrants



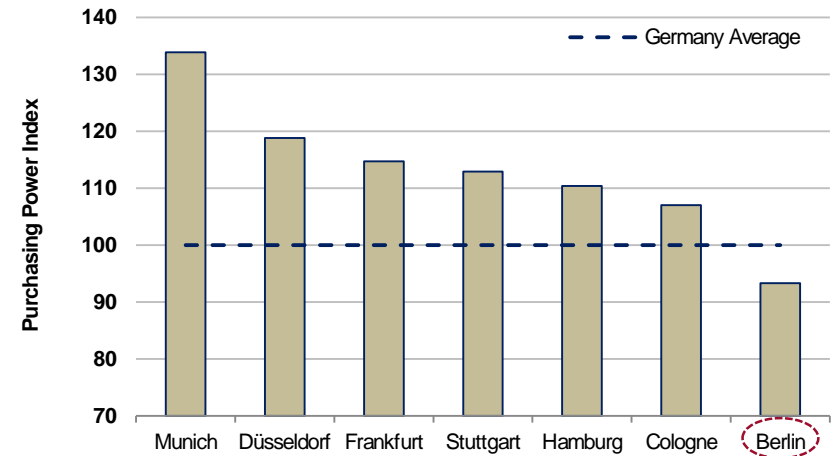
Source: Destatis (Regional Statistics)

Average resi asking rents are below other top cities...



Source: Berlin Hyp & CBRE

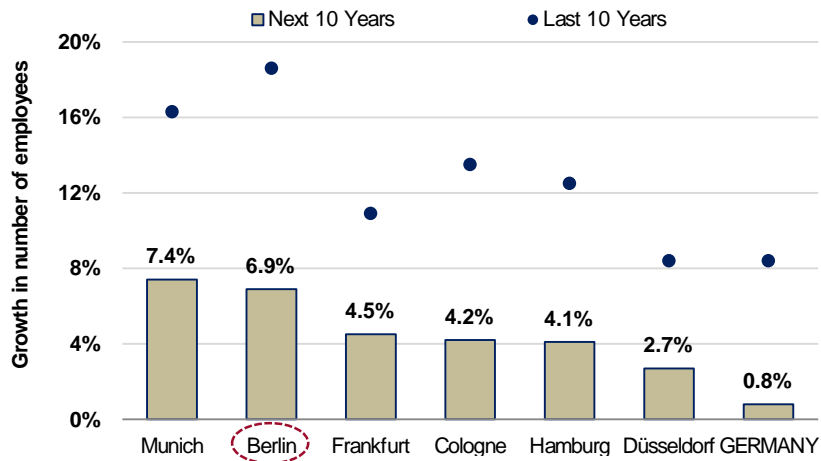
... although lower wages result in lower purchasing power



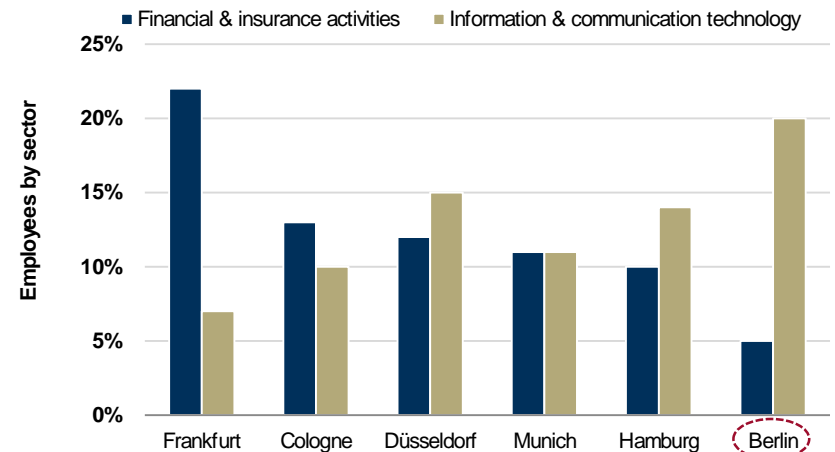
Source: Berlin Hyp & CBRE

Berlin is well positioned as a Tech hub and leader in the type of flexible office space that is in demand

Employee numbers are set to grow most significantly in Berlin and Munich

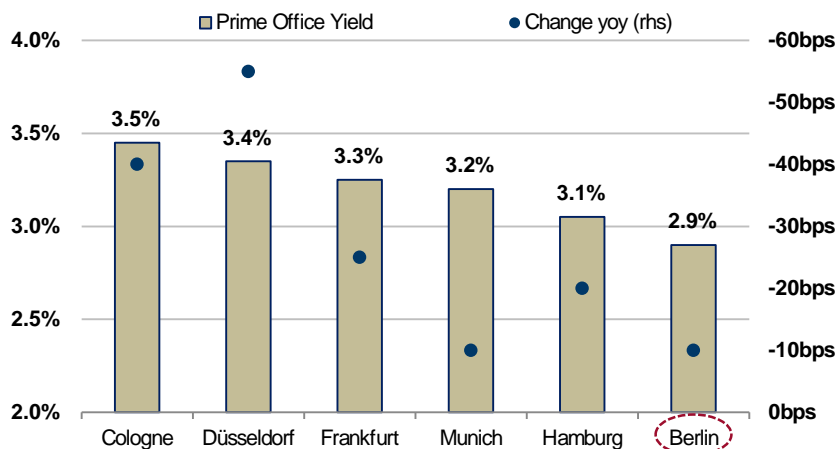


Berlin's office market is more geared towards Tech than Finance



Source: Oxford Economics (Savills report) (both charts)

Office yields have reached low-3% levels on average



Source: JLL – Q2 2018

Flexible office space providers:
 Q1 17-18 take-up across Germany = 5%,
 16% in CBD's
 ... but exposure just c.2% of total stock

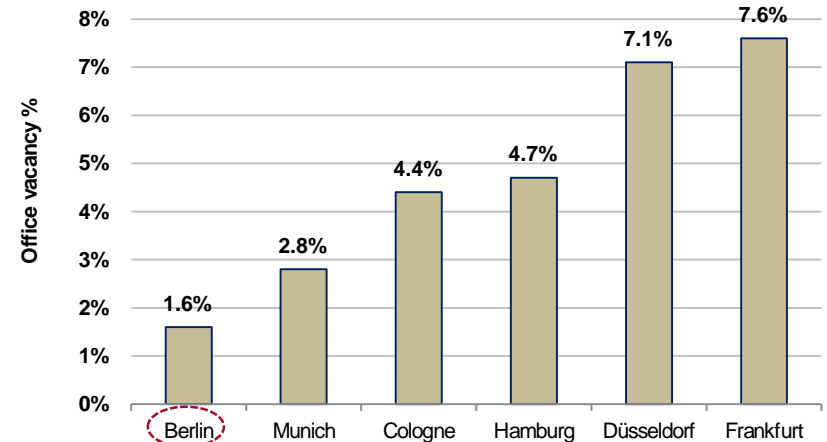
Berlin is by far the largest flexible office market

Source: JLL

Berlin's office vacancy is low but supply is increasing

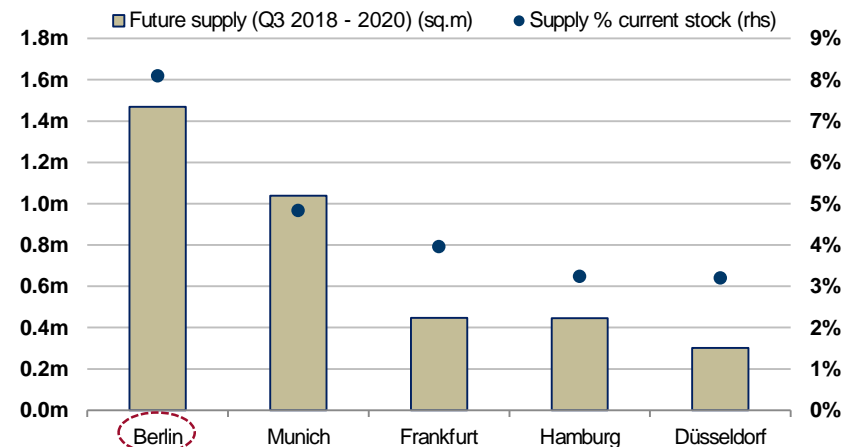
- Vacancy of 1.6% in Berlin is below other major cities (4.7% average)
- Take-up of 1.6m sq.m across Germany's top-6 office markets in H1 2018 declined 6% yoy. In Berlin, 422k sq.m take-up was down 11% (FY 17: +9%) as lack of availability has become a constraint
- Prime rents in Berlin of €34.10/sq.m/m are below Frankfurt and Munich
- New supply is set to dampen rental growth, although near-term availability is constrained by high levels of pre-letting

Offices in Berlin are almost fully let...



Source: Savills – Q2 2018

... which is encouraging a bigger supply response



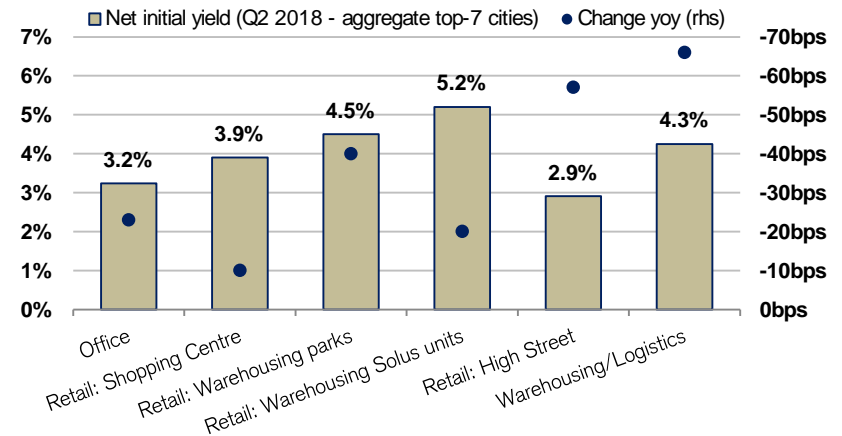
Source: CBRE, Credit Suisse estimates (supply % of current stock)

4. Commercial property

Offices dominate the investment market but the popularity of other sectors grew in 2018

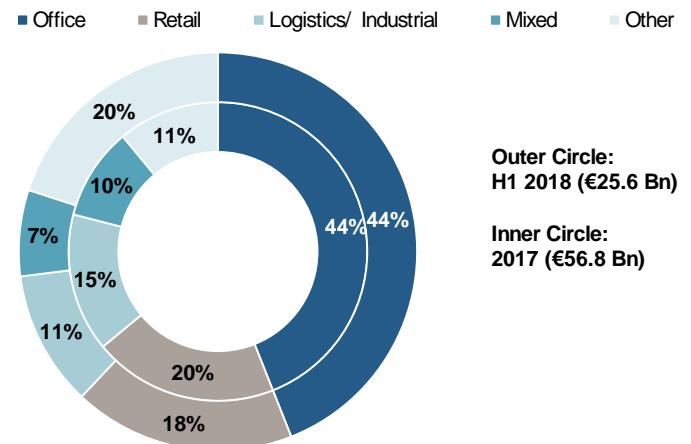
- Transaction volumes of €25.6bn in H1 2018 were flat yoy. JLL forecasts €55bn for 2018 (vs. €57bn in 2017)
- Transactions across Germany's top cities increased 29% in H1 2018 boosted by Frankfurt (+62%) and Hamburg (+34%)
- Office transactions highest in Frankfurt (86%) compared to 40% in Berlin. Other categories such as Hotels, Developments and Specialist Properties growing
- Over half of transactions are from domestic investors, much lower in Berlin

Property yields have continued to compress



Source: JLL – Q2 2018

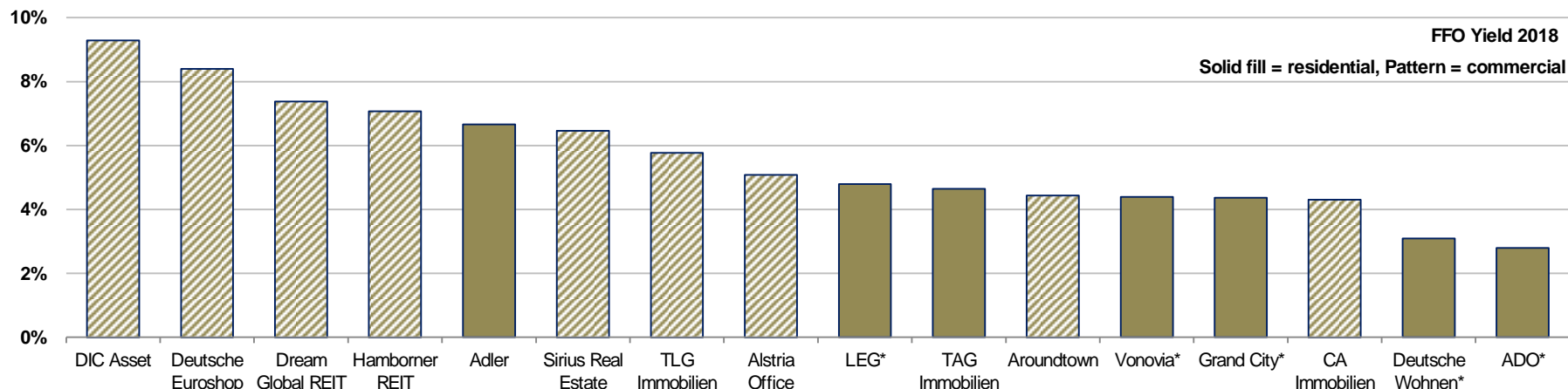
Offices make-up almost half of commercial investment



Source: JLL (Other includes Hotels, Development Sites and Special Properties)

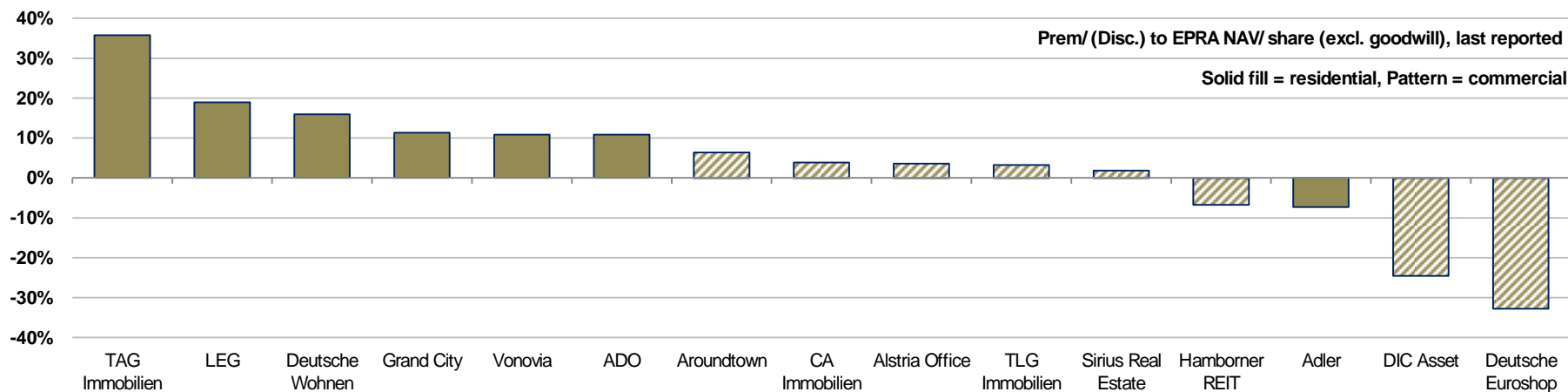
Commercial property is following resi out of the shadows

Commercial property stocks generally offer higher earnings yields even before maintenance capex



Source: Thomson Reuters, Company data (annualised H1 2018 FFO, reported FY 17/18 for Sirius Real Estate), *Credit Suisse FY estimates

Residential stocks trade at higher ratings to EPRA NAV (ex. goodwill) than commercial



Source: Thomson Reuters, Company data

Thank you

The Credit Suisse European real estate team

Ben Richford – Head of European real estate equity research

Ben joined CS in 2014 to reintroduce pan European coverage having spent five years jointly leading coverage of UK and Swiss stocks at Green Street in London. Previously he spent five years in real estate corporate finance post qualifying as a Chartered Accountant within EY's real estate team. Ben graduated in Economics from the University of Durham.

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Marios Pastou – Research Analyst

Marios joined the CS real estate team in 2015 and is lead analyst on German real estate stocks. He joined from KPMG where he worked in Management Consulting after qualifying as a Chartered Accountant (ACA) in the Private Equity division. Marios graduated from the University of Reading with a first class degree in Quantity Surveying and Construction Management.

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Mathias Peters – Specialist Sales (Real Estate & Insurance)

Mathias joined CS in 2016 as Sector Specialist for real estate and insurance from Citigroup, where he spent two years covering global financials and real estate as Specialist Sales. Prior to this he managed the Financials cash trading desk at Citigroup, having been a market maker for nine years for financials and real estate stocks. Previous employers include Nomura and Lehman Brothers. Mathias graduated in Business Management from University of Muenster, Germany. CFA Charterholder.

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Companies Mentioned (Price as of 31-Aug-2018)

ADO Properties (ADJ.DE, €55.35)
Adler Real Est (ADLGF.F, €15.92)
Austria Office REIT-AG (AOXG.DE, €13.02)
Aroundtown (AT1.DE, €7.685)
CA Immo (CAV.VI, €31.6)
DIC Asset (DICn.DE, €9.92)
Deutsche Euroshop (DEQGr.DE, €29.42)
Deutsche Wohnen (DWNNG.DE, €43.54)
Dream Global (DRG.U.TO, C\$14.64)
Grand City Properties (GYG.DE, €29.5)
Hamborner (HABG.DE, €9.32)
LEG Immobilien (LEGn.DE, €105.15)
Sirius (SRET.L, \$8.09)
TAG (TEGG.DE, €21.2)
TLG Immo (TLGG.DE, €23.26)
Vonovia (VNA.N.DE, €44.19)

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