Why Germany appeals to late-cycle Real Estate Investors

In the annual survey of INREV members, Germany emerged as their primary investment target for 2019. Christine Fritz of KGAL looks at what it is about the German economy and its real estate market that makes it so attractive.

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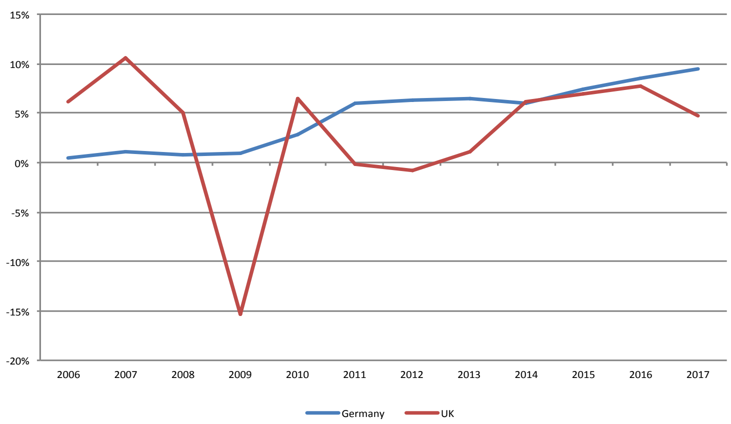
The German love of Ordnung (order) and how that informs its legal system and business world may mean that the country will never rank as one of the world's most exciting environments, but for investors it is this very stability which appeals at a time of global political and social uncertainty.

Thrift and prudent saving are powerful influences on the German mind-set - in good times and bad. The average household savings rate has remained relatively unchanged at 10% - despite a decade of essentially negative interest rates. Record low unemployment and a preference for 15 year-plus fixed-rate mortgages[1] mean that neither interest rate increases or a choppy global economy are expected to cause widespread strife in German household budgets.

And solid budgets – whether at the family or national level – are great news for property returns. This fiscal discipline positively impacts on consumer spending patterns and underpins returns from property asset classes such as retail, logistics or residential. During the global economic crisis, German house prices - instead of crashing - showed steady increases. Customer spending and retail rents saw at most a slight dip, but by 2012 had completely recovered any lost ground.

Chart 1: Housing Price Index (Yearly change %)



Source: Office of National Statistics, riwis, Deutsche bank Research

But you shouldn't get the idea that Germans are boring – the country equally ranks among the most innovative in Europe, with one in three European patent applications in 2017 coming from Germany, particularly in forward-looking technologies such as digitally-networked mobility, driverless vehicles and electric mobility.[2] Since 2008, Berlin has continued to climb the tables for start-up development and venture capital and is now generally seen as the second largest start-up cluster in Europe and probably the fastest growing.[3] Innovation is boosting German cities, particularly office employment, which continues to significantly outpace national population growth, resulting in record take-up in the office market.[4]

REGIONAL POWERHOUSES

The regional diversification of business across Europe's most populous country remains one of its inherent strengths. The country does not have one dominant urban area. London produces around 24% of the UK's GDP while Berlin – Germany's largest city – only generates around 4% of the country's total domestic output.

The so-called "Big 7" – the seven strongest cities in Germany – account in total for only 18.4% of national GDP.[5] Each city exerts not only a regional gravitational pull, but performs internationally with any number of industry clusters. Stuttgart and Munich are known in part for their automobile industries, Essen is a forerunner in the energy sector, Hamburg and Bremen in shipping and aircraft, and Leipzig in logistics and petro-chemicals. These regional specialisms bring stability on both a local and national level, allowing for a more balanced employment and economic structure. In France, the 20 largest firms are all based in the Paris region.[6] The equivalent list in Germany spans 13 different cities, with no single city or urban region dominating. For property investors, this means that individual cities may present attractive opportunities at different times, depending upon the current market conditions and growth potential of local industries.

A CONSTRAINED OFFICE MARKET

Low unemployment and increasing urbanisation are contributing to strengthening German office markets in both the largest cities and across the country's strong regional powerhouses. Office rents have increased on average by nearly 25% since 2013 while vacancy rates in cities such as Munich, Berlin or Stuttgart are below 3%. However, office construction activity remains sluggish not least because of a focus on other types of development. For example, in Frankfurt and Munich, the loss of office space to residential conversion in the past seven years has either equalled or surpassed the amount of new office space being developed.[7] As a consequence, the German office market in many regions has insufficient product to meet current demand, and a restricted pipeline.

ACCESSING THE MARKET

So it's clear to see why investors are drawn to the market, however, accessing it does not always feel so straightforward. It is often because of Germany's regional structure that many international investors can find it overwhelming to develop a comprehensive strategy for German real estate investment.

There's an understandable tendency for investors to reduce Germany to "the cities we've heard of". However, this 'safe bet' approach can actually eliminate a large proportion of potential opportunities and the opportunity to benefit from German stability and portfolio diversification.

Ultimately, all real estate markets are local and we would argue that unlocking the potential of a market demands collaboration with a local investment manager. With 50 years' experience of German and Austrian property investment, KGAL has grown its AUM to €20.5 billion and advises a wide range of institutions and investors on accessing what is rapidly becoming a favourite investment destination for many investors. So we'd recommend all real estate investors to check out German investment opportunities but be prepared for a more multi-layered market than you may be used to.

If you would like to discuss achieving income security and out-performance through investment into the German market, please contact Christine Fritz at KGAL for a meeting (Christine.Fritz@kgal.de). We shall also be at MIPIM this year on booth R7.G16.

FOOTNOTE

1 German Statistical Office and Deutsche Bundesbank
2 German Foreign Office
3 EU-Startups.com, October 2018; European Investment Fund, May 2018
4 RIWIS, German Statistical Office
5 German National and State Statistical Offices, Most recent data reported: 2016
6 Fortune 500 Ranking 2018/Wikipedia
7 RIWIS

KGAL REAL INVESTMENTS