

Opportunities, not just risks

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The new year remains suspenseful for the global real estate economy. Major challenges remain, but there are also a few bright spots that should not be overlooked (p. 2). The outlook is largely positive for the US office markets (p. 3), as is the development in the commercial real estate market in Germany (p. 4).

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1 At a glance

2011: A difficult investment year – diversification still called for

Yearly performance by investment classes, %

2004	2005	2006	2007	2008	2009	2010	2011
RE Equities Eurozone 38,0%	RE Equities Eurozone 28,5%	RE Equities Eurozone 50,0%	Equities Germany 22,3%	Bonds Germany 12,2%	RE Equities Eurozone 43,1%	Commodities 27,4%	Bonds Germany 9,8%
Commodities 11,0%	Equities Germany 27,1%	Equities Germany 22,0%	Commodities 20,4%	Bonds Eurozone 9,2%	Commodities 38,0%	Equities Germany 16,1%	Bonds Eurozone 3,4%
Bonds Eurozone 7,6%	Commodities 22,5%	Equities Eurozone 15,1%	Equities Eurozone 6,9%	Open-ended RE Funds 4,8%	Equities Germany 23,8%	RE Equities Eurozone 15,5%	Open-ended RE Funds 1,5%
Bonds Germany 7,4%	Equities Eurozone 21,3%	Commodities 13,5%	Open-ended RE Funds 6,4%	Commodities -25,9%	Equities Eurozone 21,0%	Bonds Germany 6,3%	Commodities -9,1%
Equities Germany 7,3%	Bonds Eurozone 5,4%	Open-ended RE Funds 4,2%	Bonds Germany 2,0%	Equities Germany -40,4%	Bonds Eurozone 4,3%	Open-ended RE Funds 1,6%	RE Equities Eurozone -14,2%
Equities Eurozone 7,3%	Bonds Germany 5,3%	Bonds Eurozone -0,4%	Bonds Eurozone 1,9%	RE Equities Eurozone -43,4%	Open-ended RE Funds 3,3%	Bonds Eurozone 1,1%	Equities Germany -14,7%
Open-ended RE Funds 2,7%	Open-ended RE Funds 2,4%	Bonds Germany -0,4%	RE Equities Eurozone -24,2%	Equities Eurozone -44,3%	Bonds Germany 1,9%	Equities Eurozone -5,4%	Equities Eurozone -17,5%

* CRB Commodity index, iBoxx bonds indices, DAX, EuroSTOXX50, EPRA real estate equity index Eurozone, IPD German open-ended real estate funds index OFIX
Sources: Datastream, IPD, Helaba Research

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 is 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.

Last year was not a good one in the stock market. The development of European real estate equities was similarly bad as the stock market overall, and no money was to be made with commodities, either, in contrast to the previous two years. Against this background, the yearly performance of the problem-ridden German open real estate funds with a plus of 1.5 % does not look that bad. High-quality sovereign bonds did better – whereby the performance of the European bond index was depressed by the developments in the crisis countries of the euro zone. The ranking list of the performance of various asset classes, which changes year by year, confirms once again: diversification makes sense – also in a financial crisis.

2 Selected real estate analyses

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2.1 2012: A good or bad real estate year?

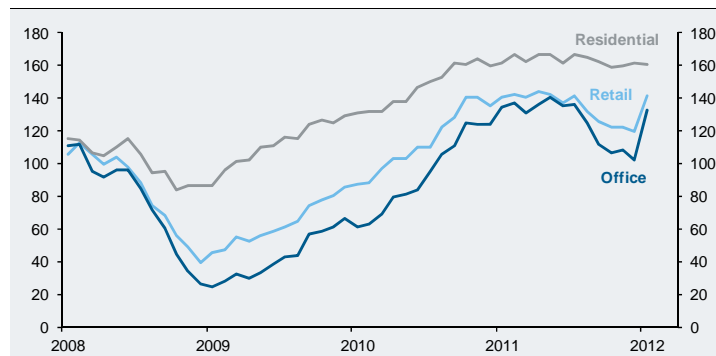
Most outlooks for the year focus on negative aspects like the current economic slowdown, the European sovereign debt crisis, and a credit crunch. Is 2012 in danger of becoming a bad real estate year?

Challenges remain ...

The old challenges remain in the new year: many European countries have begun with the necessary consolidations and structural reforms, which will cost growth over the short term. Continued job cuts will take place in the financial and in the public sector. The European sovereign debt crisis has not been solved yet, and in view of shrinking bank balance sheets the discussion about the threat of a credit crunch is heating up. Against this backdrop it comes as little surprise that the sentiment was gloomier in the German real estate sector until December – though from a fairly high level.

German real estate climate: positive surprise in January

Deutsche Hypo real estate climate index



Sources: Deutsche Hypo, BulwienGesa, Helaba Research

... but improvements
also foreseeable

However, in Germany the economic slowdown will not grow into a recession, and the economy will pick up steam again in the second half of the year, at the latest. When it comes to the debt crisis, optimism has returned to the financial markets in the last few weeks. The affected countries in the euro zone are making progress in the structural reforms, which will lead to an improved competitiveness over the long run. This will also pay off for the respective real estate markets. In an uncertain environment, real estate in 2012 remains in the sight of investors, who hold piles of liquidity. For the time being they continue to focus on prime objects in the best locations. But with a gradual easing of the financial crisis, investors' appetite for risk should slowly increase not only in the stock market, but also in the real estate market. While the purchase prices of the sought-after core properties have already risen noticeably, the correction in weaker market segments has progressed far by now, which means that interesting investment opportunities could open up here soon.

This leaves the financing market as a possible bottleneck. But at least there is no sign yet of a credit crunch. To be sure, many banks will operate more cautiously in the new regulatory environment. And the still growing refinancing volumes pose a major challenge. However, attractive new projects will still be financed, whether through debt or equity investors. In the end, financing that is more conscious of risk compared to the boom before the financial crisis will ensure that construction activity will not depart too far from what is a rather weak demand for commercial real estate. This is making a crucial contribution to stabilizing the commercial rental markets. All in all, 2012 therefore need not by any means turn out to be a poor real estate year.

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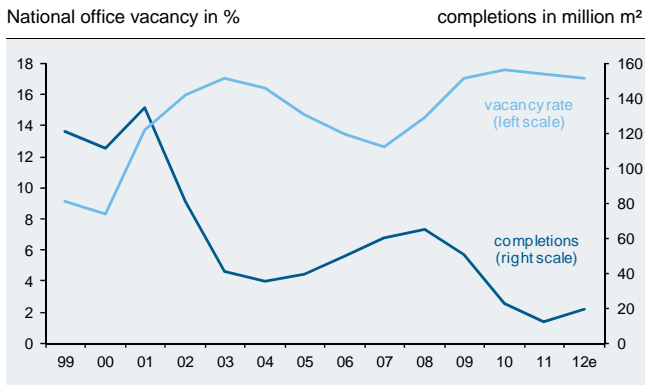
2.2 US office market slowly on the rise

The gradual improvement in the US labour market is benefiting the office market. By now on net more than 2.6 million of the 8.8 million jobs previously lost have been replaced. A slight growth in demand with ongoing moderate new construction activity argues in favour of a continuation of the recovery in the US office market.

Major differences between locations

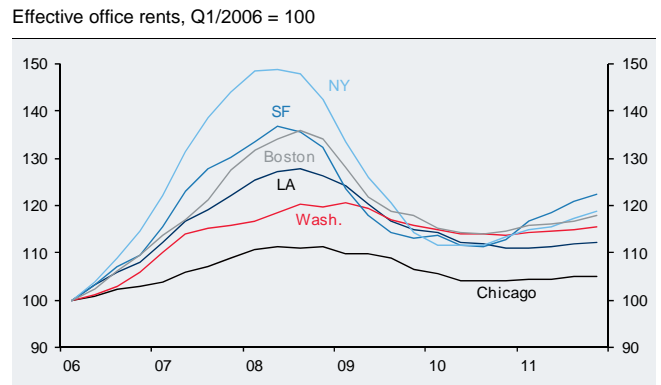
Most of the leading US office centres recorded job growth last year. However, not all locations were able to participate equally in the recovery. In the current office market cycle, New York and San Francisco are more advanced, while Los Angeles and Chicago, for example, are lagging behind. On the demand side, the sector structure in particular plays a crucial role. For example, the demand for space in the financial and the public sector remains weak, while companies from the technology and energy sectors have a growing demand for office space. This should be a reason for the most recently positive trend in effective office rents in San Francisco and Boston. Office rents have also recovered noticeably in New York, a particularly cyclical market. By contrast, the catch-up process in Washington and Chicago has been modest so far – but in both locations the previous decline in rents was also moderate. Last among the leading office centres in the US is Los Angeles, where rents only found their bottom at the beginning of 2011. On average for the country as a whole, the US office market should have achieved a rise in rents of nearly 2 % in 2011.

Relief from the supply side



Sources: REIS, Helaba Research

Downtrend in office rents has ended



Sources: REIS, Helaba Research

Decline in new construction activity provides relief

The uptrend in office demand continued in the second half of 2011. Net absorption in the US office market increased significantly against the previous year. In many locations new construction activity that is very low compared to earlier cycles is providing relief. One exception is Washington, though because the market there is in fairly good shape, it was able to absorb a higher growth in space. In the wake of the financial and economic crisis, a number of planned real estate developments were cancelled or delayed, with the result that in 2011 in the US as a whole, the bottom in the current construction cycle was reached. Office completions should increase significantly in 2012 from a very low level, but even so they would not reach half of the 10-year average. Beginning in 2007, the national vacancy rate for office spaces rose by a total of five percentage points to a high of 17.6 % by the end of 2010, and since then it has fallen only marginally to 17.3 %. However, prime objects in best locations show substantially lower vacancies than objects in peripheral locations. Against the background of the continuing, moderate demand for office space, the national vacancy rate will presumably not drop below 17 % in 2012, either. The rise in effective office rents should continue across the country at a rate of more than 2 %.

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2.3 German real estate market: Where is the crisis?

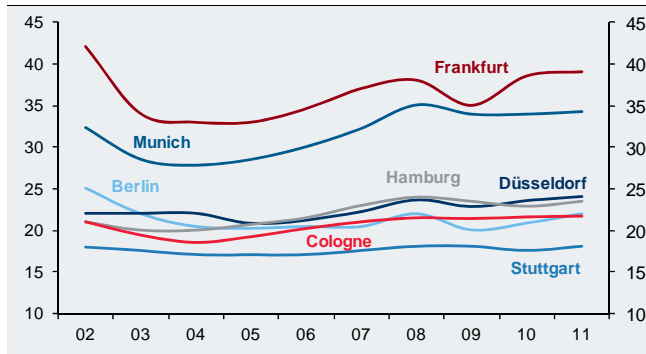
2011 was a successful year for the German real estate market. In some cases a markedly higher take-up in the office markets is complemented by positive results in the retail sector. So far there was little sign of crisis. However, will the concerns concerning the European debt crisis and the economic downturn materialize in 2012?

German real estate
 market defies the crisis

So far, no substantial effects of the European sovereign debt crisis on the German real estate market have been apparent. In fact, looking at the most important key figures, the picture for 2011 is quite positive. This development is underscored by mostly rising prime rents as well as high turnover rates. A growing interest in German real estate properties could be observed especially among foreign investors. Not quite half of total investments came from abroad. Of these, about 40 % refer to portfolios. As a result, transaction volumes rose by about one quarter over the previous year. Retail properties dominate with nearly 50 % of total investments. By contrast, office buildings, a former focal point of investments, lag clearly behind at 25 %.

Frankfurt and Munich office rents in a league of their own

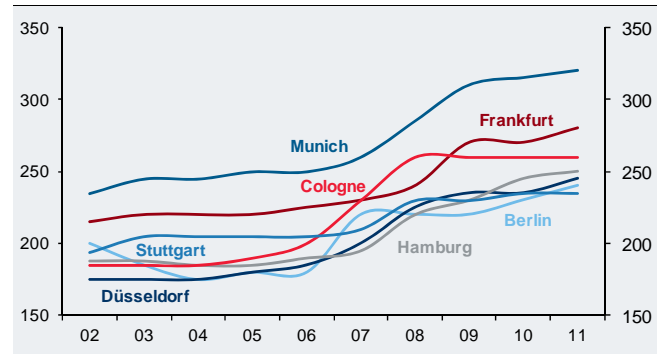
Prime office rent in €/m²



Sources: GIB, Gif

Clear rise in retail rents since 2007

Retail prime rent in €/m²



Sources: GIB, realtor data

Focus remains on
 core real estate

Uncertainty about the economic development will lead in 2012 initially to general restraint in office rentals and investments. Should the debt crisis slowly ease and the economy pick up again, this would have positive effects on the demand for offices. Most recently the interest, for safety reasons, focused largely on core real estate. In fact, in this segment demand is at times exceeding supply. This trend will continue in both the office and the retail segment in the future. In the final analysis, take-up and prime rents in the office markets will remain virtually stable this year. Due to the slight decline in construction activity, this should cause vacancy rates to drop. Because the outlook for the German economy has been stable so far, the high demand by foreign investors will persist in 2012.

The picture in the retail market is more positive. Most recently, demand in the retail sector has focused chiefly on downtown areas and established shopping centres. This had led to declining vacancy rates and in some instances to rising rents in the traditional 1A locations. Especially the 1A locations cannot be expanded at will, which is why the supply of space is becoming scarcer. Many existing properties in city centres and also in shopping centres are now ageing and in need of renovation. Since the most stable rent levels are achieved in the 1A locations, these investments seem sensible. And the interest of international retail chains in expanding also seems unbroken. Still, the confidence of consumers in the economy is the precondition for the continued good sentiment in the German retail sector. ■