

Brexit Update on Frankfurt's Real Estate Market¹

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- The United Kingdom's exit from the EU will have an impact on Frankfurt's real estate market. In the medium term, we expect a rise of at least 8,000 banking employees as a result of Brexit.
- Despite a significant fall in the vacancy rate, it is likely that additional demand on the office market will be met thanks to a range of project developments.
- The housing market remains under pressure. Increased new construction activity will not be sufficient to cope with the arrival of new residents. Thanks to their considerable building land reserves, surrounding districts will provide the solution to the shortage of housing.

Consequences for Frankfurt's office market

Shortly before the conclusion of the Brexit negotiations, the Frankfurt office market is in good shape – better than we had expected a year ago. Average office rents have been rising for years, but are still below their historic highs at the turn of the millennium. In a comparison of the leading German office locations, rent levels in Frankfurt are substantially higher. Compared to other European financial centres, however, office space here does not seem as expensive: rents are considerably lower than in London and noticeably below those in Paris and Dublin – a competitive advantage in relation to other financial centres.

Frankfurt: Rising office rents, strong decline in vacancy rate



Sources: Scope, Helaba Research

In fact, there is still enough available office space in Frankfurt so that the influx of several thousand additional bank employees should be manageable without any problems. However, the vacancy rate has already declined from a peak of over 15 % to a current level of only around 8 % (and thus by more than 600,000 sqm). The on-going employment boom has contributed to this: Between 2007 and 2017, the number of employees subject to social security contributions in the city increased by more than 92,000. It is estimated that almost half of these are office jobs.

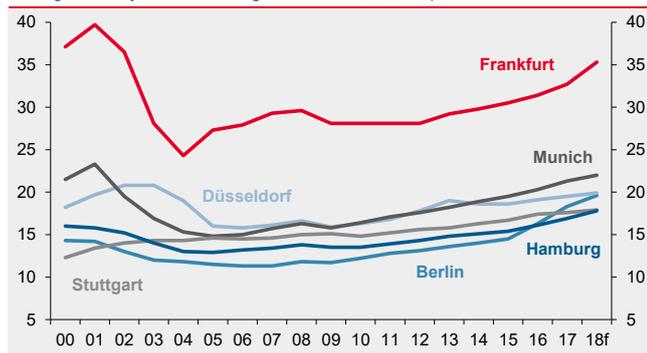
This publication was very carefully researched and prepared. However, it contains analyses and forecasts regarding current and future market conditions that are for informational purposes only. The data are based on sources that we consider reliable, though we cannot assume any responsibility for the 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.

¹ This Real Estate Report is an excerpt from our publication "Financial Centre of Frankfurt: Brexit Banks are packing their bags" of 24 September 2018 (English version of the study will shortly be available)

The conversion of office space into residential space, in particular, has also played an important role in reducing the vacancy rate. Over the past few years, more than 400,000 sqm has been converted in this way. Nevertheless, Frankfurt has the highest vacancy rate in Germany, while other top locations already have a shortage of space of 2 % to 4 %. With 12.6 million sqm of office space in Frankfurt, just under 1 million sqm are currently vacant. Less abundant is the availability of modern office space in central locations preferred by the financial sector. After all, only about half of vacant office space boasts up-to-date equipment and less than a third of vacant space is situated in inner-city locations, including the banking district and Westend. Taking both quality characteristics into account, vacant office space relevant for Brexit banks probably amounts to as little as around 200,000 sqm.

Frankfurt office rents approaching previous highs

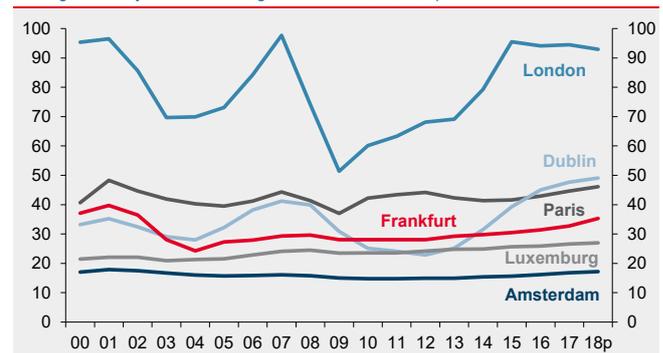
Average monthly office rents in good locations, EUR/sqm



Sources: Scope, Helaba Research

Frankfurt's office rents in an international comparison

Average monthly office rents in good locations, EUR/sqm



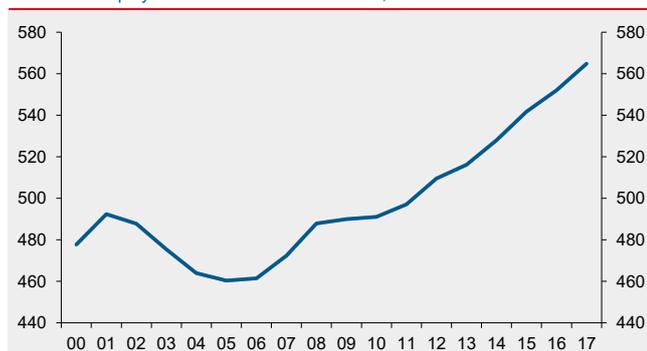
Sources: Scope, Helaba Research

The first contracts have been signed

If several banks are looking for larger amounts of space in this segment of the market, not all of them will find their preferred offices in the short term. However, some Brexit banks are not dependent on renting new space, as they can accommodate additional employees at their current locations. In many cases, staffing levels are initially limited and only increased over time. In this regard, the availability of co-working space in the city, which is expanding rapidly, could provide the necessary flexibility. Since only a few months remain until the United Kingdom leaves the European Union, it comes as no surprise that the first new lettings have been signed in connection with Brexit. In particular, this includes Goldman Sachs renting space in the Marienurm, but excludes larger contracts signed in recent months (such as FAZ, KfW or Finanzagentur).

Rising demand for offices due to higher employment

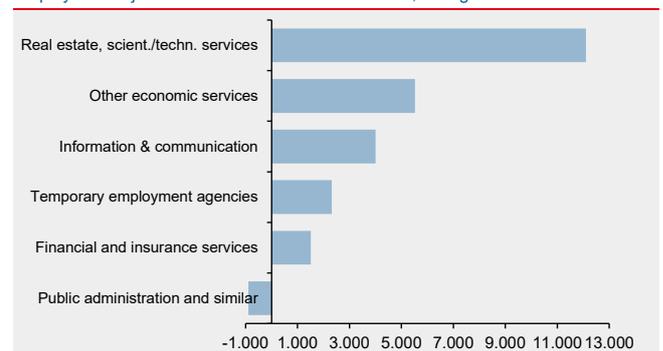
Number of employees* in Frankfurt in thousands, as of 30 June



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

Impulses from the service sector

Employees subject to social insurance contributions, change 2013-2017*



*sectors particularly relevant to the office market; as of 30 June
Sources: Federal Employment Agency, Helaba Research

Demand for space not limited to banks

We estimate that the Brexit will increase the number of office workers in Frankfurt by 8,000, in a process lasting several years. When factoring the ongoing consolidation of major Frankfurt-based banks into the equation, the net effect is lower. Assuming an average office space of about 20 sqm per capita, we anticipate additional Brexit-related demand of approximately 100,000 sqm in total for the next few years. Theoretically, it could be easily met using the currently available vacant space.

However, over the next few years numerous jobs will also be created in other sectors that are relevant to the regional office market. Therefore, the financial sector will only generate part of the future demand for space. Although in terms of rental turnover the sector has recently outpaced other service sectors, such as consulting firms or co-working providers, overall demand for office space in Frankfurt is broadly diversified. In fact, a closer look at employment data shows that the impetus in recent years has not come from the financial sector at all. Among the services relevant to the office market, scientific, technical and other business services, including real estate management as well as information and communication, stand out (see chart at top right). In the coming years, the number of office workers will therefore continue to grow much faster than the effect that Brexit alone can be expected to have on banking employment. This is likely to result in a correspondingly stronger demand for space.

Well-stocked pipeline to counteract shortfalls

A number of project developments is the main reason why there will probably be no real bottlenecks on the Frankfurt office market. Over the next few years, they will ensure a growing supply of space, especially in the sought-after central locations. Next year, for example, when the Brexit effect takes hold more strongly, five larger projects with a total office space of around 140,000 sqm will be completed (most of them in a central location). However, there are already significant pre-leases here. It will probably be another three years before the completion of "Four Frankfurt", the largest project on the former Deutsche Bank site with around 100,000 sqm of office space (see overview below).

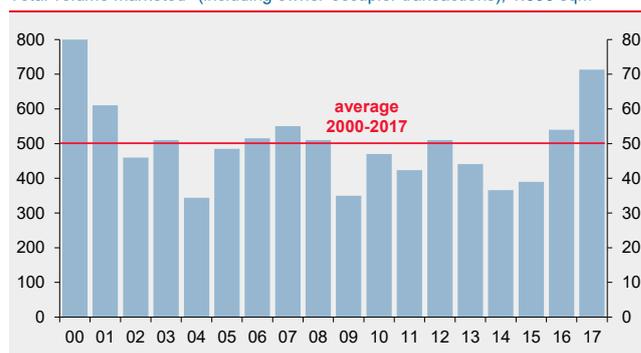
Selected office projects in Frankfurt

| Project | office space, sqm | completion |
|----------------|-------------------|------------|
| Marienturm | 44,500 | 2019 |
| Omniturm | 44,000 | 2019 |
| Hafenbogen | 14,000 | 2019 |
| Junghof Plaza | 21,000 | 2019 |
| The Docks | 18,000 | 2019 |
| Grand Central | 45,000 | 2020 |
| Global Tower | 33,000 | 2020 |
| ONE | 43,000 | 2021 |
| 99 West | 24,000 | 2021 |
| Four Frankfurt | 100,000 | 2021/2022 |

Sources: Press releases, developer, Helaba Research

Highest office space take-up since 2000

Total volume marketed* (including owner-occupier transactions), 1,000 sqm



*Frankfurt including Eschborn and Kaiserlei
Sources: gif, Helaba Research

Rents will approach previous all-time highs

The Brexit will contribute to a further reduction in the vacancy rate in Frankfurt. In view of the well-stocked development pipeline, however, we do not expect it to reach the very low levels of other top German locations. Thanks to the Brexit effect, office rents in good locations should continue to rise strongly in the coming year and thus approach their previous all-time highs at the beginning of the millennium. However, Frankfurt remains an affordable office location in comparison with internationally competing financial centres. Rental turnover should remain at an above-average level in a long-term comparison (not only because of Brexit). Positive take-up figures in the first half of 2018 confirm this trend.

Impulses for secondary locations as well

Although old and new banks in the financial centre will continue to focus their attention on central locations, we expect positive effects for neighbouring office locations as well. Banks wishing to relocate to the city, but who cannot (initially) find any suitable space in the centre, will move to neighbouring districts. This should benefit secondary locations that have hitherto been used for banks' back offices. Thanks to its easily accessible location about ten minutes from the city centre, this should apply to Kaiserlei, which is part of the city of Offenbach. In addition, companies from other sectors that are not prepared to pay the ever-increasing rents in central locations could switch to cheaper inner-city alternatives. These include the Lyoner Quartier (formerly Bürostadt Niederrad) and the Mertonviertel as well as the office district in Eschborn outside Frankfurt's city limits.

Regional housing market still under pressure

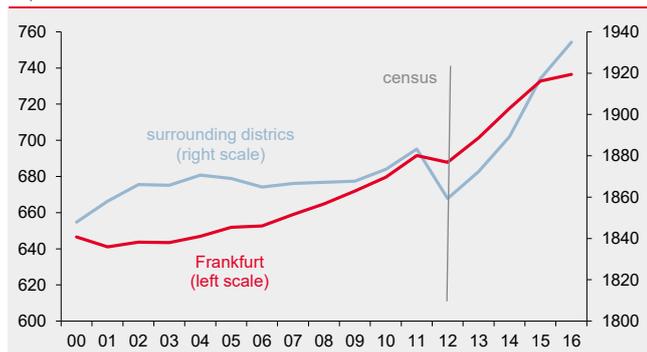
The situation on Frankfurt's housing market has changed little since last year. In contrast to office space, which is still abundantly available, there is practically no vacant space in the residential segment. The population of the city has grown: while the State Statistical Office recorded an average annual increase of around 15,000 inhabitants for the city from 2013 to 2015, an increase of only 3,700 was reported for 2016. In the surrounding districts, the increase last year, at 17,600, was only slightly lower than in the previous three-year period.

Considerably higher new construction activity – but still too little

In recent years, a marked increase in construction activity has been offset by a large influx of new residents to the Rhine-Main conurbation. The number of completions in Frankfurt rose to more than 5,000 units in 2017 – much more than the average of around 2,400 dwellings per year between 2000 and 2013. This was due to the systematic mobilisation of building land reserves and the accelerated conversion of offices into apartments. Despite the higher completion figures and a somewhat slower recent increase in the number of inhabitants, the gap between supply and demand on Frankfurt's housing market does not seem to be narrowing. This is indicated by the development of residential property prices, which continue to rise for both owner-occupied apartments and homes (see chart p. 4). The expected Brexit newcomers will exacerbate the situation on the local housing market in the coming years and should contribute to ensuring that the rise in residential property prices and rents continues at least at a similar pace.

Population growth in city and its environs

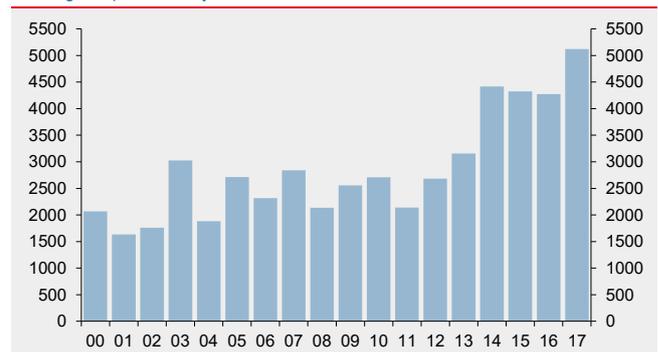
Population as of 31 December, thousands



Sources: Federal Statistical Office, Helaba Research

Record number of completed dwellings

Housing completions* city of Frankfurt



*all buildings including completions in existing properties

Sources: Statistical office Hesse, Helaba Research

Regardless of Brexit, the problem of a shortage of housing can only be overcome in the long term in collaboration with the surrounding area. The average number of housing completions in relation to the number of inhabitants shows that Frankfurt has made by far the largest contribution to better housing provision in the last three years. While more than six residential units per 1,000 inhabitants were completed here in this period, the comparable figure in the neighbouring districts is considerably lower. In the Main-Kinzig, Hochtaunus and Offenbach districts, for example, less than three completions were achieved; in the city of Offenbach, at least, it was more than five (see chart next page).

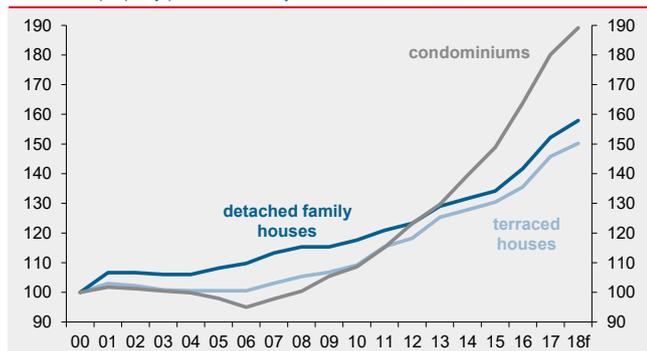
In view of a dwindling stock of building land, it will become increasingly difficult for the city of Frankfurt to provide any noticeable relief to the housing market in the next few years. In view of on-going improvements on the office market, the next couple of years will also see a decline in the volume of office space converted into residential units. Even without several thousand Brexit newcomers, the city and the surrounding area face a challenge on the housing market. The densification of existing residential areas would therefore have to be supplemented by new residential neighbourhoods in the periphery on land previously used for agriculture or recreation.

New quarter meets with intense opposition

However, initial plans for a new quarter in northwest Frankfurt are already encountering fierce resistance, especially in neighbouring municipalities. It is therefore debatable as to whether or to what extent the potential for up to 12,000 dwellings can be exploited. In any case, the realisation of this project would probably take ten years and thus come much too late to provide any relief to Frankfurt's housing market when any newcomers arrive due to the Brexit. Therefore, if the conurbation is to continue to grow, it will primarily require more construction activity in the surrounding area. This will involve, in particular, an expansion of the (transport) infrastructure so that capacities keep up with demand and commuter times remain manageable. Experience also shows, however, that the planning and implementation of such infrastructure projects can be measured in decades rather than years.

Unbridled growth in residential property prices

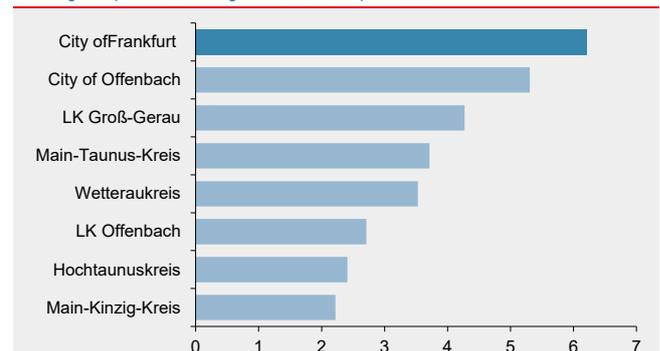
Residential property prices in the city of Frankfurt, 2000 = 100



Sources: Scope, Helaba Research

Residential construction activity per resident

Housing completions, average of 2015-2017 per 1,000 inhabitants*



* based on the population at the end of 2016

LK = Landkreis (district)

Sources: Federal Statistical Office, Helaba Research

Frankfurt's residential properties affordable for Brexit newcomers

An overstretched housing market will be less of a challenge for well-heeled Brexit bankers than for local residents and employees in other sectors. The displacement of lower-income sections of the population from the increasingly expensive urban area is therefore an issue that must be taken seriously. Bankers relocating from London are familiar with residential property prices and rents that are up to three times higher than in Frankfurt. They are also used to living in outlying districts because of the significantly higher cost of living. Considering prices in Frankfurt, which in their view are not so high at all, and above-average incomes in most cases, inner-city areas should also be affordable for them. Some of these newcomers therefore belong to the target group for residential towers under construction or planned in the upper price segment.

Brexit newcomers' varied demand for living space

However, not all Brexit-related jobs created in Frankfurt will be filled by employees from London. Some will be recruited elsewhere or even in Frankfurt and, in some cases, will not require additional living space. Others will initially commute and use serviced apartments or boarding houses, an adequate supply of which is emerging. In many instances, their families will join them at a later date and they will not be looking to rent larger apartments or buy a home until then. Part of this demand will be generated in inner-city residential areas near the workplace, while another part will be concentrated in the attractive surrounding area. ■