



Challenges

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- The moderate upswing is continuing in the Paris office market (p. 3).
- Despite a methodological revision of the consumer price index, the statistically reported increase in residential rents remains manageable (p. 4).

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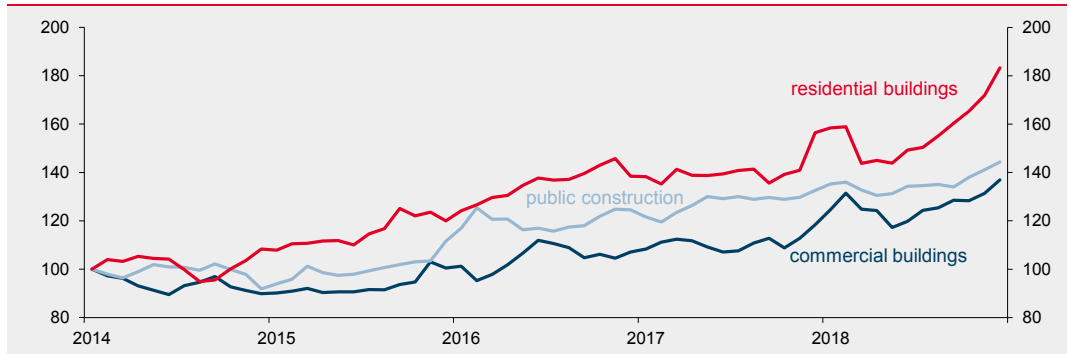
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1 At a glance

German construction sector booming

Nominal new orders, Index: January 2014 = 100, seasonally adjusted (smoothed)



Sources: Feri, Helaba Research

The German construction industry is booming, in stark contrast to the anaemic manufacturing sector. New orders in the construction industry rose sharply again towards the end of the year and in real terms even reached their highest level for more than 20 years. What is particularly pleasing is that all three sub-sectors are now experiencing an upward trend: in addition to residential construction, which has been particularly dynamic for some years now, public and commercial construction are also gaining momentum. However, it is difficult to process the increasing order backlog. Capacity utilization in the German construction industry is already at record levels, and given the shortage of skilled workers, a rapid expansion of capacities is unlikely. As a result, while construction investment will thus make a noticeable contribution to growth in the current year, its real growth will be moderate at around 2 %.

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2 Selected real estate analyses

2.1 The real estate sector in the crosshairs of German politics

The growing housing shortage in Germany is moving into the focus of political debates. This is not without risks to the sector.

Even more so than an economic slowdown, the increasing scarcity of residential space – especially affordable housing in large cities – could become the greatest challenge for the German real estate industry, as it has put the sector at the centre of the political debate. The bottlenecks in the housing market are increasing the pressure not only on politicians, but also on the real estate industry to find solutions. Some observers are already seeing demonstrations against housing shortages and rising rents as the beginning of an extra-parliamentary protest movement similar to the "yellow vests" in France, which could endanger the "social peace" in the country.

Housing policy measures
often not productive

Politicians are responding with housing policy measures, some of which are pushing back market mechanisms without improving the supply of affordable housing. In the highly emotional public debate, the objective arguments of the real estate industry take a back seat. For example, the tightening of the rent cap and the modernisation levy may be suitable for limiting an increase in rents in individual cases. However, this will not create additional living space. The new construction child allowance (*Baukindergeld*) is costly, but is unlikely to lead to additional housing units beyond the freerider effect. However, those units are urgently needed to close the gap between supply and demand on the German housing market. Instead, the toolbox of the "new" housing policy includes "milieu protection zones" (*Milieuschutzgebiete*) and rights of first refusal for municipalities. The high point of the increasingly strong dirigiste interventions is the demand for the expropriation of larger housing stocks, as is being sought in Berlin through a petition for a referendum. If this were to happen, the highly indebted capital would face costs in the tens of billions – without a single additional apartment being built. However, the regional housing market could have profited significantly but for a referendum in 2014 which rejected the development of the Tempelhof field, which covers more than 300 hectares.

Initiative by the real
estate sector needed

The real estate industry must be careful not to be held solely responsible for the problems in the housing market. To this end, it should work with decision-makers at all levels of government to overcome the housing shortage. Starting points could be innovations, e.g. in the area of serial and modular construction, with which construction costs can be reduced. The highly utilised capacities in the construction industry must be used more efficiently and, in view of the shortage of skilled workers, career prospects in the sector must be improved through training and attractive working conditions. In addition, it would benefit the industry's reputation if more companies were to concentrate not only on high-price segments of the housing market. The construction industry should prepare itself for a renaissance of social housing construction and take advantage of the associated opportunities.

The public sector can and must also do more. Instead of interventionist interference, planning and approval processes should be accelerated, e.g. by better equipping the building authorities. Increasingly higher and cost-driving building standards must be reviewed and tax burdens on housing construction reduced. The forthcoming land tax reform could offer a good opportunity here. However, many home owners and tenants might in fact even face considerable additional costs. But the central starting point for creating more living space is and remains the mobilisation of additional building land: in the big cities and in cooperation with the surrounding communities. The most recent proposals for infill development, increasing the size of existing residential buildings, or building on top of super markets and car parks could also make an important contribution overall.

2.2 Paris office market continues moving up

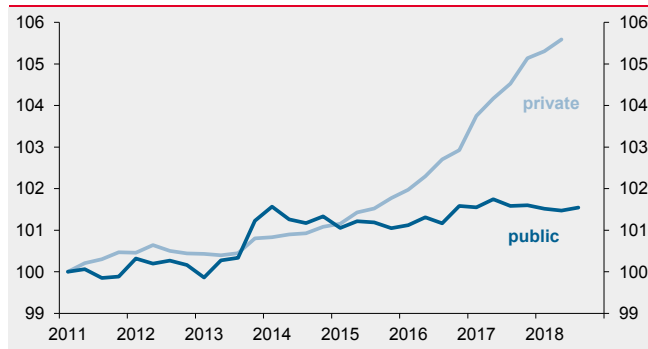
The French economy is growing moderately. This is sufficient for the continued expansion of jobs, from which the office market in the capital region is benefiting. The positive development should continue in the current year.

Continued moderate growth, slight improvement in the labour market

Economic growth in France last year was 1.5 % in real terms, well below the previous year's figure of 2.3 %. In contrast to the German economy, however, the momentum here even picked up somewhat in the second half of the year. The labour market improved slightly, but the unemployment rate, which fell from an annual average of 9.4 % to 9.1 %, is still comparatively high (euro zone: 8.2 %). This indicates that despite initial reforms in the labour market by President Macron, there is a need for further action. Employment growth in the greater Paris area has slowed compared with 2017, but in autumn 2018 it was still about 65,000 jobs higher than in the previous year (+1.4 %). Employment growth was driven by the private sector, while the public sector has more or less stagnated for years. Overall, the general economic conditions for the office market in the city of Paris and Île-de-France remain positive.

Clear rise in private sector employment

Employment, Île-de-France, Q1/2011 = 100

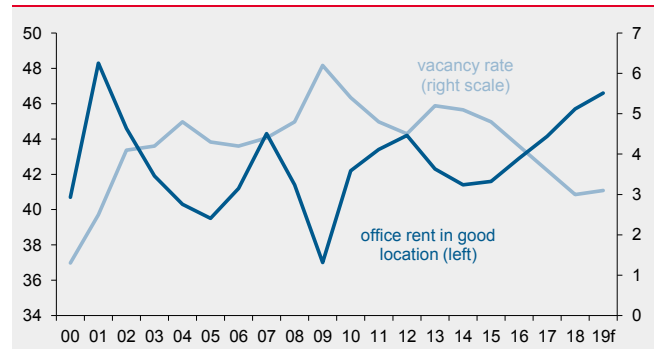


Sources: INSEE, Helaba Research

Rising office rents and low vacancy rates

Average office rent*, euro/m²

vacancy rate, %



* Paris city region
Sources: Scope, Helaba Research

Scarce office space in central locations

The office market in the capital region has been improving for about five years. In this largest European office market, with a total of around 55 million m² of office space (a good 30 % of which is in the Paris metropolitan area), the rental results indicate a sustained high demand for space. Thus, at 2.5 million m² in 2018 as a whole – of which around 1 million m² was in the city of Paris – the good result of the previous year was only slightly missed and the ten-year average of around 2.3 million m² was again exceeded. In contrast to 2017, this time it was not the large spaces but rather spaces of medium size that gave the rental market a boost. With office vacancies down to 3 %, there is already a shortage in the city area of Paris, so that some interested parties are moving to less central locations. In the Île-de-France region as a whole, the vacancy rate is around 5½ %, with large differences remaining: In some peripheral locations, such as the Western Business District (Croissant Ouest), the vacancy rate is still in the double-digit range.

The upward trend on the office market in the capital region should continue in 2019 thanks to the continued solid economy. The brisk demand for space is accompanied by moderate construction activity. Currently, approximately 1.5 million m² are under construction and a further 1 million m² have been approved. The high proportion of pre-leases shows that additional office space will be taken up without problems and will probably not be sufficient in the short term to overcome the existing shortage in good locations. The rise in rents, especially in the coveted central locations, should therefore continue. The net initial yield in the Central Business District, which remains low at 3 %, should remain acceptable for many investors in view of the persistently low level of interest rates. At the same time, this historically low level is generating much demand for in real estate investments beyond the core segment.

2.3 New German price index: rise in rents remains unspectacular

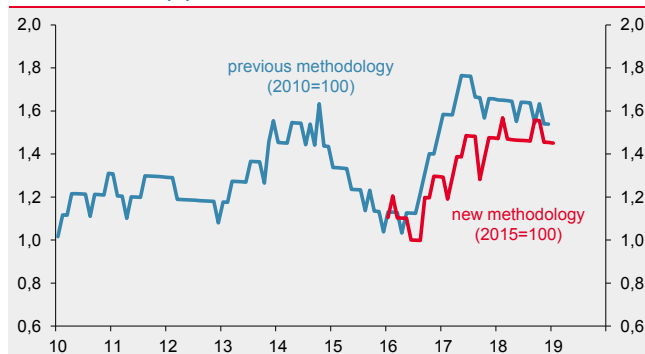
The increase in residential rents in Germany reported by the official statistics was not very spectacular in recent years and seemed to some observers to underreport the actual development. Has the regular revision of the consumer price index provided new insights?¹

Subjective perception and statistics diverge

For some time now, the consumer price statistics have not reflected the much-discussed rise in residential rents in Germany. Since 2010, this component of the basket of goods and services has only shown an increase of between around 1 % and 1.8 % p.a. It thus usually lagged behind the inflation rate. This does not seem to be in line with the high rises in rents, which are reported especially from the major conurbations and dominate public opinion. Can the recently revised consumer price index provide more transparency in this regard? In addition to the changeover to a new base year, the basket of goods and services was adjusted to the changed expenditure structure. Since consumers are now spending more money on housing, the weight of the basic rent (excluding heating and other costs) in the index has been increased from 21.0 % to 21.7 %. More interesting, however, are the methodological innovations in recording the rent increase on the basis of a new sample of rents.

Rent increase now even more moderate

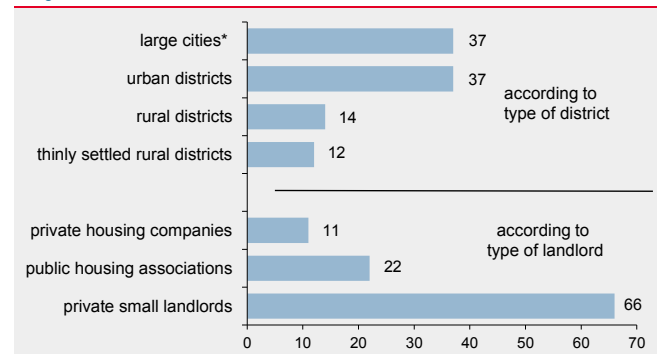
Residential rents, % yoy



Sources: Federal Statistical Office, Datastream, Helaba Research

High share of private small landlords

Weights in the new rental index, shares in %



*independent of a district ("kreisfrei")

Sources: Federal Statistical Office, Helaba Research

Rents from existing contracts dominate the rental index

The moderate rise of residential rents in the statistics is mainly due to the fact that all leases are included here. Usually, existing rents rise much less sharply than new rents. In existing leases, for example, the rent is often not adjusted or only marginally adjusted over many years, while a change of tenant leads to an average price increase of more than 10 %. But since only about one tenth of rental agreements are newly concluded each year, the stronger increase in new rents is swamped by the stock of existing rents. Moreover, the upward pressure on residential rents in large cities is not representative of the national average. For example, the new rent sample differentiates between district types, with 37 % being accounted for by large cities and only part of this by the seven "metropolises". Even here, according to the Federal Statistical Office, the reported increase in rents last year of 1.8 % was not much higher than in "sparsely populated rural districts" with 1.2 %.

The newly introduced breakdown of the rental sample by landlord type is also revealing. According to this, 66 % of all rental apartments surveyed are let by private small landlords and a further 22 % by public housing associations. On average, these two landlord types raise rents less strongly than the more profit-oriented private housing companies. In line with their share of total rental expenditure, small landlords will more heavily weighted in the index in the future, which will dampen the overall increase in rents. All in all, according to the revised data, the rent increase in Germany in 2018 was 1.5 %, which was in fact slightly lower than the previously reported 1.6 %.

¹ See Federal Statistical Office (*Statistisches Bundesamt*), Hintergrundpapier zur Revision des Verbraucherpreisindex für Deutschland 2019 from 21 February, 2019, pp. 14-18.