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PRAXI VALUATIONS

German Market Insights: Warehouses in High Demand

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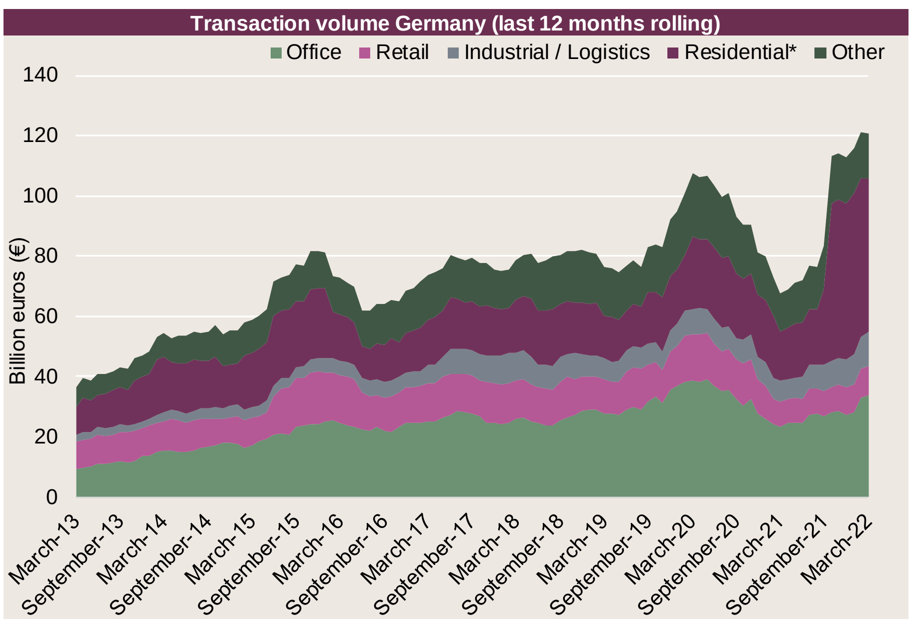
Logistics Real Estate Market in a Post-Corona Environment

During the pandemic, the asset class of logistics real estate was able to attract more and more investors, which led to intense competition for available core products.[1] In 2021, in addition to the rapidly positive development of online retail, corona-related corporate warehousing represented the far central reason for investing in logistics real estate in Germany and Europe. Due to structural or temporary capacity bottlenecks, the burgeoning demand could not be met. Just-in-time production was supplemented by increased storage capacities for indispensable preliminary products as part of industrial manufacturing.[2] The rents for logistics properties had already managed to defy the corona-induced recession in 2020 and increased by 5.4% already in the first year of the pandemic. A key reason was the online retail boom, which increased significantly during the pandemic, and the accompanying rise in demand for logistics warehouses close to cities. In 2021, this trend continues, and rents increase by 3.0%. Outside the metropolitan areas, many new buildings with modern location quality in particular came onto the market in 2021. This appears to perpetuate a trend toward peripheral locations, as companies are (need to) increasingly switch to available and less expensive properties.[3]



Source Savills / * only transactions with at least 50 residential units

Investor interest in logistics properties remained high in 2021: Large investors found logistics properties an attractive alternative to the pandemic-hit asset classes of retail and hotels.[4] The commercial real estate market is experiencing a real hype around the asset class, which is largely due to the extremely promising development over the past 24 months. The resilient demand for logistics space during the pandemic played an enormous role, as did the associated upswing in online retailing and the need for well-functioning urban logistics to handle the above-average parcel volumes.[5] Germany is one of the most attractive logistics markets in the world due to its central location in the middle of Europe, its outstanding infrastructure, and its high technological standards, to name just a few aspects.[6] The German industrial and logistics real estate market ends 2021 with a new record

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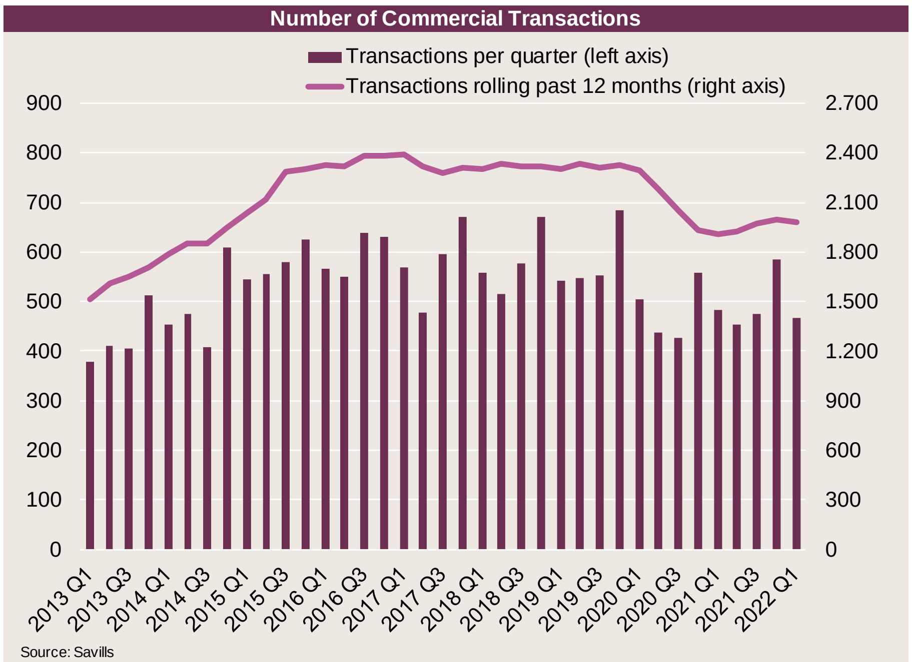
[1] Colliers: Marktbericht Deutschland – Industrie- und Logistikmärkte im Überblick 2020/2021
[2] Catella: Market Tracker "Black Swan VI", 2021
[3] BNP Paribas, 2021; ZIA, 2022
[4] Deutsche Hypo: REECOX 04-2021
[5] Colliers: Marktbericht Industrie und Logistik Investment 2021/2022
[6] Colliers: Marktbericht Deutschland Industrie- und Logistikmärkte im Überblick 2020/2021

volume. A total of over €9.2 billion was invested in industrial and logistics assets. The previous record year of 2017, with around €8.7 billion, was exceeded by around 8% following an above-average end-of-year rally.[7] It is notable in particular that the 2017 result was predominantly achieved through three large-volume, multi-billion platform acquisitions, whereas no single transaction of this size was recorded on the German market in 2021, and ultimately the high level of market activity alone led to the outstanding result. The five-year average was significantly exceeded with an increase of 37%, allowing the asset class to consolidate its position as the second strongest property type on the commercial real estate market.[8]



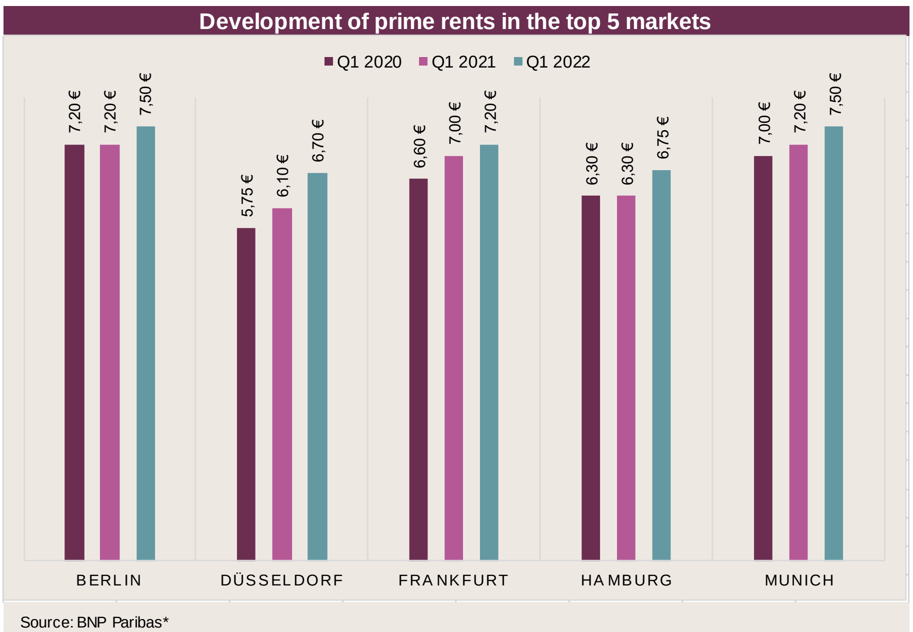
The issue of sustainability remains a challenge for the industry: On the one hand, the consumption of land as a result of the size of logistics centers and, on the other hand, energy consumption in ongoing operations is relevant. The distribution of the high volume of parcels to end customers and the associated traffic flows also remain problematic. One trend is the conversion of former industrial sites into urban logistics areas. In addition, DIY stores or department stores in central city locations that are no longer needed could serve as urban hubs for urban logistics.[9]

Rental Market

The development of rents for industrial and logistics properties in 2021 continues to be dominated by the Covid 19 pandemic, although with different implications than in the previous year. In the second year of the pandemic, the warehousing and logistics submarkets recorded significant rent increases. However, rents for the production building submarket are stagnating, following a sharp drop in the previous year.[10]

[7] Colliers: Marktbericht Industrie und Logistik Investment 2021/2022
[8] Colliers: Marktbericht Industrie und Logistik Investment 2021/2022
[9] DekaBank: Wie Corona die Immobilienmärkte bewegt, August 2021
[10] IWIP-Index 2021, Institut der deutschen Wirtschaft Köln e. V.

The TOP 8 industrial and logistics property markets generated a floor-space turnover of around 1.1 million m² in Q1 2022. This above-average result is primarily the result of the acquisition (own use) of Tesla in the Berlin logistics region (around 327,000 m²), which is the largest transaction of the quarter and accounted for around 30% of the total take-up in the TOP 8. Excluding this special effect, the TOP 8 regions recorded a solid start to the year with take-up of 769,000 m². This represents a decline of 9% compared with the previous year. The three-year average was exceeded by around 27%. Regional differences were particularly noticeable at the start of the year. Four out of eight of the TOP 8 regions recorded an increase in turnover. Above-average demand remains at a very high level. This development and rising construction costs is continuing to drive up prime and average rents in all locations. For example, the top rents in three locations (Berlin, Frankfurt, and Stuttgart) recorded growth of up to 8%. In isolated cases record growth in average rents of up to 10% (Berlin) was registered.[11]



Rents increased by an average of 3.9% year-on-year in 2021. Following the pandemic-related drop in the previous year (-2.2%), the market has recovered noticeably. The main reason for this development is a low supply of industrial properties combined with a high demand for such properties once again. Another reason for the recovery is the economic upswing last year. For example, GDP increased by 3.9% in 2021, although this does not fully compensate the previous year's slump of 4.6%. The industrial sector's recovery of 4.1% in 2021 is noticeable, but real growth momentum has yet to materialize against the backdrop of international supply chain challenges.[12]

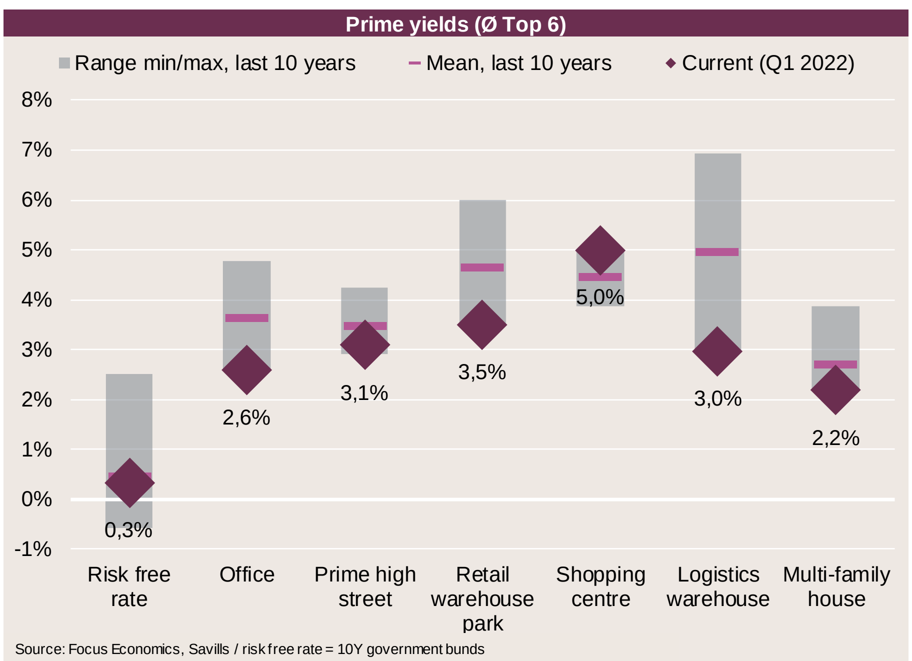
In 2021, rents increased by 6.1% compared with the previous year, the strongest increase being recorded in the warehousing segment, which is the largest sector in quantitative terms. The further increase in the trend towards e-commerce is leading to a significant increase in demand for warehouse space. That indicates a part of the demand is shifting from high-priced prime locations with a shortage of space to less attractive locations. In addition, it is becoming increasingly apparent that the level of fit-out and quality of the warehouses is being compromised.[13]

[11] Colliers: Logistikvermietung TOP 8 Q1 2022
* BNP Paribas: Logistikmarkt Deutschland Q1 2020, Q1 2021, Q1 2022
[12] Statistisches Bundesamt, 2022a / b
[13] IWIP-Index 2021, Institut der deutschen Wirtschaft Köln e. V.

Rents for production halls declined slightly by -1.1% in 2021. This follows the continuing sluggish trend in industrial production, which has not yet returned to its pre-crisis level in 2021. The decline in prices is the result of an increase in the quality of locations and equipment, as fewer offers are being made in more favorable locations with low quality.[14]

Yields (ROI)

The trend in returns over the past year continued to decline, with supply remaining limited at the same time. The peak gross yield of 3.70% at the beginning of the year dropped to 3.25%. Over the year, it can be observed that investors see hardly any risks even in properties with short lease terms, as long as they are located in areas with forecasted rental growth. Instead, short-term rental periods are seen as an opportunity to increase the annual rental income from the property once the leases have expired. The updated risk assessment is also confirmed by the purchase price factors, which are above the 30-fold of the gross annual income and have been achieved by numerous transactions in the last twelve months. In addition to the classic logistics assets, investor demand for light industrial properties remains high. Due to the lack of properties on the market, the share of total investment volume is quite small at €1.8 billion or (approx. 20% market share). For core properties located in the prime investment locations, the peak yield at the end of December 2021 was 4.25% which is below the previous year's level.[15]



The investment market entered the year of crisis 2022 with a new record result, exceeding the previous all-time record set in Q1 2020 with a transaction volume of €18.2 billion. Three quarters of the volume was attributable to strategic corporate acquisitions and investments in crisis-resilient sectors and markets. Industrial and logistics assets were also in strong demand this quarter, taking second place behind offices. Thanks to acquisitions and numerous logistics portfolios, the share of package sales increased significantly. The high level of interest from foreign investors was also evident again in the transaction volume after few deals in the previous year.

[14] IWIP-Index 2021, Institut der deutschen Wirtschaft Köln e. V.
[15] Colliers: Marktbericht Industrie und Logistik Investment 2021/2022

While prime office yields in the TOP 7 remained at the low level of the previous quarter, logistics yields continued their downward slide towards 3% and further converged with office yields. Despite the geopolitical crisis, the overall high market dynamics suggest another strong investment year, in which real estate is likely to gain in importance as a hedge against inflation.[16]

Conclusion and Forecast

Without any doubt, the demand for logistics real estate persists and remains at a very high level. More and more investment firms are now focusing on logistics, so that sufficient capital is available and could be invested. The transaction volume would certainly be significantly higher if more properties were available on the market. Investors who did not succeed in the bidding process are therefore under pressure to achieve their target allocations. Under these circumstances, expectations are high and also influenced by continuing yield compression.[17]

The results illustrate that the rental market for industrial and logistics properties, which boomed in the 2010s, appears to have overcome a period of weakness in the wake of the pandemic in 2021. The logistics sector in particular is arising from this crisis stronger than before. The problems resulting from a shortage of available space and further increases in property prices became apparent again in 2021. However, together with global price increases along the supply and production chains, the cost problem will challenge the entire industry in the future. Fierce competition with varying developments in the individual sectors and locations is expected for 2022, which should be associated with slower rental momentum overall.[18] These forecasts do not yet incorporate the Russia-Ukraine war, which started to heat up in February 2022 and has caused numerous supply chains to have to be rerouted and many companies and logistics providers being burdened as a result.[19]

With rising inflation, the turnaround in interest rates and economic risks resulting from the war in Ukraine, the list of negative factors for the German investment market seems longer than it has been for a long time. The risk aversion of many investors is likely to have become even greater, with the result that Core focus is once again growing stronger. This will increase the demand surplus in this segment even further and is likely to ensure stable and possibly even slightly rising prices. In the non-Core segment, on the other hand, the declining risk mark-up of real estate compared with bonds, and, above all, rising financing costs could have a price-dampening effect in the medium term. Overall, it is assumed that Germany will remain one of the preferred and safe investment locations for most investors. Nevertheless, the forecast has clouded over the past few weeks, and this could also slow down investment activity in the coming months.[20]

[16] Colliers: Investment Deutschland Q1 2022
[17] Colliers: Marktbericht Industrie und Logistik Investment 2021/2022
[18] IWIP-Index 2021, Institut der deutschen Wirtschaft Köln e. V.
[19] Grömling, 2022; Puls, 2022
[20] Savills: Investmentmarkt Deutschland April 2022