Munich Office, Q2 2017

Office take-up higher year-on-year; rents continue to rise

Take-up
154,500 sq m

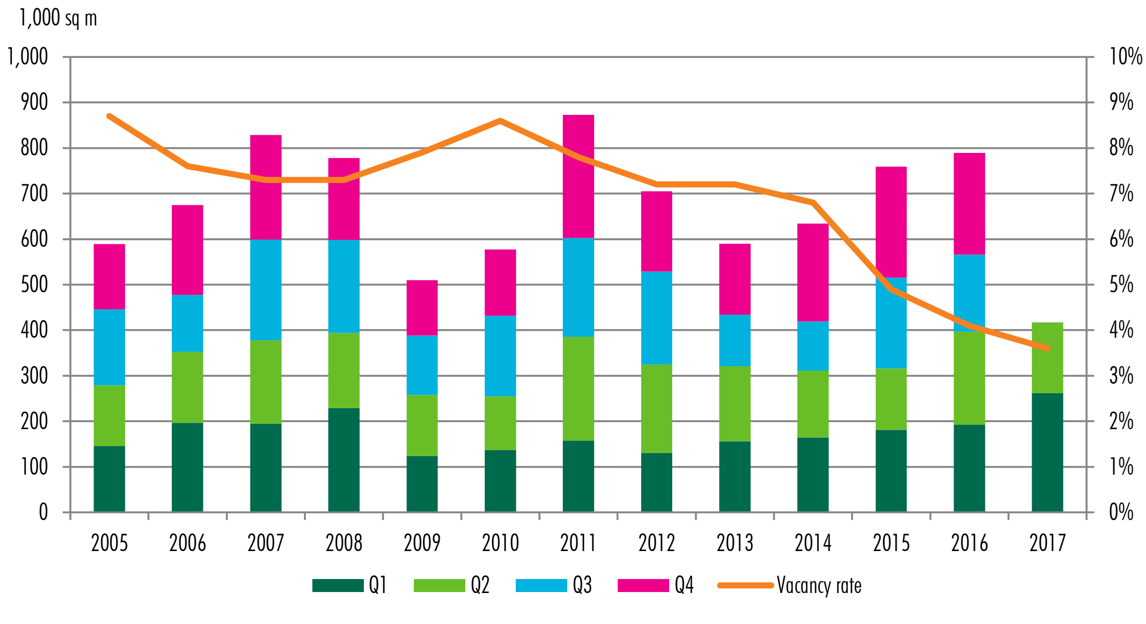
Prime rent
€35.00 /sq m

Vacancy rate
3.6%

Completions
24,400 sq m

Arrows indicate change from previous quarter

Figure 1: Office space take-up and vacancy rate



Source: CBRE Research, Q2 2017.

- Office take-up of 416,900 sq m in the first half-year; an increase of 5% compared to the same period in 2016
- 15 large-scale lettings in the >5,000 sq m size category
- Scarcity of supply in the city resulted in significant increase in take-up in the Munich periphery
- Achievable prime rent is €35.00 /sq m/month
- Vacancy rate falls to 3.6%, and below the 10% mark in the periphery for the first time
- Strong first half-year on the investment market
- Net initial yield for premium office properties falls to 3.00%

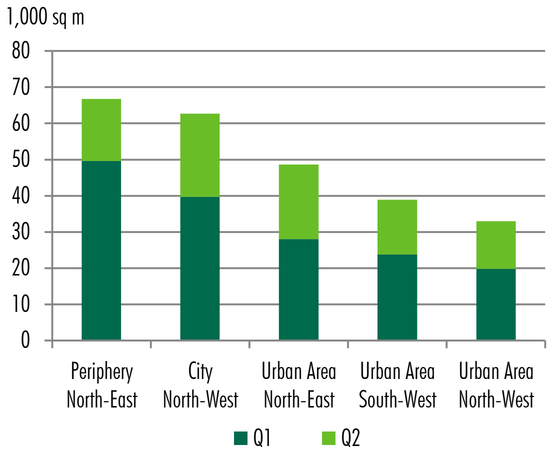
The economic upswing across Germany is likely to continue and, according to Consensus Forecast, the German economy will grow by 1.6% in 2017, and by 1.7% in 2018. Economic conditions in Munich remain to be favorable. The current demographic report prepared by Planungsreferat Munich anticipates that the city's population will grow by around 16% to 1.8m by 2030. The rising trend in employment figures resulted in a 30 basis points fall in the unemployment rate to 4.1% in a year-on-year comparison.

OFFICE SPACE TAKE-UP

Take-up (including owner occupiers) in the Munich office leasing market was 416,900 sq m in the first half of 2017, which was an increase of 5% compared to the same period in 2016. After the record start to the year, take-up slowed to 154,500 sq m in the second quarter.

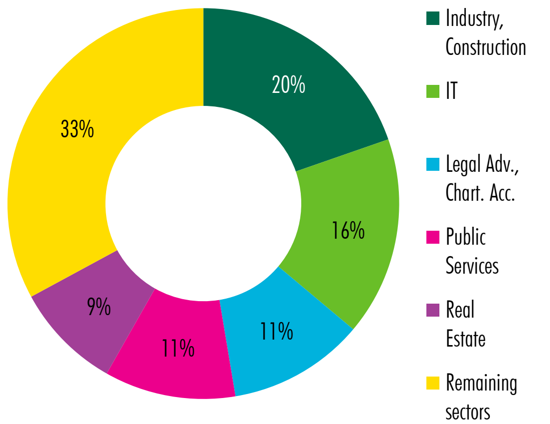
Whilst 70% of the office take-up in the first half of the year was attributable to the city of Munich, there was a significant year-on-year increase of 62% in the periphery. The distinct scarcity of office supply in the top locations has encouraged the focus to shift to less central locations. Given the good supply situation in new-build properties and development projects at attractive rental prices, many companies have made a conscious decision in favour of the Munich periphery. In addition to the largest transaction in the first half of the year, the owner-occupation of around 15,000 sq m of office space in Neubiberg by Infineon, two of the five transactions in the >10,000 sq m size category were completed in the periphery, including the letting to the Deutsche Pfandbriefbank in Garching. The largest deals in the second quarter included the letting to Design Offices of around 8,300 sq m in the ATLAS new development in the Werksviertel district at Ostbahnhof railway station. Beyond, BMW leased around 7,400 sq m in the Microcity property in Unterschleissheim.

Figure 2: Office space take-up by submarkets (Top 5)



Source: CBRE Research, Q2 2017.

Figure 3: Office space take-up by sectors* (Top 5)



Source: CBRE Research, Q2 2017.

*in total 20 sectors

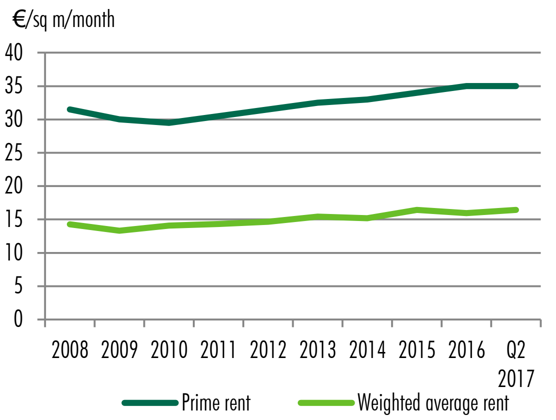
Figure 4: Office market key data	Q2 2016	Q2 2017	Y-o-Y
Total stock (all grades), million sq m	21.21	21.32	+0.5%
Take-up, cumulated, 1,000 sq m	396.9	416.9	+5.0%
Vacancy, million sq m	0.94	0.76	–19.1%
Vacancy rate, %	4.5	3.6	–0.9%-pts
Prime rent, €/sq m/month	34.50	35.00	+1.4%
Prime yield, %	3.60	3.00	–0.60%-pts
Capital value index (Q1 1986 = 100)	343	417	+21.6%

Source: CBRE Research, Q2 2017.

OFFICE MARKET RENTS

There were year-on-year increases in both the achievable prime rent and the weighted average rent at the mid-point of the year 2017, to €35.00 /sq m/month and €16.43 /sq m/month respectively. The weighted average rent within the city of Munich was €18.57 /sq m/month, a rise of 6% compared to the previous year. In the periphery, the average rent increased by 4% to €11.12 /sq m/month, due in part to the strong demand for new-build space. In a comparison of all submarkets, Periphery South-East experienced the highest year-on-year rise of 18%, which was mainly due to a large lease contract in one of the best properties within the submarket.

Figure 5: Prime rent and weighted average rent



Source: CBRE Research, Q2 2017.

OFFICE SPACE PIPELINE

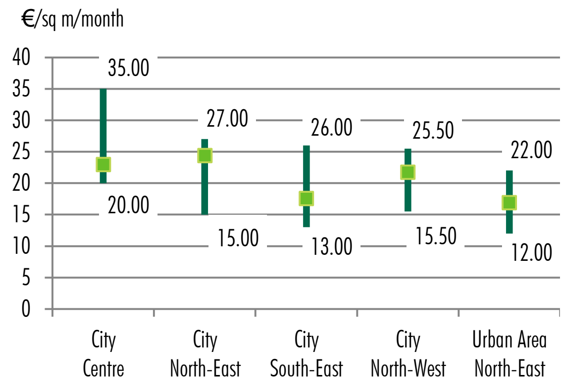
The completion forecast for the full-year 2017 is not expected to relieve much pressure in the supply situation in Munich. Of the total projectted office space of 171,800 sq m, just one fifth is still un-let. Projects due for completion by the end of the year include the BayWa-Tower in Arabellapark and the HIGHRISEone in the Werksviertel.

Based on current information, approximately 284,100 sq m will be completed in 2018, including the Leuchtenbergring Office property, under development by Münchner Grund, and the Bavaria Towers at Vogelweideplatz. Of the total volume due to be completed during 2018, 42% has already been pre-let.

It is expected that only from 2019 numerous new projects will concretely relieve the limited supply situation in the Munich office market. According to current information, the total completion volume will be around 660,000 sq m, of which more than 80% is still un-let. Completions expected in 2019 include the Kap West in the Quartier Hirschgarten, the ATLAS in the Werksviertel and the MY.O in the Nymphenburg district.

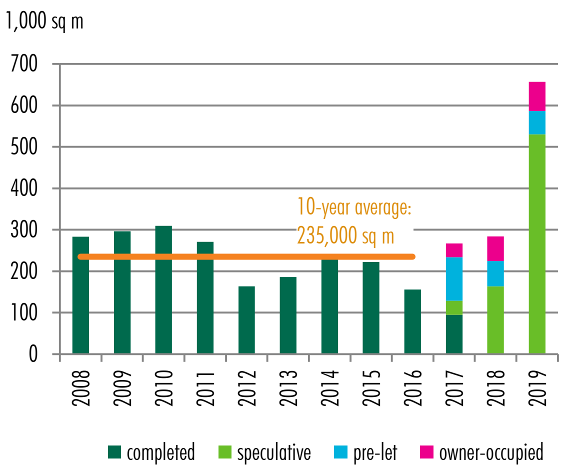
In addition to the urgently needed residential space, Munich needs further state-of-the-art office space to be constructed to remain a sustainable business location.

Figure 6: Rental bands by submarkets (Top 5)



Source: CBRE Research, Q2 2017.

Figure 7: Office space future supply



Source: CBRE Research, Q2 2017.

VACANCY

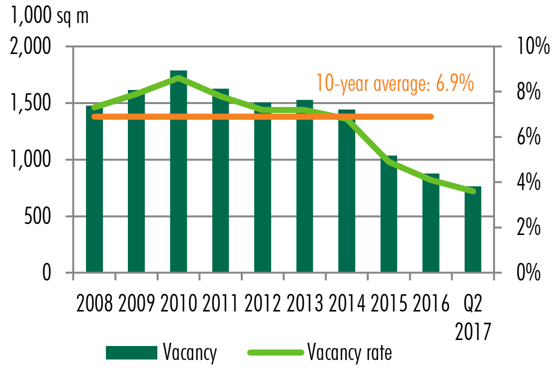
As little speculative office space came onto the market during the second quarter and many vacant office properties were removed from the market through demolition or conversion, mainly to hotels and residential buildings, office vacancy in Munich has continued to decrease. The current office vacancy of 764,500 sq m is almost a fifth down on the previous year. The vacancy rate was 3.6% at the mid-point of the year, 90 basis points below the previous year's level. The current vacancy rate in the city of Munich is just 2.2%. Vacancy has also continued to fall in the periphery to 9.2% of the corresponding total stock at the end of the first half-year. This is the first time it has fallen below the 10% mark since records began.

INVESTMENT MARKET

The transaction volume in the investment market reached a remarkable €2.2bn in the first half of 2017. This is an increase of 12% compared to the same period in 2016 and 11% above the five year average of the first half-years.

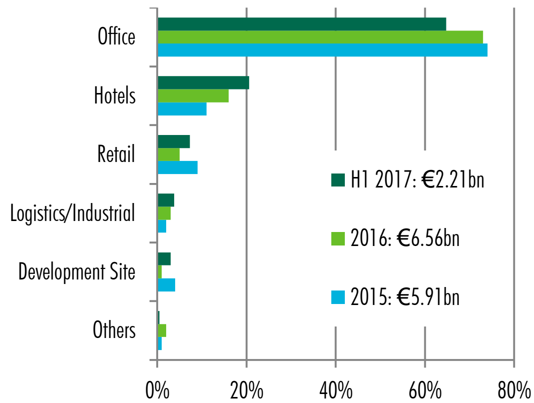
Demand from national and international investors remains high. There were 13 large-volume deals in the >€50m size category, contributing almost 58% of the half-year total. These included the sale of the office buildings Kap West in the Hirschgarten district and Campus E at Georg-Brauchle-Ring. However, the market is increasingly characterised by a lack of product, especially in the core office segment, that limits the transaction volume.
Nonetheless, the most traded asset class in the first half of 2017 was office property, contributing almost two thirds of the total volume. Hotel properties accounted for over one fifth of the investment turnover, again proving their attractiveness as an alternative investment to the office segment. The principal investor focus is still on premium office properties, resulting in a further fall in the prime office yield (net initial yield) to 3.00% in the second quarter.

Figure 8: Office space vacancy



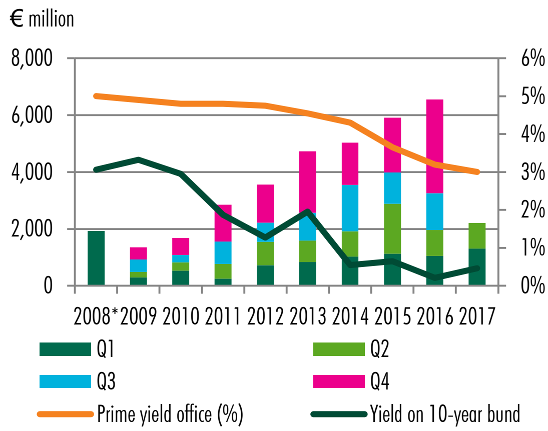
Source: CBRE Research, Q2 2017.

Figure 9: Investment volume by property type



Source: CBRE Research, Q2 2017.

Figure 10: Investment volume, prime yield office, benchmark yield



Source: CBRE Research, Q2 2017.

*prior to 2009, year-total

OUTLOOK

New enquiries registered by CBRE in Munich are still at a high level and point to a continuation of the brisk activity and good performance in the letting market over the second half of the year. Competition for good-quality space in central city locations is likely to intensify and will ensure that demand for space in secondary and peripheral locations will continue to increase. The expected result is a continued fall in vacancy levels and a rise in office rents. Considering the very limited supply of good-quality existing space, the signifycance of development projects will increase in the future. New-build projects cannot satisfy short-term inquiries, as there is a long lead-in time before the space can be occupied.

According to our current market analysis, we expect that the full-year take-up in the Munich market area in 2017 will be between 750,000 and 800,000 sq m.

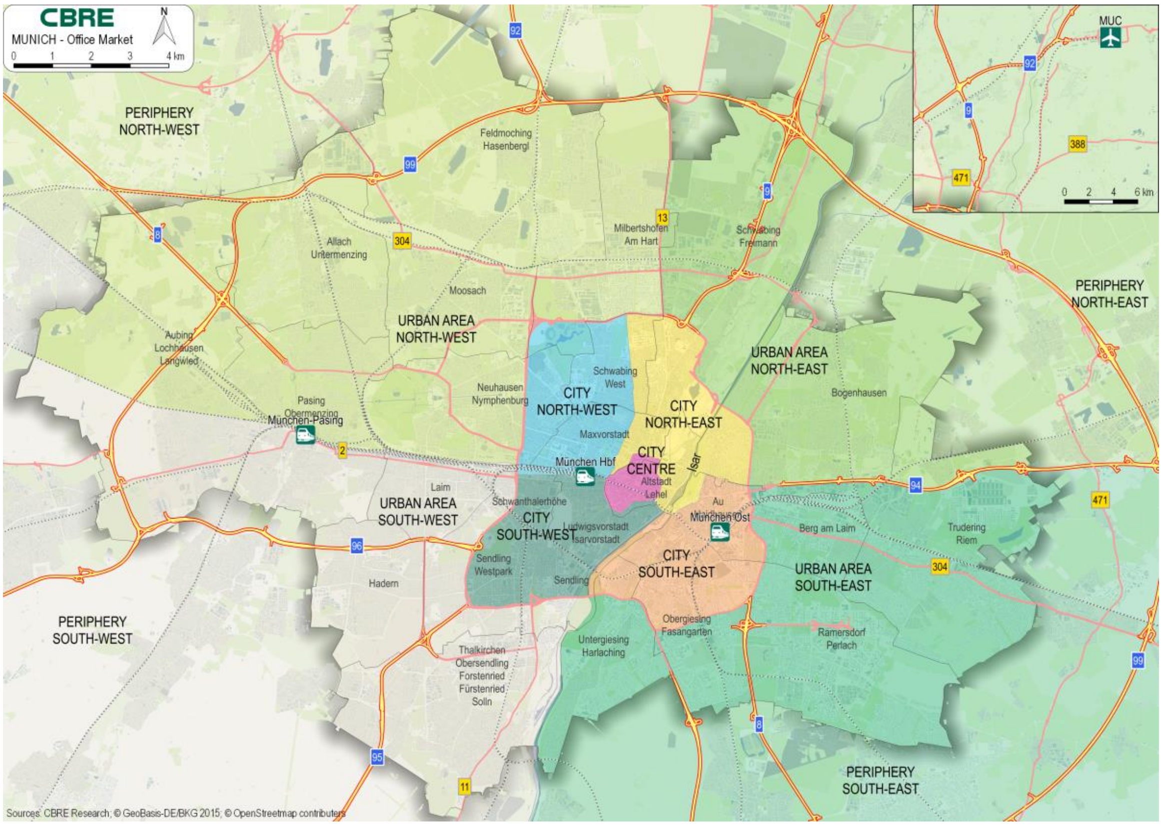
Given the continued excellent economic conditions in the Munich region and the ongoing pressure on investors to make purchases across all asset classes at a time of significant availability of capital in the German real estate markets, we expect a stable growth of investment business in Munich in the second half of the year.

Continued yield compression, especially in the core segment, will encourage investors to widen their focus on value-added office properties and high-quality products outside the CBD. Furthermore, development projects and alternative asset classes such as hotels, logistics and healthcare are increasingly of interest to investors.
Net initial yields across all asset classes are likely to stabilise at a low level and may even fall slightly.

Figure 11: Submarket key data

Submarket	Cumulated Take-up (sq m)	Future supply Q3 2017-2019 (sq m)	Vacancy rate (%)	Rental band (€/sq m/month)	Weighted average rent (€/sq m/month)
City North-East	30,600	17,000	1.0	15,00 – 27.00	24.37
City North-West	62,700	82,800	1.1	15,50 – 25.50	21.72
City South-East	28,300	109,100	3.9	13,00 – 26.00	17.54
City South-West	20,000	19,400	0.7	13,00 – 20.00	16.56
City Centre	21,700	10,800	1.1	20,00 – 35.00	22.97
Urban Area North-East	48,600	133,800	3.6	12,00 – 22.00	16.91
Urban Area North-West	33,000	190,000	1.3	12,00 – 20.00	16.29
Urban Area South-East	7,600	109,200	5.6	11,00 – 18.50	13.35
Urban Area South-West	38,900	119,000	2.4	11,00 – 18.50	13.53
Periphery North-East	66,800	224,300	10.1	9,50 – 14.50	10.80
Periphery North-West	18,300	34,400	8.0	9,00 – 13.50	11.62
Periphery South-East	32,000	43,600	9.6	9,00 – 13.50	11.01
Periphery South-West	8,400	19,400	6.0	9.50 – 14.00	11.91
TOTAL	416,900	1,112,800	3.6	9.00 – 35.00	16.43

Source: CBRE Research, Q2 2017.



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