



With an article by
 **Sparkasse
Nürnberg**

Market Report
Nuremberg 2017

Investment

EDITORIAL

The 2016 real estate year has ended and the time has come to take stock while looking forward. What determining factors shaped events in the year that has just ended? How will the local real estate market develop and what changes are to be expected?

As in 2015, we experienced a very high level of real estate demand in 2016 – a level that supply was unable to keep up with. During the course of 2016, figures from the TOP 7 locations gave the impression to expect a significant decline, yet a dynamic 4th quarter topped the results of the previous year and once again, new highs were reported.

In line with these scenarios, Nuremberg's market for commercial real estate investments was also as strong as a bear and is likewise expecting a new record result. Current figures clearly demonstrate the persisting high demand in combination with the willingness to invest in rising purchasing prices and show the robust character of the local market.

This caused lower returns – not just in what is still the strongest segment of office real estate, where we could determine reductions in the returns of approx. 250 basis points. In the residential asset class, decreases were clearer – and the following pages will elaborate on this.



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UNBROKEN BOOM PHASE

To start with, we notice that competition for core properties has kept increasing – along with an unbroken strong demand. This caused a further reduction of returns – a scenario that has been part of our most important forecasts for two years, as Germany's 14-B locations are furthermore brought into the spotlight of the buyers willing to invest who search for adequate returns.

Sinking returns and declining supply in the TOP 7 cities ensure that this situation will persist. Selectively speaking, acquisitions will also expand to C and D locations.

Among the above-mentioned 14-B locations, Nuremberg's scores well with its strong figures for the unemployment/employment rate and the employment forecast, which indicate further growth to be expected.

However, what should be done now about the increasing discrepancy between the investment and rental market, the so-called "yield compression"? Rental markets are sending only cautiously positive signals, and demand in the user market is not developing to the same positive extent as the investment market. In the medium term, this could lead to problems, at the latest when the first prolongations in the financing structures are pending.

Therefore, caution is the order of the day and risk hedging almost indispensable. However, the involvement in B cities is already a form of risk hedging when we take as basis that these markets are generally less prone to economic fluctuations.



THE MOST IMPORTANT ASSET CLASS

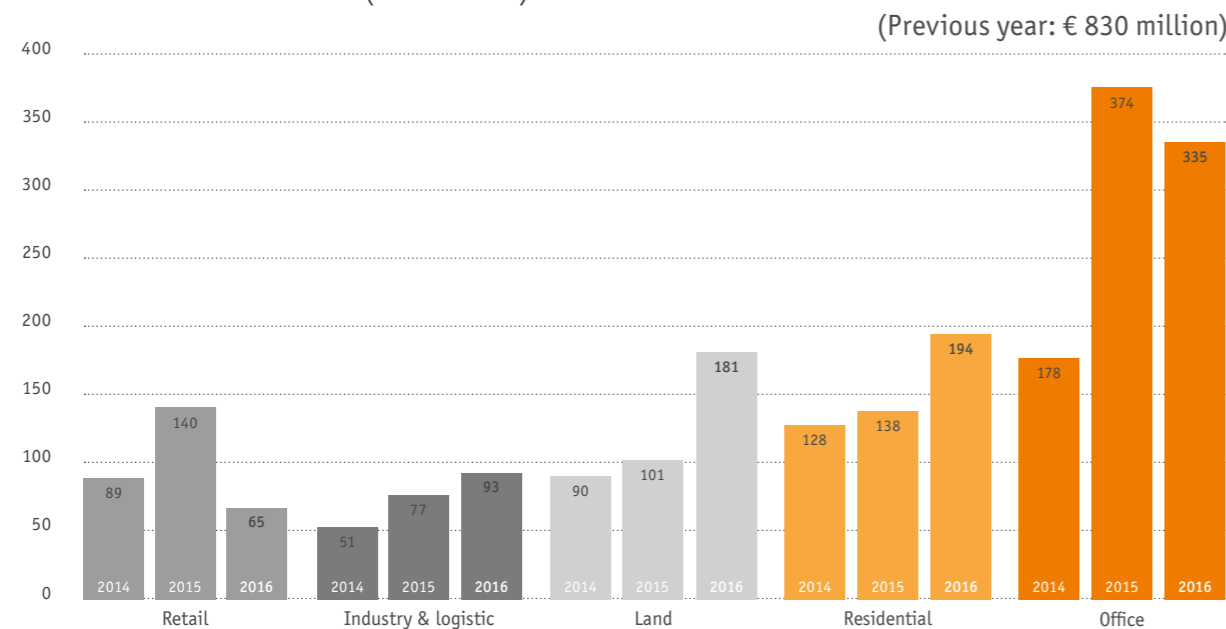
We are not going to experience a paradigm shift so quickly in investing behavior. Therefore, the investment class that was by far the most in demand in 2016 and responsible for the largest monetary turnover was office real estate – and if a higher supply had existed, profits would have also significantly increased once again.

Nonetheless, we can remember that residential real estate has caught up in popularity and clearly moved forward to second place. Since sales of plots are already on third place, we can assume project developers to remain very active of and have a full pipeline of new products. Owing to the unbroken attractiveness of the Nuremberg location, we expect mostly housing projects from this.

The following places are occupied by industry & logistics as well as retail. We can explain the weak performance of the retail sector only due to the insufficient supply and a restrictive permit policy.

Thus, the transaction volume of Nuremberg's commercial real estate adds up to 868 million euros, of which almost 38.6% represent office real estate, 22.3% the residential asset class, 20.8% plots, 10.7% industry and logistics, and 7.5% retail.

Transaction volumes in 2016 (€ in millions)



SUPPLY AND DEMAND

If classical economics is believed, then it can be assumed that a certain property whose price climbs relentlessly will certainly face slower demand as its price increases. At the same time, more suppliers enter the market because properties can be sold for a higher price. This is the theory.

In the real world of the real estate sector of recent years and last year, this theory was increasingly invalidated and almost turned into its opposite. Although real estate prices increase, demand also goes up. We are experiencing an expansion on the part of demand, i. e. an increasing number of customers enter the market looking for adequate investment properties while no more suppliers ensure an equilibrium. The result: supply becomes increasingly scarce, but the price reacts in a typical way – it increases and keeps increasing.

Customers react and look for alternatives. They switch to other markets and asset classes, start looking around and focus increasingly on Nuremberg.

Consequently, we recorded active trading in 2016 and 2015 in all asset classes that we looked at. In this context, the relatively weak turnover in Nuremberg's retail sector is possibly noteworthy. On the other hand, some spectacular deals were concluded in the neighboring city of Fürth with the sale of the "Neue Mitte Fürth", the "City-Center Fürth", and the "Phoenix-Center". If the sale of the "Uferstadt" in the city limits is also included – Union Investment was awarded the contract – then it can be said that markets are now being developed too that in recent years had not directly targeted by investors.

Average 2016 yields



* Gross initial yield (management and acquisition costs not considered)
** Furnished apartments, student residences, boarding houses



PURCHASER GROUPS

Last year, the group of project developers and builders dominated the scene by far. Expressed in numbers, the purchasing group accounted for approx. 61.8% of purchasing activities, which involved both the construction of new properties and the development of various types of use.

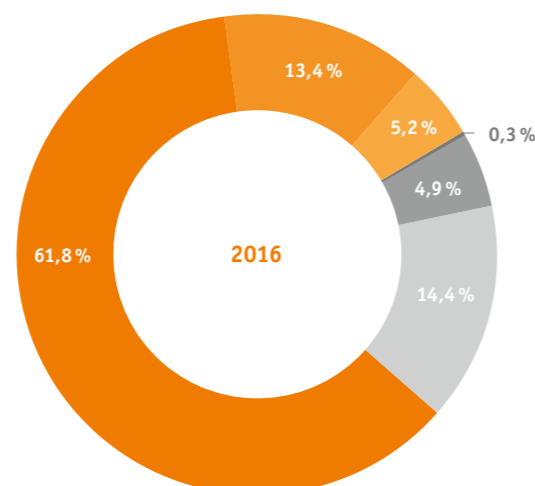
Significant, therefore typical for developers, is the strong focusing on plots and residential units. Thus, demand for plots remains just as strong and therefore growth figures for Nuremberg's residential construction are once again expected for 2017.

No wonder when one looks at the forecasts announced a long time ago about "migration to growth regions", "influx from abroad", "creation of smaller households", or "rural exodus". This trend, caused by the so-called demographic transition or demographic change, has been continuing now for a long time and will only end slowly until 2020 or 2030.

It is also not surprising that the city's largest individual deal ended with the Dream Global Reit fund. This deal has exemplarily shown the unique performance of B cities, namely that big deals are possible but large quantities should not be expected.

Buyer groups

Project developers/ building contractors	61,8%
Funds, open/ closed	13,4%
Private investors/ family offices/ foundations.....	5,2%
Banks/ insurance companies	0,3%
Owner-occupiers.....	4,9%
Other	14,4%



SELLER GROUPS / DEALS AND FACTS

Project developers are responsible for Nuremberg's significantly larger share of purchases in this year too. As a whole, this share amounts to approx. 55%, and has therefore fallen somewhat compared to last year. Worth mentioning are the shares of owners (approx. 11%) and fund companies (approx. 22%). Otherwise, the big picture remains basically unchanged compared to 2015.

Who dominated the headlines in Nuremberg and attracted attention with the large deals?

In the residential sector, Capital Bay must be mentioned. It is a Berlin investor that acquired a portfolio consisting of properties in Nuremberg, Dresden, and Erfurt from PI Pro-Investor located in Röthenbach on the Pegnitz.

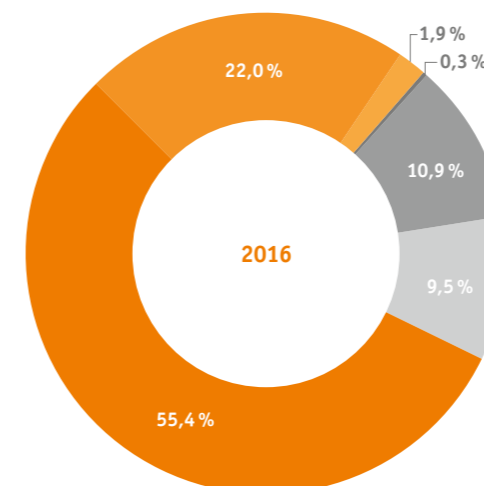
The GBW Group acquired a project of Ten Brinke on the Welsersstraße worth about 38 million euros and additionally a 2-hectare plot behind the Tafelhalle from the City of Nuremberg.

We already mentioned Dream Global Reit in the office real estate segment. We now add the P&P Group of real estate entrepreneur Michael Peter, who acquired the former Telekom building on the Bayreuther Straße for approx. 35 million euros. Pegasus Capital Partners attracted attention with several deals, and only the purchase of three properties on the Richard-Wagner-Straße and the Lina-Ammon-Straße in Nuremberg and in the Nägelsbachstraße in Erlangen will be mentioned here.

Additional deals, such as the purchase of the former Kaufhof plot at the Aufseßplatz by Edeka or the purchase of a portfolio with Nuremberg's participation by Accom Immobilien Holding together with Värde Partners Europe, prove the unbroken dynamism of the Nuremberg real estate market.

Seller groups

Project developers/ building contractors	55,4%
Funds, open/ closed	22,0%
Private investors/ family offices/ foundations.....	1,9%
Banks/ insurance companies	0,3%
Owner-occupiers.....	10,9%
Other	9,5%

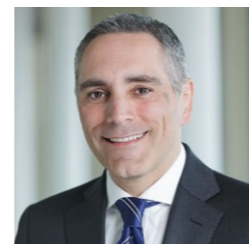




Something is happening in Nuremberg's real estate market

With a volume exceeding 1.3 billion euros, Sparkasse Nürnberg is the market leader in commercial real estate financing in Nuremberg's metropolitan area. Financing experts support real estate investors, housing companies, investment companies, project developers and builders in their commercial building projects. They are very well interconnected in the real estate sector, know the market, and therefore have a good insight into regional development.

"High-level further development" is the positive conclusion reached by Sparkasse Nürnberg for the 2016 residential and commercial real estate market in the Nuremberg region. Due to the attractiveness of the location and the persisting favorable conditions – above all the robust economy and low interest rate environment – regional investors (and increasingly trans-regional ones as well) are streaming into the commercial real estate sector. After many years of "near" standstill, several large real estate development projects will be initiated in Nuremberg's inner city in the coming years.



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REAL ESTATE FINANCING: STRONG IMPETUS STARTING ON THE SECOND HALF OF THE YEAR

After the still restrained demand for commercial real estate financing during the first months of 2016, it increased sharply starting in the second quarter. The continuing lowering of interest rates and lack of investment alternatives gave the impetus to start investing heavily again. From the third quarter of 2016, the financing volume had reached approximately the high level of the previous year. For 2017, experts of Sparkasse Nürnberg are expecting a similar trend in the regional real estate market.

Currently, Nuremberg's real estate market is still characterized by a relative lack of supply of attractive properties, both for residential and commercial purposes. Interesting plots are also in short supply.

On the other hand, new things are happening in large real estate development projects. Thus, new urban quarters and complexes with residential and/or commercial real estate are being built. Examples are the Augustinerhof in the innermost city, on the former Coca-Cola building on the Ostendstraße in Mögeldorf, the former Telekom building on the Äußere Bayreuther Straße, the former "Auto-Krauss" area between the Peterskirche and Luitpoldhain in St. Peter as well as the 100-hectare "Lichtenreuth" area on the Brunecker Straße. All of them attract cultural and social institutions – as is the case with the planned branch of the German Museum at the Augustinerhof – and increase the attractiveness and quality of life of the Nuremberg location.

NO SIGNS OF A REAL ESTATE BUBBLE IN THE URBAN CENTER

The purchasing price development remained at a high level in the residential sector, whereas prices increased in the commercial sector. Relative to the higher purchasing prices, rents developed along to a certain extent, partially compensating the price increases. Generally speaking, there were slight declines in almost all asset class returns.

For your business sector, Sparkasse Nürnberg is still not seeing any signs of a real estate bubble. Nonetheless, when purchasing properties, real estate customers should pay particular attention to their location and fungibility.

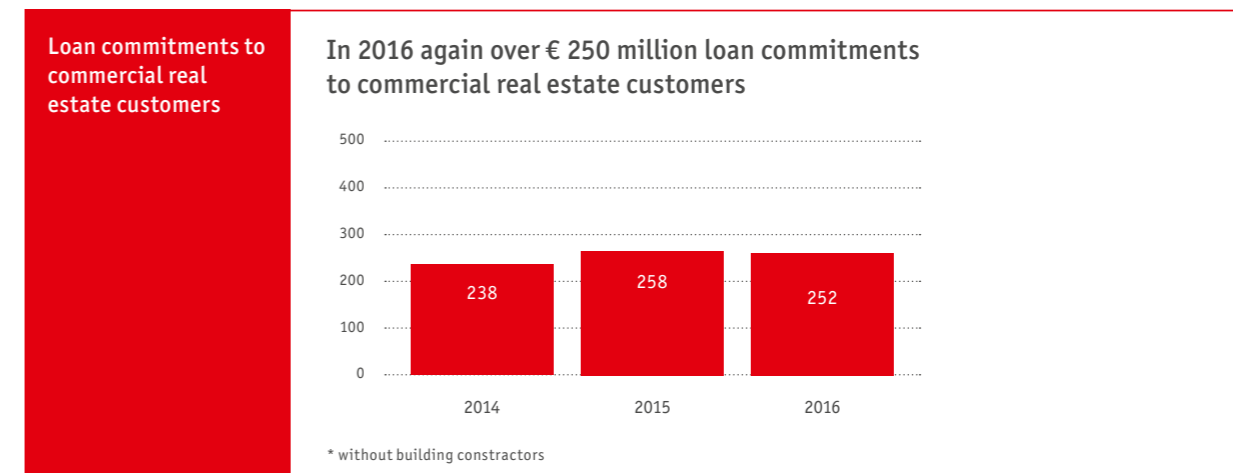
THE NUREMBERG METROPOLITAN AREA IS A PROFITABLE B LOCATION

Although compared to the metropolises of Munich or Berlin, investors consider the Nuremberg metropolitan area as a B real estate location, but properties in A locations are still within reach and especially lucrative. Thus, whereas returns of about 2.5% are possible in Munich right now, they are 4.5% in the Nuremberg metropolitan area. The interest of inter-regional investors will therefore keep growing owing to the risk and return aspects.

SPARKASSE NÜRNBERG IS THE LARGEST FINANCING PARTNER

Sparkasse Nürnberg, as a reliable financing partner given the best scores by customers, recommends investors the "right financing" depending on their individual situation. In the current low-interest level, portfolio holders profit from preferably long-term interest rate hedging, for example. Depending on customer needs, a combination of short- and long-term interest rate hedging could make sense – on the hand, to participate in the more favorable, short-term interest rates, and on the other hand, to minimize the interest rate change risk in the future. An important part of financing is also a redemption structure adapted to the customers' initial situation.

As the largest local real estate agent for residential properties, Sparkasse Nürnberg registers increasingly shorter marketing periods owing to the lack of supply. Purchasers are making ever-faster decisions, and equity capital is becoming increasingly higher. Therefore, Sparkasse Nürnberg recommends the timely and detailed clarification of one's own financing. This increases the chance to also get the desired property in the fast race for attractive properties.





OUTLOOK AND CONCLUSION

As has already occurred in recent years, we keep experiencing falling returns in 2016 in combination with continuing strong demand. We ask ourselves about the 2017 performance and are also optimistic this year because the responsible factors will remain stable. However, precisely these factors are especially worth examining and analyzing in an intense way because the first clouds are gathering on the horizon.

Will the long-awaited change in interest rates come and thus end the low- to zero-interest rate policy?

The latest statements from the ECB and the Federal Reserve allow us to conclude that the interest rate change has at least been initiated. Although so far the ECB has not raised interest rates, there are increasing signs of the end of cheap money.

The prerequisites for an increase in Europe are still absent. Economic growth remains relatively weak and inflation low. In this respect, neither key interest rate increases by the ECB nor appreciable increases in the returns of long-term bonds can be expected.

What does this scenario mean for the real estate market?

Here are our forecasts for Nuremberg in 2017:

1. Increasing rents in all asset classes, except for retail, falling vacancy rates
2. Increase of transaction volumes in the asset classes of logistics, servicing, and student housing
3. Supply-side decline of inner-city sales, thus stronger demand for peripheral locations and environs
4. Strong demand for all asset classes, especially for housing
5. Returns under pressure, thus dropping
6. Transaction volume at the same level

We expect another extraordinary year in Nuremberg's real estate market, but also think that a successive end of the boom phase will come.

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- **Sales**
- **Consultation**
- **Appraisal**
- **and development of real estate.**

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Your success!