



## Gentle recovery for German commercial real estate

The German commercial real estate market has bottomed out. We explain why prices could continue to rise moderately and why there are likely to be considerable differences between the individual sectors.

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### The commercial real estate market is on a gentle recovery course ...

The commercial real estate market has experienced an even greater crisis in recent years than the private residential real estate market. In 2022 and 2023, rising financing costs also caused commercial real estate prices to fall, with the decline of 17% almost twice as large as that of residential real estate prices (title chart). In addition, the outbreak of the coronavirus pandemic had already brought the rise in commercial real estate prices to a halt in 2020, while residential real estate prices rose by another 25% during this period.

However, the market correction now appears to be over and prices seem to have begun a gradual recovery. Prices have been rising again since mid-2024, and the number of transactions has at least stopped falling recently.

### ... which should continue

Several factors suggest that this moderate recovery is likely to continue for the time being:

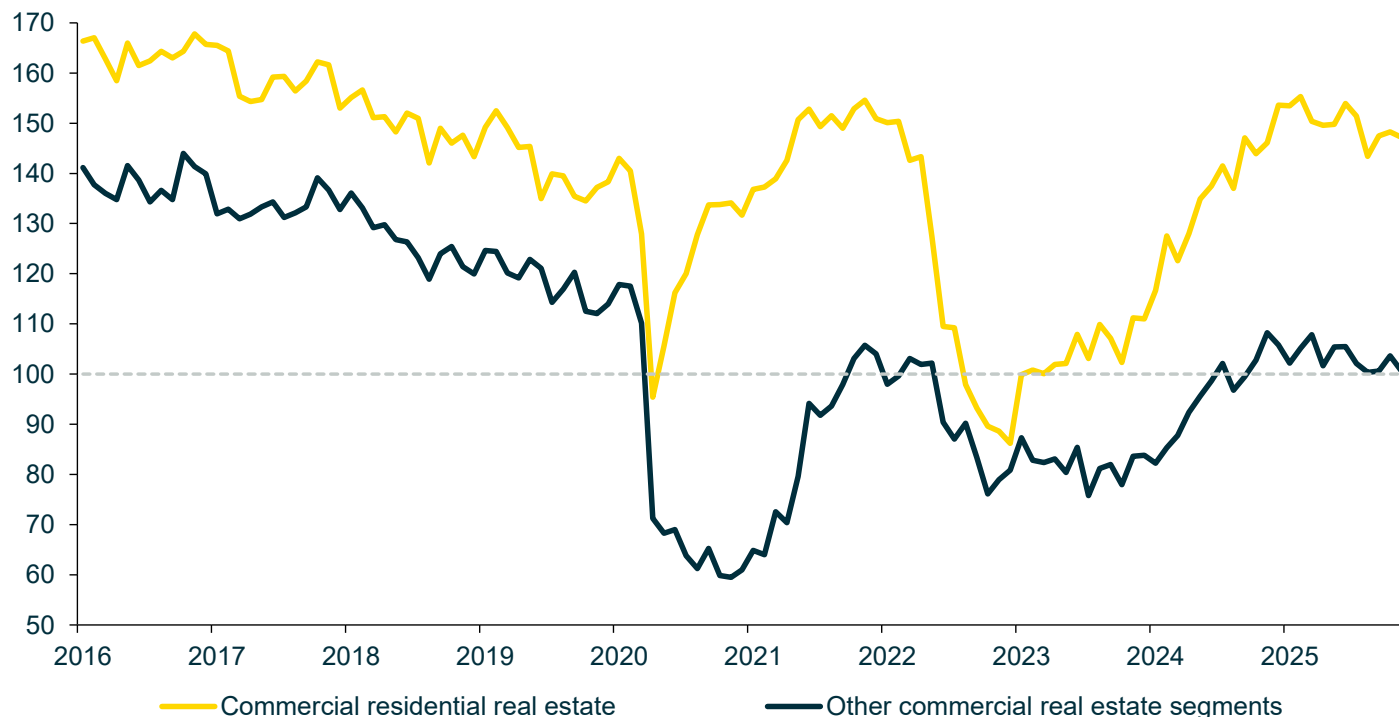
- As a result of the ECB's interest rate cuts between mid-2024 and mid-2025, **financing conditions** have improved significantly again. We expect key interest rates to remain at their current low levels for the foreseeable future. In the short term, the risk is more likely to be lower rather than higher key interest rates.
- Supply is tight in many areas, and this is unlikely to change for the time being due to relatively low construction activity. As a result, **rents** are likely to rise somewhat more dynamically, which will improve returns on investments in the relevant properties.

Against this backdrop, although investor sentiment remains more negative than before the crisis, it has brightened since the beginning of 2024. This is largely due to greater confidence in commercial residential real estate (Chart 1). However, surveys show that other areas of commercial real estate have also regained their appeal for investors.



### Chart 1 - Investors are once again seeing opportunities outside of residential real estate

Real estate climate for commercial real estate by segment (residential, office, retail, logistics, and hotels), index 2008=100



Quelle: Deutsche Hypo, Commerzbank Research

### Logistics and industrial real estate dynamic

However, there were already significant differences between the individual sectors during the crisis, and developments are unlikely to be uniform in the future either. Logistics and industrial real estate, for example, came through the crisis years virtually unscathed. This is partly due to a shortage of supply. New construction is suffering from a lack of space, partly because local authorities are more restrictive than before when it comes to designating new commercial areas, partly to avoid additional soil sealing. On the other hand, demand is increasing due to reshoring and nearshoring, increased warehousing, and the continued growth of online retail. This is inevitably leading to rising rents; since 2020, rents have nearly doubled in many locations.

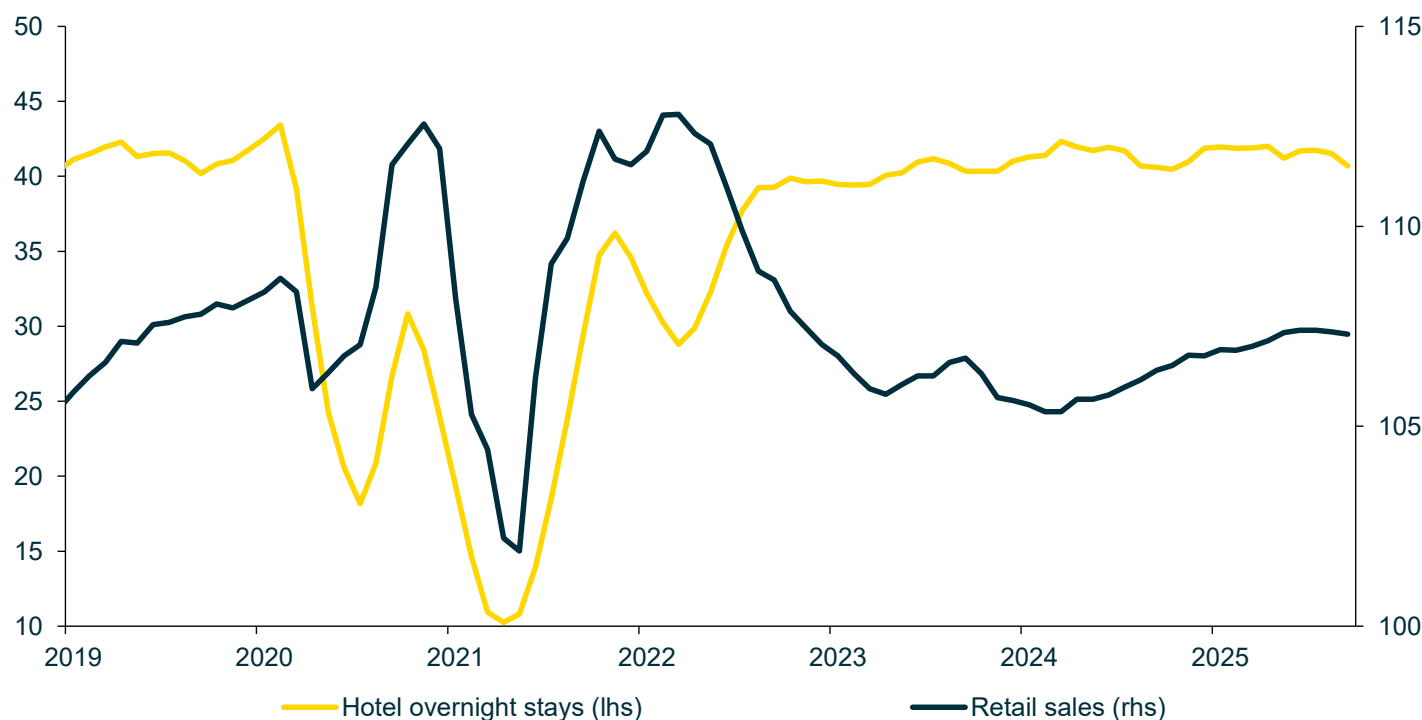
### Hotels on the right track ...

Hotels were hit hard by the coronavirus crisis. Investors now view this sector as positively as they did before the crisis. After all, Germany has seen a similar number of overnight stays as in 2019, i.e., before the coronavirus crisis (Chart 2). Hoteliers were able to significantly increase their occupancy rates and thus their margins. This is particularly successful for hotels that can offer guests – both tourists and business travelers – amenities that go beyond the standard. Many smaller, often privately owned hotels find it difficult to stand out from the crowd unless they occupy a specific niche.



### Chart 2 - Retail trade showing slight upward trend

Hotel overnight stays in Germany, seasonally adjusted, in millions; retail sales in stores, price- and seasonally adjusted, index 2015=100; each series 5-month average



Quelle: Federal Statistical Office, Commerzbank Research

### ... just like retail real estate

Retail real estate is also on the upswing again. Foot traffic in shopping streets is largely back to pre-coronavirus levels, and sales in retail spaces have also recovered somewhat (Chart 2). Against this backdrop, rents for new leases have been rising again for about two years, after falling quite significantly for five years.

However, the retail landscape has changed. Large, monolithic department stores are a thing of the past. Customers want to find targeted product ranges that ideally combine the shopping experience in the city with that of the online world. In addition, customers increasingly value high-quality items and personal advice, which primarily benefits the luxury sector.

However, there are also some problem areas. Medium-sized, remote shopping centers are struggling to attract enough customers. Successful centers score points with a food court that covers culinary trends, a clever combination with everyday offerings such as supermarkets or drugstores, and a high quality of stay. This is increasingly being supplemented by digital services such as click & collect, smart parking solutions, and interactive signage.

### Office real estate faces challenges, ...

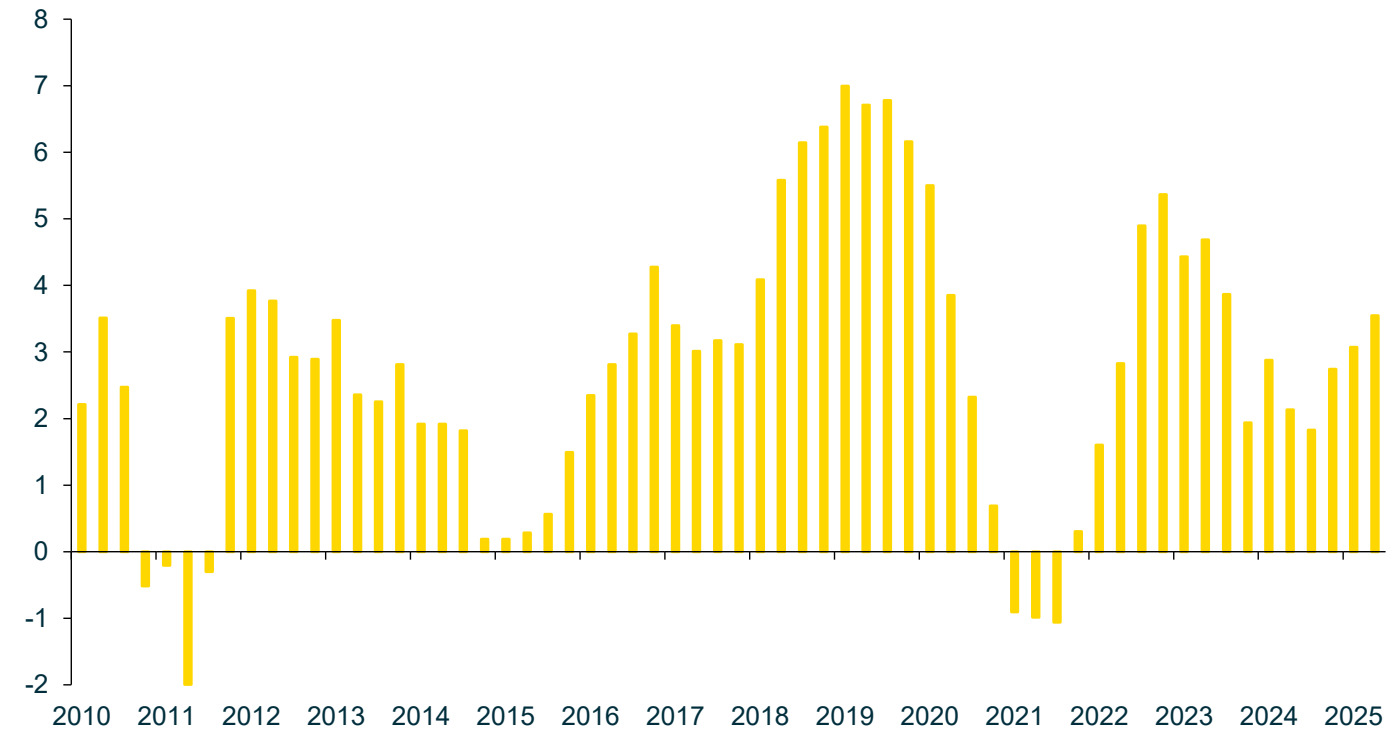
Office properties are facing immense challenges. Offices in peripheral locations in particular are feeling the competition from home offices. In contrast, there is hardly any vacancy rate for offices in the city centers of major cities. In the so-called Central Business Districts (CBDs) of large cities, demand even exceeds supply in some cases. Munich, for example, has an overall office vacancy rate of 8%, while within the area of the Mittlerer Ring it is just under 4% and in the CBD it is below 2%.

Against this backdrop, rents for new leases have been rising again since 2021 despite all the doom and gloom about the death of the office (Chart 3), with rents for prime offices in top locations in major cities increasing by up to 50% in some cases in recent years.

Rents are likely to continue to rise sharply, especially for offices in prime locations. New construction figures have also slumped due to high construction and financing costs, which is why competition for existing premium space is likely to increase further in the near future.

**Chart 3 - Office rents rising a bit faster**

New office property rents, in percent compared to previous year



Quelle: VDP, Commerzbank Research

**... where the following applies: new buildings (or with updated standards) beat old buildings**

In the coming years, it is likely to be even more true than in the past that prices for new buildings or buildings with updated standards will perform better than those for unrenovated old buildings. This is because in recent years, a number of sustainability regulations for real estate have been enacted and tightened, obliging both owners and tenants to optimize the energy consumption of buildings or to rent only buildings that meet the relevant standards. So far, there are far too few of these “green” buildings, especially in the office segment, to adequately meet demand.

But even aside from environmental considerations, modern buildings offer important advantages for tenants and thus also for investors. For example, space flexibility has become an important requirement for all segments of commercial real estate. Buildings must be able to be redesigned quickly and flexibly and adapted to changing trends. Buildings that meet these criteria are likely to perform significantly better in the future than buildings that do not.



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