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Frankfurt | Office letting and investment | Q1 2014

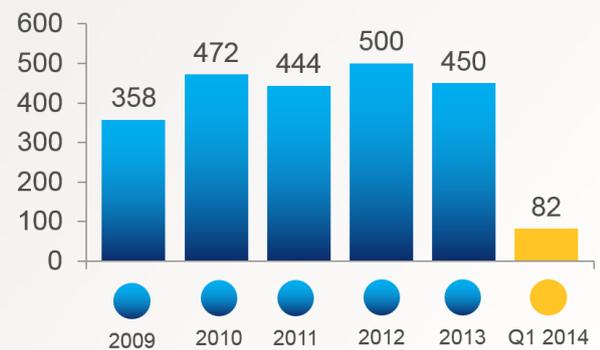
MARKET REPORT

# A solid start to the year on the office and investment market

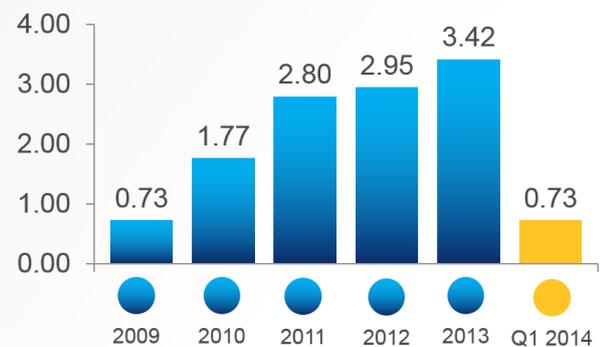
Dr. TOBIAS DICHTL | Research Analyst

- > Take-up of space up about 25% year on year
- > major signing by Deutsche Bank defines the market
- > decline in demand in small and medium-sized space segments
- > completion volume up again in 2014
- > average and prime rent holding steady at a high level
- > investment market: sale of the police headquarters property lifts transaction volume to last year's level
- > project developers markedly ramp up activity
- > supply of large-volume investment opportunities limited

Take-up of office space  
(in 1,000 m<sup>2</sup>)



Commercial transaction volume  
(in billions of euros)





Frankfurt Skyline (Bild: iStockphoto©Thinkstock)

The Frankfurt real estate market has started 2014 with a solid first quarter. Both the office leasing market and the investment market are benefiting from a major signing, exceeding last year's quarterly results. The positive overall economic outlook and additional large-scale requests that are testing the market along with the sustained interest in Frankfurt as a location among German and international investors promise brisk market activity over the rest of the year.

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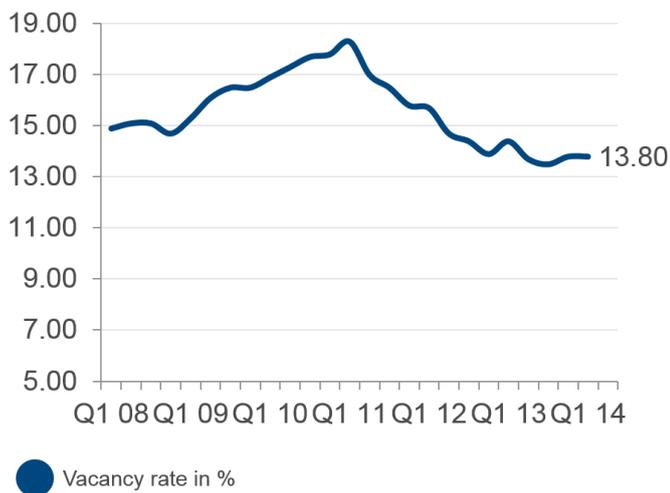
## Major signing buoys take-up of space

In the first quarter of 2014, approximately 82,000 m<sup>2</sup> of office space was leased out in Frankfurt, representing an increase of about 25% year on year. The new lease signed by Deutsche Bank for 32,000 m<sup>2</sup> of space in a development project on Mainzer Landstrasse and an existing building on Weserstrasse is responsible for 39% of the total space taken up, while also representing the sole signing for more than 5,000 m<sup>2</sup> and one of just four new leases for more than 2,000 m<sup>2</sup>. The number of signings between 1,000 m<sup>2</sup> and 5,000 m<sup>2</sup> fell from 14 in the first quarter of 2013 to 11 in 2014. Alongside the lack of large-scale signings, activity in the space segment below 1,000 m<sup>2</sup> is also not as brisk as in 2013. At about 27,000 m<sup>2</sup> of space leased and 97 leases signed, there were reductions in both take-up of space (-18%) and the number of transactions (-9%) in the smaller space segment. Consequently, the good quarterly result is largely the product of the large-scale signing by Deutsche Bank, while the space segments below 5,000 m<sup>2</sup> were unable to match last year's figures.

## Central locations still sought-after

In the first quarter of 2014, as in the past, demand among office tenants was focused on inner city locations. At 46,000 m<sup>2</sup> of space taken up, 56% of the office space leased was in the CBD, which increased its market share once again year on year. One out of every two deals was signed in this area, making it the most sought-after market, even without including Deutsche Bank. With three signings for 1,000 m<sup>2</sup> of space, total take-up of space at 7,800 m<sup>2</sup>, and 11 signings in all, the central station and Westhafen area was also highly sought-after in the first quarter. Close proximity to the CBD, the improvement processes that have taken place over recent years, and the excellent traffic and transportation connections available here make this sub-segment an increasingly attractive option for office users.

### Vacancy rate of office space (in %)



## Completion volume up significantly once again

About 100,000 m<sup>2</sup> of new office space was completed in the first quarter, with over 200,000 m<sup>2</sup> to follow during the rest of the year. As a result, completion volume will rise significantly again in comparison to 2013. Aside from the TaunusTurm, where the first tenants moved in during the first quarter, completions begun on a speculative basis remain the exception rather than the rule. About 78% of the office space scheduled for completion in 2014 has already been leased to tenants. The new supply of modern office space is contrasted with older office buildings that are being revitalized or torn down and rebuilt as part of development projects. There are especially striking examples of this in the banking district, where the refurbishment of the Taunusanlage 11 property was completed in the first quarter and the construction work to demolish and

rebuild Taunusanlage 8 is under way. On the Marieninsel and along Mainzer Landstrasse, further conversions are in the project planning stages, and it will be possible to realize these plans if advance leasing levels are sufficient. Based on the high demand seen in recent years, however, project developers are increasingly willing to start building on a speculative basis in top locations. High demand for living space boosts the appeal of older office properties for developers of residential real estate, who have become active in recent years, especially in areas close to the city center, such as the Westend district. Residential conversions alone depleted the stock of office space by more than 40,000 m<sup>2</sup> in the first quarter of 2014. Because vacancies and existing inventory are declining simultaneously, the vacancy rate is holding steady at 13.8%, a reduction of 60 base points in the course of the past year.

### Prime and average rent for office space (in €/m<sup>2</sup>)



## Attractive supply of space brings high rents

The supply of high-quality office space in top locations provided by properties such as the TaunusTurm development and the development projects in the MainTor and Taunusanlage areas continues to open up opportunities for lease signings at high rental prices. The average and prime rents both held steady during the first three months of the year, at € 18.50/m<sup>2</sup> and € 38.00/m<sup>2</sup>, respectively. Over the past 12 months, however, a significant increase has been noted, a trend attributable to signings in the buildings mentioned above. The most active companies in the first quarter were those in the banking and finance sector as well as the consulting industry. This means that industries that are looking for high-end office space and are willing to pay the high rental prices continue to be active on the market.

# Investment market holding steady at last year's level

After the very strong year experienced by the Frankfurt investment market in 2013, the positive development has continued at the start of 2014 as well. In the first three months of the year, the total volume of commercial real estate changing hands in the Frankfurt market area came to € 732.4 million, a slight increase – 0.6% – over last year. The sale of 18 state government properties as part of the LEO I portfolio was the most significant deal in the German investment market. The police headquarters in Frankfurt accounted for about one-third of the volume, representing the largest transaction in Frankfurt. This one deal alone meant that portfolio sales accounted for 46% of the transaction volume for the first quarter.

## Project developers looking to leverage potential

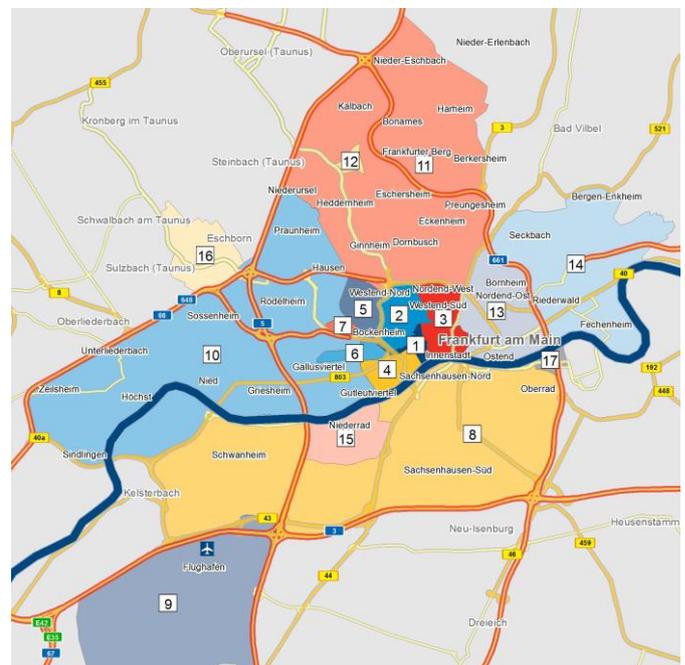
The Frankfurt investment market continued to focus on office properties in the first quarter of 2014, as in the past. With volume at € 617 million, about € 50 million more was invested than during the same period of last year. The number of transactions also rose, going from 13 to 20. With seven transactions and a volume of € 79.4 million, commercial properties followed in second place. The limited supply of existing properties makes properties in good locations an appealing alternative for investors looking to leverage opportunities through development projects.

This development also becomes clear if we look at investors' risk profiles. While core properties still make up the majority of all investments, accounting for 58% of transaction volume, developments and refurbishments follow, accounting for 32.8% and 18 transactions, significantly ahead of core plus properties. Alongside purchases of land for new developments, existing properties were also sold in the first quarter of the year, with the new owners expressing plans for conversion or refurbishment. Examples of this are found especially in the Westend area, where a large supply of outdated office space coincides with high demand for living space. In these areas, developers of residential properties are willing to pay prices significantly above the economic limits for office developers.

Open-ended real estate funds and special funds were the most active players on the market on both the buyer and seller sides. They sold nine properties collectively valued at over € 460 million and invested more than € 380 million in purchasing three properties. The main factor here was once again the purchase of the police headquarters building as part of the LEO I portfolio by Patrizia Immobilien AG, which plans to integrate

Fast Facts	
<b>Office letting</b>	
Take-up	82,000 m <sup>2</sup>
Letting take-up	82,000 m <sup>2</sup>
Prime rent	38.00 €
Vacancy rate	13.8 %
Office stock	11.6 mil.m <sup>2</sup>
<b>Investment</b>	
Transaction volume	732.4 mil. €
Largest group of buyers: Open-ended real estate funds and special funds	52.3 %
Largest group of sellers: Open-ended real estate funds and special funds	63.3 %
Most important type of real estate: Office	84.2 %
Prime yield office	4.85 %

## Sub-markets Frankfurt



- 1: Banking District / 2: Westend / 3: City
- 4: Central Station/Westhafen / 5: Bockenheim
- 6: Europaviertel/Fair District / 7: City West
- 8: Frankfurt South / 9: Airport / 10: Frankfurt West
- 11: Frankfurt North / 12: Mertonviertel / 13: Eastend West
- 14: Eastend East / 15: Niederrad / 16: Eschborn / 17: Kaiserlei

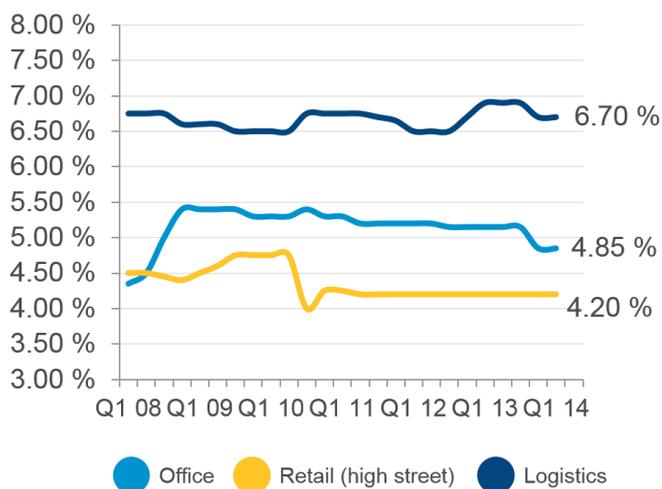
the portfolio into a special fund. Project developers and building contractors accounted for the largest number of purchases, acquiring 14 properties at a volume of about € 211 million. On the seller side, asset and fund managers were active alongside the open-ended real estate funds and special funds mentioned above. This group sold nine properties with a volume of € 155 million during the first three months of the year. No other group of investors passed the 100-million mark on either the buyer or seller side.

International investors have not yet made a major appearance in the transactions concluded so far this year. Accounting for about 6% of real estate purchases and about 20% of sales, this group is significantly below its figures for the same period of last year, at 19% and 55%, respectively. However, interest in Frankfurt as a location to do business remains high among international investors, so activity in this segment can be expected to increase as the year progresses.

## Stable yields, high demand

The ongoing high demand for core properties in top locations and the fact that the supply of these investment properties specifically has contracted from previous years have combined to keep gross prime yields stable at the low level of 4.85% for office properties. Retail properties continue to achieve the lowest yields, with the prime yield in this segment at 4.20%. The ratio of supply and demand is expected to remain the same over the rest of the year, so yields are expected to be stable.

Gross prime yield by asset type (in %)



## Supply of large-volume options severely limited

The high transaction volume seen in recent years has combined with the low completion volume to severely limit the supply of properties in Frankfurt with investment volume of over € 100 million. There are two properties on the market – the PalaisQuartier complex, consisting of the Nextower high-rise, the MyZeil shopping center, and a high-rise hotel, alongside the MesseTurm property – that could have a high impact on transaction volume if sold. The office buildings in the banking district that are in the project planning and construction stages offer further opportunities for investors who are willing to invest early on as part of forward deals.

## Summary and outlook: activity expected to pick up over the rest of the year

The year-on-year increase in take-up of office space is due primarily to the Deutsche Bank signing. In all other space segments, the quarterly result is below the previous year's figures. Since further large-scale requests are active on the market and attractive, modern office space in central locations is available for leasing, we expect to see new leases increase, especially in the large space segment. Greater activity is also expected in the segment encompassing smaller spaces, since the economic outlook remains positive, offering expansion opportunities for small and medium-sized companies. Total take-up of space can still realistically be expected to reach 500,000 m<sup>2</sup> for the year.

On the investment market, there is high demand from German and international investors who are looking for profitable investment options. After the large-scale transactions seen in recent years, however, the supply of top properties has been thinned out, exacerbating the competition for these properties. Project developers, who are responding to the short supply by tapping into new potential, will remain active. Alongside commercial properties and existing buildings in need of revitalization in the CBD, residential projects are also increasingly an area of focus for investors. The short supply of residential space and ongoing pressure from the large and growing local population have made residential construction projects an interesting alternative for project developers. As a result, conversion of older office buildings is expected to continue. We expect activity on the investment market to be brisk over the rest of the year, and in the event that the large-volume properties available for sale are in fact sold, the Frankfurt investment market should see a high transaction volume once again. Because the supply is lower, however, the market is not expected to be able to reach the same results as last year.

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# 485 offices in 63 countries on 6 continents

United States: **146**

Canada: **44**

Latin America: **25**

Asia Pacific: **186**

EMEA: **84**

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**€1.54**

billion  
in annual revenue

**€57**

billion in transaction volume with more than  
80,000 investment- and leasing-deals

**136**

million square metre  
under management

**15,800**

Professionals worldwide

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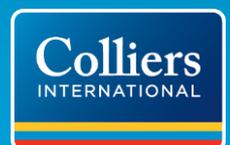
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