

Special Report

Residential Market Germany

2010/2011

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RESIDENTIAL MARKET & PORTFOLIO SALES GERMANY

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INTRODUCTION

Since the start of the financial crisis in 2007/2008, with the associated uncertainty in the capital and commercial property markets, investors worldwide have been seeking investment vehicles that provide stable value and a return on capital invested that exceeds that on government bonds and is above the rate of inflation. It appears that the risk-return profile of German residential property is attractive to private and institutional investors, both foreign and domestic. In 2008, CB Richard Ellis in Germany registered a slight decline in the demand for residential investment property. However, in 2009, and, in particular, in 2010, interest in residential investments has recovered significantly. In the first six months of the current year, the trend of a solidifying demand for German residential investment property is continuing to show.

1 RESIDENTIAL MARKET GERMANY

1.1 SOCIOECONOMIC SITUATION - DEMOGRAPHIC CHANGES

In the period until 2025, Germany will have to adjust to continuously increasing, disperse population trends. This is the conclusion of a current CB Richard Ellis investigation into demographic changes in Germany at local level. Based on data from the Federal Institute for Research on Building, Urban Affairs and Spatial Development (BBSR: Bundesinstitut für Bau-, Stadt- und Raumforschung), CB Richard Ellis have compiled forecasts for the 413 districts and administratively autonomous towns and cities in Germany, for the period 2007 to 2025. The analysis comes to the conclusion that population increases in German metropolitan cities such as Cologne (0.3%), Hamburg (0.7%), Berlin (0.9%), Frankfurt/Main (1.7%) and Munich (1.8%) will occur.

In addition, the conurbations around German cities in particular will experience more population growth than the "core" cities do. Accordingly, the largest population increases in

the whole range of towns, cities and districts are expected in the districts of Munich (16.4%) and Erding (16.8%). A similar situation applies in the districts of Potsdam-Mittelmark, near Berlin (10.0% rise) and Lüneburg near Hamburg (8.5%). The factors behind this positive trend towards urbanisation are the strong pull of the cities on the education and employment markets, their more sophisticated range of private and cultural services, and changes in the lifestyle of a large proportion of the younger population.

Consequently, by 2025 an average population increase of 3.5% can be anticipated in regions of western Germany that have a higher-order centre with over 100,000 inhabitants and a population density of less than 300 per sq km in the surrounding areas. The population of rural areas of Germany will continue to decline: they will have to expect an estimated 6% reduction by 2025.

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Nevertheless, the populations particularly of medium-sized university towns and cities will increase, such as, for example, in Ingolstadt (by 9.0 %), Freiburg im Breisgau (7.6 %), Regensburg (5.7 %), Aachen (5.3 %) and Tübingen (4.9 %). This generally positive trend is principally based on employment growth in the innovative and newly developing fields of science and technology and in industrial and service sectors, such as mechanical and automotive engineering, medical and solar technology. New industries have developed in these regions, due to government stimulus packages, market demand and the availability of public and private research and development facilities. In a nationwide comparison, the proportion of young (i.e. under 35) specialists and management staff in these regions is the highest.

In contrast, 225 districts and administratively autonomous towns and cities in Germany will have to cope with declining populations. 85 of the municipalities studied will actually lose more than 10 % of their populations by 2025. Particularly rural areas of Western Germany and large parts of Eastern Germany will be equally affected by this sharp population decline. Overall, the towns and cities that will have to cope with the sharpest falls include New Brandenburg (- 26.9 %), Suhl (- 26.1 %) and Gera (- 25.8 %). By 2025, the population of the whole of Germany is forecast to decline by 1.7 %. In the East of the country, the average fall will be as much as 10.0 %. Western Germany, however, can still anticipate a population increase of 0.4 %.

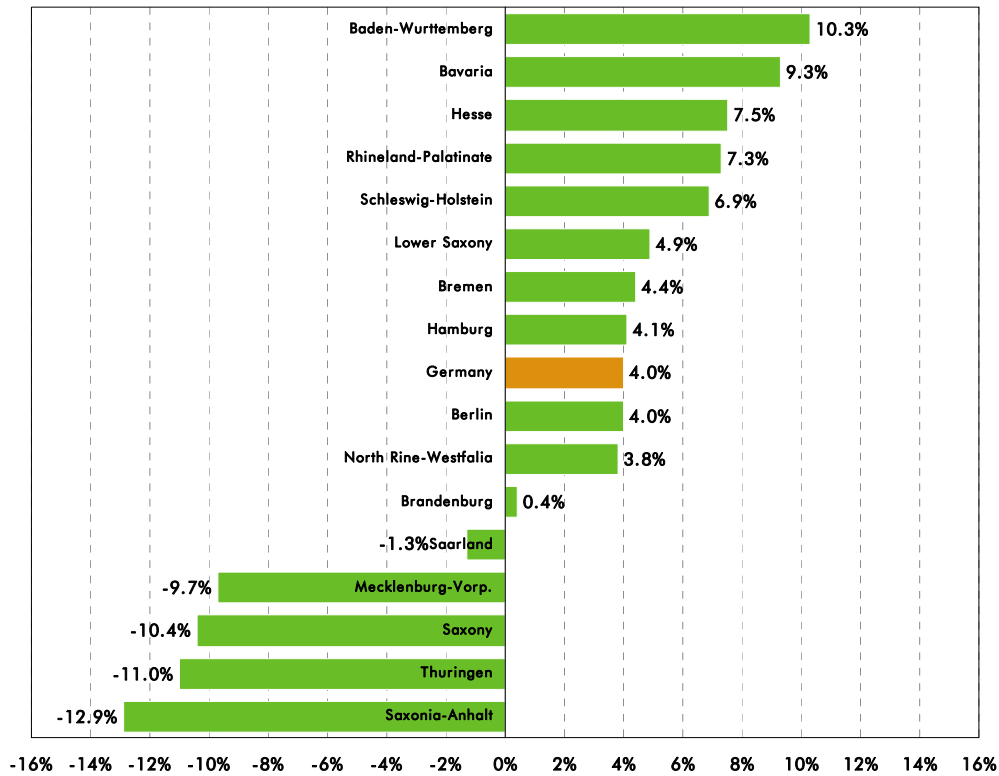
Fig. 1: Population forecast 2007-2025



Source: BBSR; CB Richard Ellis

The population trend is of secondary importance for the residential market. In fact, the crucial figure is the number of households. According to the current forecast of the Federal Statistical Office, the overall number of private households in Germany is expected to increase by approximately a million to 41 million. As a result of the decreasing size of the average household, the trends of population and of the number of households can move in different directions. For example, the population of the "new" federal states fell by 730,000 to 17.23 million during the 1990s, while the number of households increased by 390,000 to 8.22 million.

Fig. 2: Private household trends 2007-2025



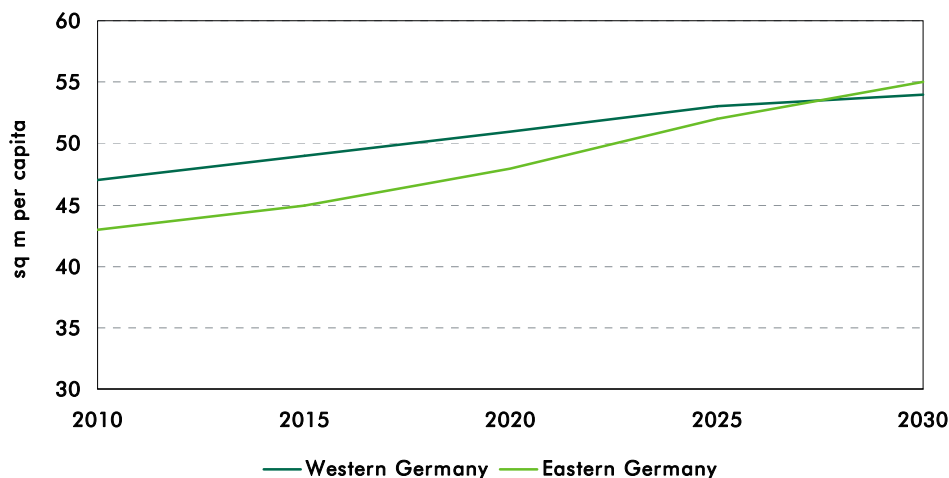
Source: Federal Statistical Office, BBSR; CB Richard Ellis

According to the BBSR's latest forecast calculations, the number of households in Germany will continue to increase during the next 15 years. The BBSR estimates that by 2025, the number of households will increase by 4 % nationwide. Nevertheless, on closer examination there is a difference between East and West. In the East of the country, the number of households is expected to decline by 5.9 %. In contrast, the number of households in Western Germany is predicted to rise by 6.7 % in the same period. A decline in household numbers is predicted for 26 of the 97 spatial planning regions. In 12 regions, a decline of more than 10 % in households is anticipated. In Western Germany, declines in household numbers will particularly affect areas with weak economies, such as Saarbrücken (1.3 % decline), Bochum/Hagen (3.1 %) and the Eastern part of Oberfranken (4.4 %). The highest growth rates are registered in metropolitan regions of Western Germany, such as Munich (13.6 %), Landshut (15.5 %) and Ingolstadt (16.1 %), the Southern hinterland of Hamburg (12.2 %) and Southern Schleswig-Holstein (11.8 %). Across Germany, the anticipated general trend until 2025 is that the number of households will increase in particular in the conurbations around core cities.

The reasons for the further increase in the number of households, while the population is stable or even declining, include the ageing of the population, the increasing proportion of single parents, and the general growth in the number of one-person households. For instance, according to the Federal

Statistical Office, the number of one-person households rose by 9 % between 2003 and 2009. In the same period, the number of households with more than one person fell by 1 %.

Fig. 3: Future Demand of Living Space in Germany

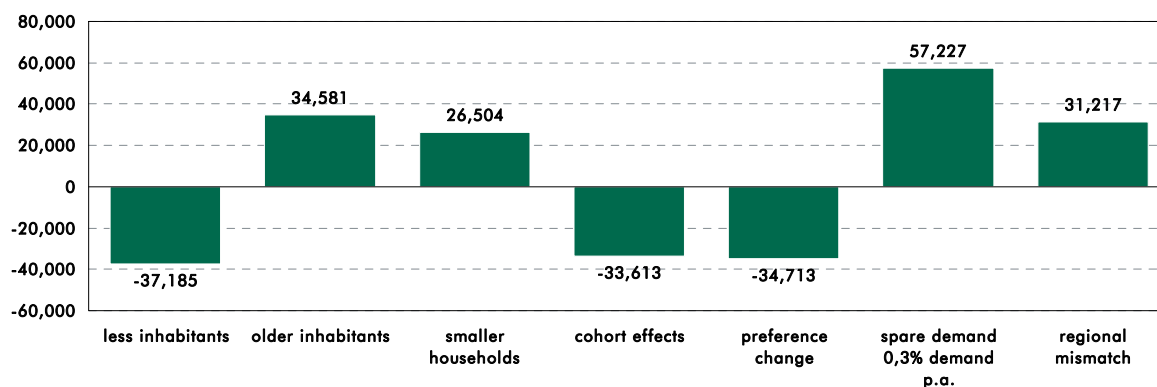


Source: empirica, LBS Research; CB Richard Ellis

In November 2009, the consultancy firm empirica AG compiled the comprehensive residential property market report (Germany up to 2040 – long-term trends and their significance for the property market) on behalf of BayernLB. In the report, empirica establish that, up to 2040, the annual additional demand in the residential market will remain relatively stable, despite the declining population. In the future, only a few spatial planning regions, e.g. the Alpine foothills in Bavaria, Baden-Württemberg and the conurbation around Hamburg can expect increases in residential demand of more than 15 %, whereas the demand in large areas of Eastern Germany will decline by up to 15 %.

Overall, empirica estimates that, by 2040, an increase in demand from the current 17.1 million residential units to 19.6 million can be expected in the market. In the next ten years, the demand for apartment buildings will dominate initially. Up to 2040, the estimated annual requirement for apartments in apartment buildings is 45,000. In contrast, annual demand for individual and duplex houses is around 130,000 residential units, due to a shift in preference towards individual and duplex (horizontally-divided two-family) houses.

Fig. 4: Summary of the annual additional demand for apartment buildings



Source: empirica; CB Richard Ellis

According to empirica, the demand for apartment buildings is already decreasing in 15 of the 97 spatial planning regions. Declining demand is particularly evident in Western Germany: in the Saarland, the Western Palatinate and the Eastern part of Oberfranken. By 2040, the demand for apartment buildings will decline by more than 5 % in more than half of the West German regions. In contrast, the demand for residential accommodation will increase in 15 of the 97 spatial planning regions. According to empirica, these include the Hamburg region, the Southern regions of Bavaria and Baden-Württemberg and the area around Cologne-Bonn.

In the East German regions, excluding Berlin and Potsdam, demand for apartment buildings will decline by more than 25 %. In the last few years, there have been attempts to reduce vacancy levels as part of the federal programme "Stadtumbau Ost" (urban renewal East) and other state programmes in Brandenburg, Thuringia and Saxony. Between 2000 and 2008, it is estimated that 3 % of the total housing stock in the new federal states, i.e. around 21 million sq m, was "reverse built", i.e. demolished. The vast majority of the buildings concerned were the no-longer-marketable Type WBS 70, the classic GDR "Plattenbau" (slab construction) blocks.

1.2 HOUSING STOCK

According to the Federal Statistical Office, at the end of 2009 (data for 2008 in brackets) there were approx. 41.18 (40.06) million residential units in residential and non-residential buildings (including individual and duplex houses) in Germany. This corresponded to a total floor area of 3.48 (3.46) billion sq m, equivalent to 491 (488) residential units per 1,000 inhabitants and an average floor area of 86.6 (86.4) sq m per residential unit. Statistically, this is equivalent to 42.5 (42.2) sq m of residential accommodation per capita, with an average of 4.4 rooms per residential unit.

4-room apartments are the most common units (29.3 %), followed by 3-room (21.4 %) and 5-room (19.6 %) apartments. 10.6 % of residential units (mainly detached and terraced houses) have six rooms, while 10.9 % have seven or more rooms. Two-room (6.1 %) and one-room (2.1 %) apartments are the smallest categories.

In early 2011, the net asset value of residential properties, valued at costs of replacement, amounted to more than 4.2 trillion €. Thus, the residential property market contributed more than half of the total amount to Germany's net asset value.

With regard to the ownership structure, in 2006 the IfS (institute for social research) together with the GdW (federal association of residential and real estate firms) compiled the following findings, on the basis of the 39.62 million residential units:

Fig. 5: Ownership of residential stock 2006 (1)

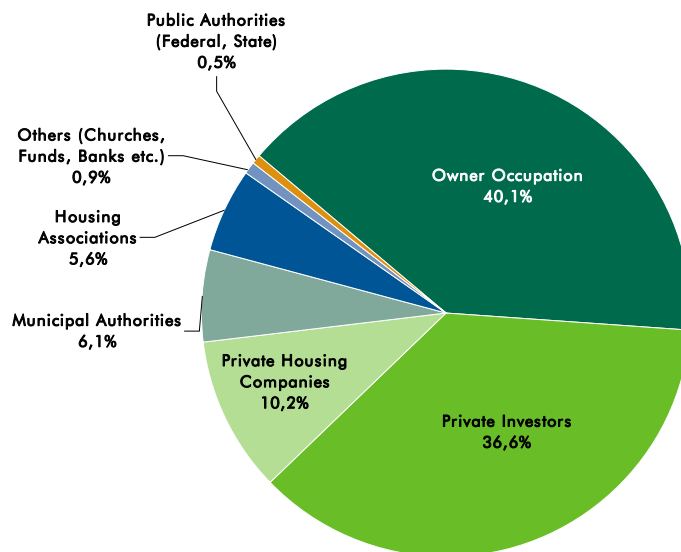


Fig. 6: Ownership of residential stock 2006 (2)

Ownership of residential stock 2006 (shares %)	
Owner-Occupation	40.1 %
Private Investors	36.6 %
Private, institutional Housing Companies	10.2 %
Municipal Authorities	6.1 %
Housing Associations	5.6 %
Others (Churches, Funds, Banks etc.)	0.9 %
Public Authorities (Federal, State)	0.5 %

Ownership of residential stock 2006 (number of units)	
Owner-Occupation, there of	
Single-family houses, terraced houses	12,812,000
Apartments	3,081,000
Private Investors, there of	
Single-family houses, terraced houses	5,421,000
Apartments	9,089,000
Private, institutional Housing Companies	4,059,000
Municipal Authorities	2,434,000
Housing Associations	2,217,000
Others (Churches, Funds, Banks etc.)	301,000
Public Authorities (Federal, State)	206,000
Total	39,620,000

Source: IFS & GdW annual statistics; CB Richard Ellis

In 2004, Deutsche Annington (Terra Firma Capital Partners) became the largest owner of residential properties in Germany, following their acquisition of the Viterro Portfolio. Their portfolio now includes around 185,000 residential units. In second place, close behind, is the listed company GAGFAH (Fortress Investment Group), which has around 170,000 residential units. In third place, after its long-heralded takeover of the THS housing portfolio, is Evonik AG, which has around 132,000 residential units. The public housing association SAGA GWG (Hamburg), which owns around 131,000 residential units, is next. Fifth but fairly well behind in the ranking of German residential asset managers is LEG Nordrhein-Westfalen (Goldman Sachs), with 92,000 residential units.

Fig. 7: Top 12 residential asset managers

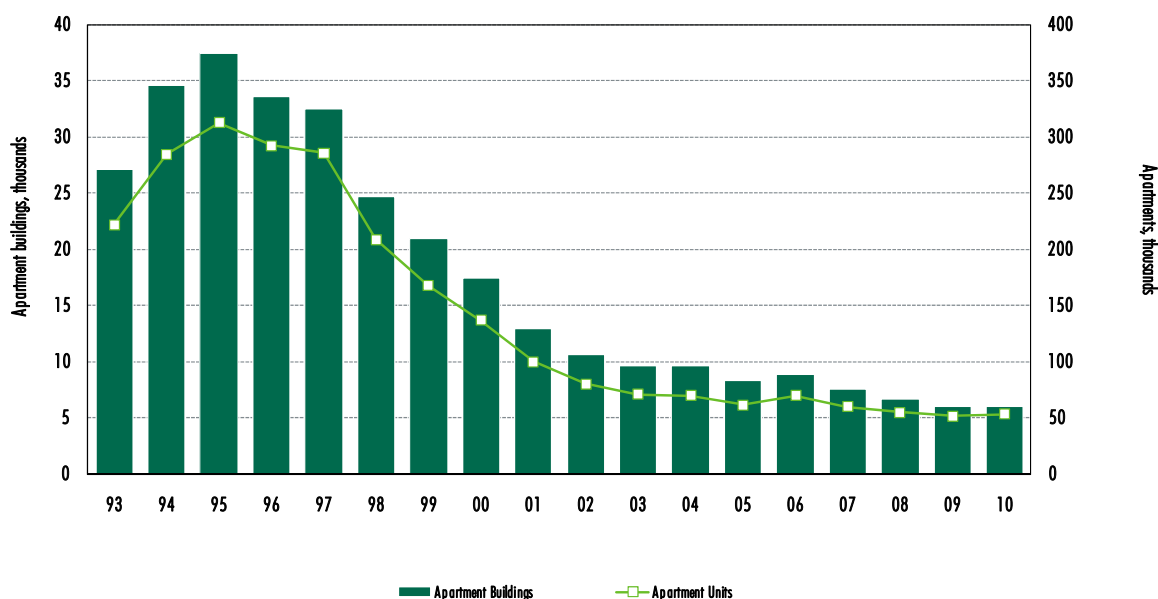
	Housing Company	Regions	Type	Number residential units approx.
1	Deutsche Annington	Germany	Institutional Investor (Terra Firma)	185,000
2	GAGFAH	Germany	Listed Company (Main Investor Fortress)	170,000
3	Evonik / THS	North Rhine-Westphalia	Industrial Company	132,000
4	SAGA GWG	Hamburg	State Authorities	131,000
5	LEG	North Rhine-Westphalia	Institutional Investor (Goldman Sachs)	92,000
6	Gewobag	Berlin	State Authorities	72,000
7	Nassauische Heimstätte	Hesse	State Authorities	64,000
8	Pirelli RE / RREEF	North- and Eastern Germany	Institutional Investor (Joint-Ventures)	60,000
9	degewo	Berlin	State Authorities	55,000
10	GSW	Berlin	Listed Company (Main Investor Cerberus; Goldman)	51,500
11	Deutsche Wohnen	Hesse, Rhineland-Palatine, Berlin	Listed Company	51,000
12	ABG	Frankfurt	Municipal Authorities	50,000

Source: CB Richard Ellis

1.3 RESIDENTIAL DEVELOPMENT ACTIVITY

Housing development in Germany has been declining for many years. After the reunification boom and the stimulus resulting from the introduction of the state subsidy for homebuyers, the so-called *Eigenheimzulage*, a collapse emerged in residential development. In 1997 around half a million new residential units were constructed; by 2010 this figure had fallen to 140,100 units. Thereby, the completion of apartments in apartment buildings increased by 3.0 %, and that of detached houses by 2.7 %. Compared to 2009, the residential development activity thus increased slightly by 2.6 %. Nevertheless, the market is still far from a change in trend. A decrease of 2.8 % was registered in two family houses.

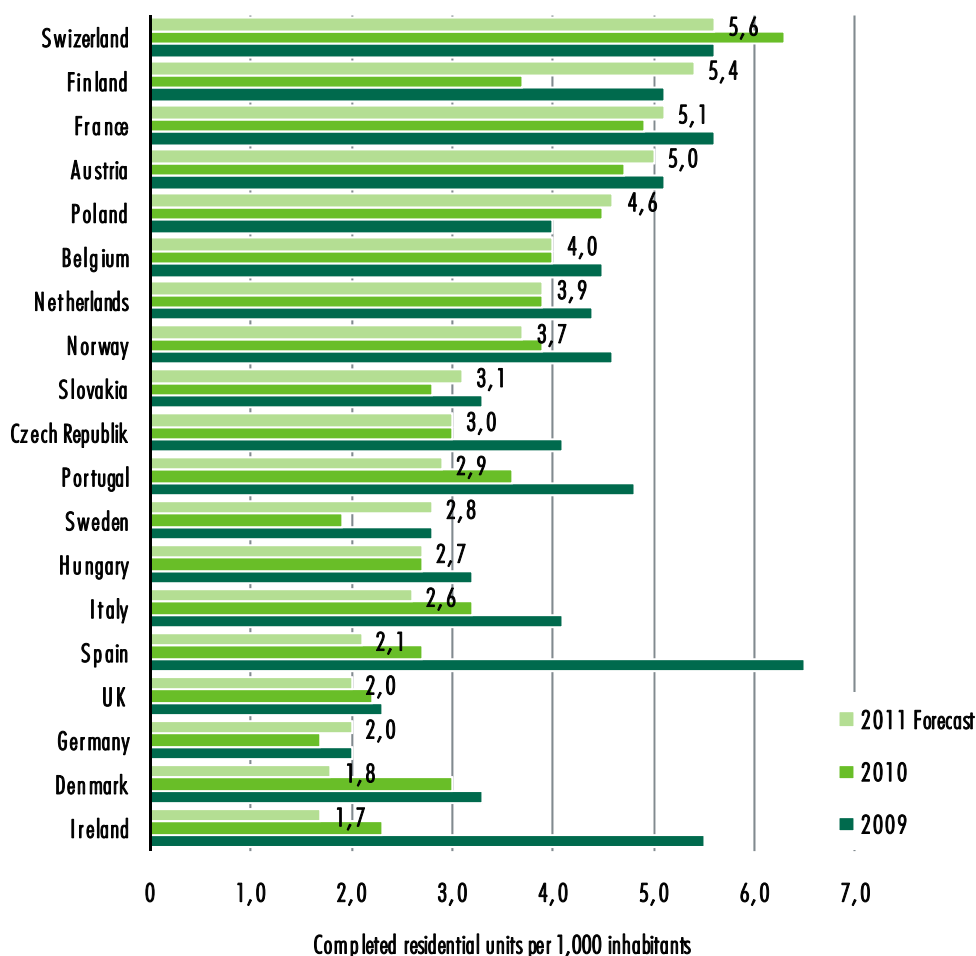
Fig. 8: Completions of apartment buildings and apartments in Germany, 1993-2010



Source: Federal Statistical Office; CB Richard Ellis

Although the number of planning consents has bottomed out and the residential developers who were surveyed in the ifo business survey *Konjunkturtest* report a considerable improvement in the business climate, the ifo Institute for Economic Research still sees no true revitalisation for Germany. This is because in 2012 completions will still be well below the benchmark of 200,000 residential units p.a. In addition, the largest proportion of the apartment building projects that are currently under construction are targeted at the higher or highest price segments. Apartment buildings are being divided up and are then sold as condominium units to owner-occupiers or investors. Privately financed residential development for letting will continue to play only a subordinate role. The main reasons for this are high land prices and, by European comparison, high construction costs. Privately financed developments of rented accommodation are not financially viable below achievable rents of 9 to 11 € per sq m per month. Higher rents are, however, only achievable in economically prosperous regions and in good locations.

Fig. 9: Residential completions in Europe – Residential units completed per 1,000 inhabitants



Source: LBS Research & Euroconstruct; CB Richard Ellis

As a result and according to the latest surveys by LBS Research in association with Euroconstruct, Germany is still occupying lower ranks in Europe in terms of completions per capita. Even though Germany has managed to leave the bottom of the table for the first time in six years, the construction activity in 2011 is still much lower than that of most neighbours. Approx. 2.0 residential units per 1,000 inhabitants were constructed in Germany, which is around two thirds less than in Switzerland, the front runner. In consequence of the global financial crisis, the Danish housing market has also clearly suffered. The situation in Spain and Ireland is even more dramatic, as new construction activity has virtually collapsed compared to the boom years. Four years ago, Spain was still constructing 17.4 units per 1,000 inhabitants, as opposed to only 2.1 in 2011. In Ireland, the apartment construction activity is currently at 1.7, which is less than one tenth of the value of 2006, when 21.3 residential units per 1,000 inhabitants were still completed.

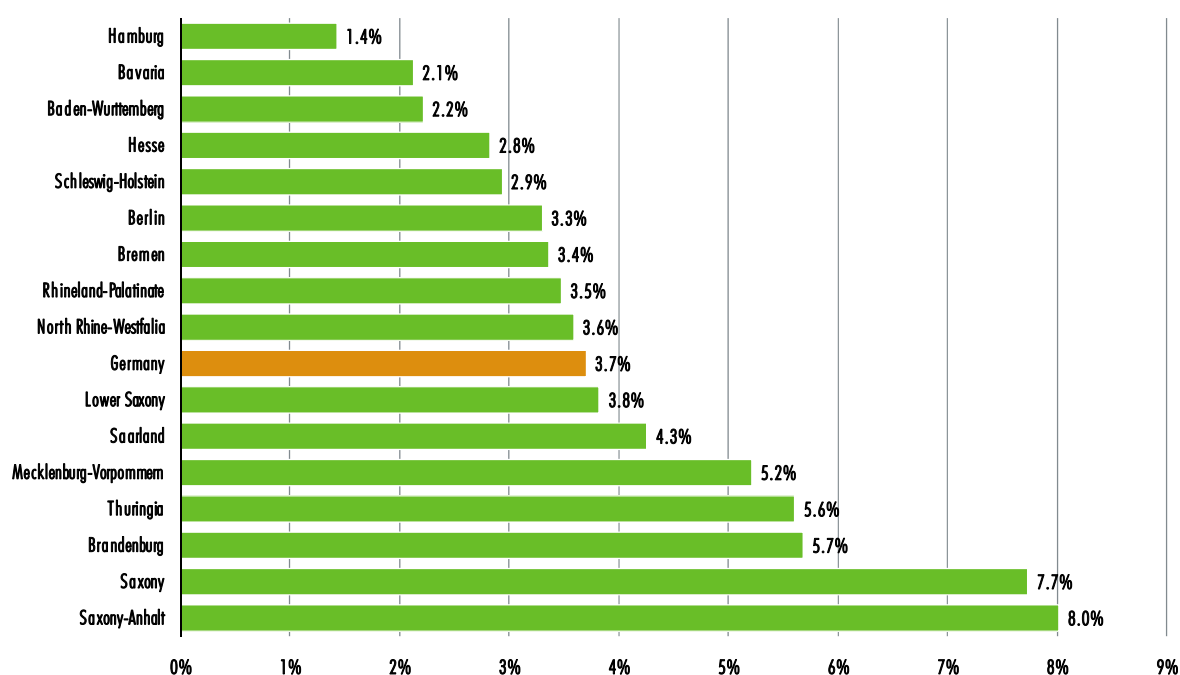
In the medium term, completions per capita in Germany will remain low in a European comparison, despite further increases. According to estimations of the ifo institute for Economic Research, around 2.5 residential units per 1,000 inhabitants will be constructed in 2013. Compared to 2009 this is an

increase of almost 50 %. However, the construction activity is still far from reaching the record values of the mid nineties, when Germany was raised with almost 7 residential units per 1,000 inhabitants.

1.4 VACANCY SITUATION

According to the Techem-empirica vacancy index 2009, the vacancy rate for apartment buildings in Germany averaged around 3.7 %. Vacancy in Germany had therefore hardly changed compared to the previous year. However, the vacancy rate of 5.8 % in Eastern Germany was considerably higher than the 2.9 % recorded in Western Germany. In Hamburg, the residential vacancy rate increased from 1.3 % to 1.4 % in one year. The situation in Eastern Germany is clearly in contrast: vacancy rates have fallen by up to -1.6 % in comparison to the previous year, but the level of vacancy is still very high.

Fig. 10: Vacancy rate in apartment buildings by federal state, 2009

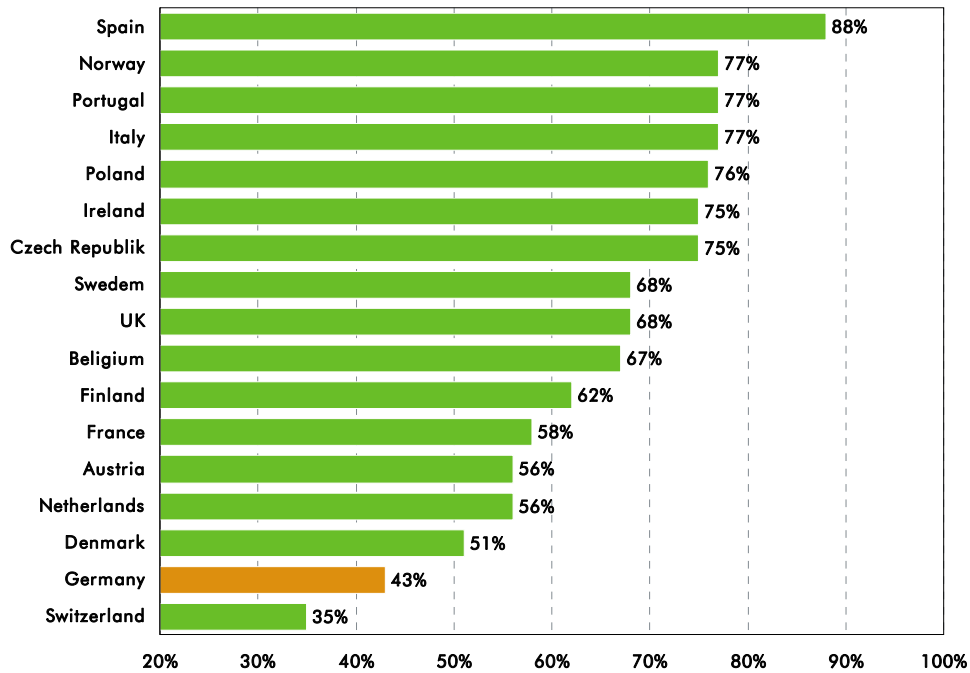


Source: Techem-Empirica-Index 2009; CB Richard Ellis

In 2009, a total of 774,000 units in apartment buildings stood empty. 329,900 of these were in Eastern Germany, including Berlin. 444,100 were in the West of the Federal Republic. The high level of development activity in Eastern Germany in the mid-1990s, spurred on by tax breaks, is still having an effect on vacancy.

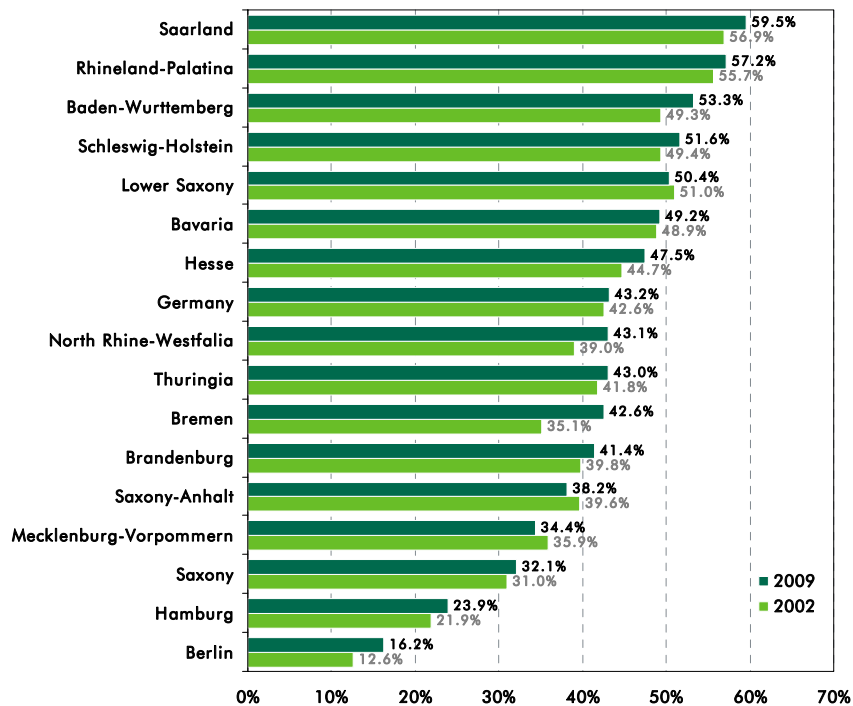
1.5 PROPORTION OF RESIDENTIAL OWNER-OCCUPATION

Fig. 11: Home ownership international 2009



Source: Euroconstruct, ifo-institute; CB Richard Ellis

Fig. 12: Home ownership Germany by federal state, 2009



Source: Federal Statistical Office; CB Richard Ellis

International comparison

Germany has the second-lowest proportion of residential owner-occupiers in Europe. In 2009, the proportion of owner-occupiers was still only 43 %. Only Switzerland had a lower proportion (35 %). Since the last expansion of the EU, the overall EU average is now around 65 %. In comparison, 69 % of housing in the USA is owner-occupied.

Comparison by Federal State

The relative proportions of owner-occupiers in the federal states have hardly changed in the last few years. The proportion of owner-occupiers is lowest in those federal states, where municipal real estate owners with partly publicly-subsidised portfolios of apartments play an important role in the provision of housing. These include, in particular, the city states of Berlin and Hamburg and the cities in Saxony.

Between 2002 and 2009, the proportion of owner-occupiers, expressed as a federal average, rose only insignificantly from 42.6 to 43.2 %. The main reason for this is the change of generations: in older age groups, a higher proportion of households rent accommodation than in younger generations. Further, individual privatisations are also behind the change, at least to a minor extent. For example, a sharp increase in the proportion of owner-occupation has been seen in the federal states of Berlin, North Rhine-Westphalia and Bremen, where large-scale residential portfolios have been traded.

From 2005 to mid-2007, the low proportion of owner-occupation was used as the major indicator for the issue of "individual privatisation" of residential units to tenants, owner-occupiers and investors. Many investors regarded privatisation potential as a way of increasing possible profit and as part of their business models. In addition to the low proportion of owner-occupation, there are other plausible reasons for the successful marketing of privatised, formerly rented apartments (transformation):

- low mortgage rates as an incentive for private property purchase;
- according to a survey of the building societies *Bausparkassen*, residential owner-occupation is by far the favourite way of investing for pensions;
- Government plans to integrate owner-occupied housing in the so-called *Riester-Rente* pension model (implemented in 2008);
- an increased proportion of households receiving inheritances and investing some of the funds in owner-occupied housing;
- the residential market in cities such as Munich, Stuttgart and Hamburg, where condominium apartments are in short supply.

However, the experience of the last few years has shown that expectations for individual privatisation were set too high. The reasons for this are principally:

- an adequate supply of well-fitted apartments for rent in most of the regional housing markets;
- the majority of the residential portfolio transactions took place in federal states such as Berlin, North Rhine-Westphalia and Saxony, where both purchasing power and household savings rates are relatively low compared with the federal average;
- the mentality of German tenants. It is considerably easier, in terms of finance, time and organisation required, to rent an apartment rather than buying a condominium;
- in Germany, at least in the cities, there is no stigma attached to living in a rented apartment: it is regarded as socially acceptable.

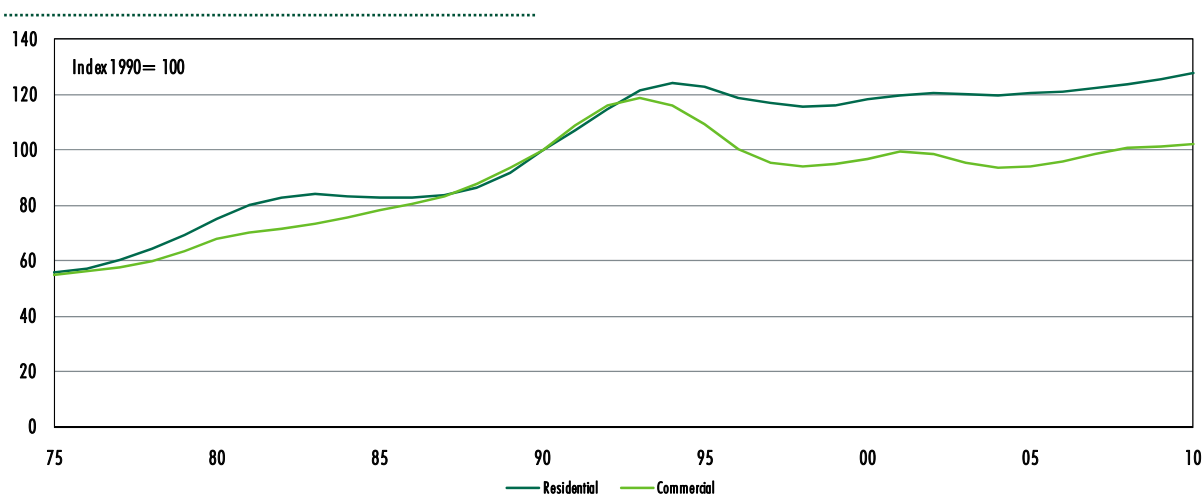
Individual privatisation only appears to be promising for old buildings from the turn of the century¹ and new developments with few residential units, in good locations. Individual privatisation of large apartment portfolios dating from the 1950s, 1960s and 1970s, with mainly older tenants, is difficult and labour-intensive. In addition, a minimum price level must be achieved on sale, in order to cover privatisation costs (subdivision, marketing etc.).

Since the end of 2007, bank lending for the financing of residential property portfolios, where the purchaser includes projected proceeds from individual privatisation in his or her business plan, has been dealt with very restrictively.

1.6 RENTS AND SALE PRICES

A study of the BulwienGesa AG German Property Market Index since 1990 shows that investments in residential property have been more profitable than those in the commercial property sector. Rents and sale prices for residential property are stable in the area of 120 index points (1990 = 100), while commercial rents and sale prices are below, or in the last few years only slightly above, their 1990 levels.

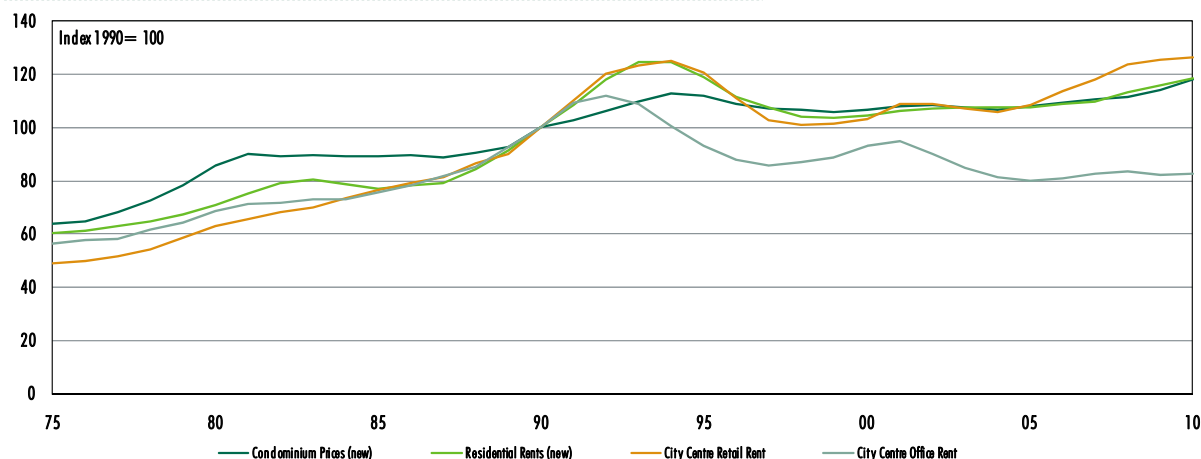
Fig. 13: German property market index



Source: BulwienGesa AG; CB Richard Ellis

It should be noted that refurbished apartments in older buildings have made the greatest contribution to this trend. Since 1990, rents for refurbished apartments in older buildings have risen by 40 % on German average. It should be noted that BulwienGesa AG calculates its property market index on the basis of nominal values, without taking into account the rate of inflation.

¹ *Gründerzeit*, the period of rapid industrial expansion in Germany (roughly equivalent to the late Victorianism)

Fig. 14: German property market indices in comparison

Source: BulwienGesa AG; CB Richard Ellis

1.7 REGIONAL DIFFERENCES

As described in the previous chapter, in Germany there are significant differences between regions and cities in terms of meaningful residential market indices. The trends of sale prices, rents and gross multipliers follow the trend of population change, economic tendencies, residential completions, vacancy rates and the absolute extent of the supply of housing.

From an investor's point of view, the locations with most potential are not necessarily cities such as Hamburg, Munich and Berlin but rather those towns and cities with favourable purchase prices to rental income ratios. In other words, the higher the potential for rental value growth and the lower the purchase price multiplier, the more promising the location is as an investment.

In general, expressed as a long-term average, nominal rental growth - depending on quality and location - is below the inflation rate. In some districts of Eastern Germany there has actually been a real decline in rental values.

By analysing more than 1.5 million anonymised rents of existing properties and new lettings in the period 2007 to 2009, together with an analysis of the socio-economic indices, completions, the property market reports published by the local valuation boards and statistics from transactions carried out under instructions, CB Richard Ellis has concluded that university towns and cities in Western Germany offer favourable risk-return profiles. These include inter alia Darmstadt, Erlangen, Ingolstadt, Mainz and Augsburg. The only East German town in this top bracket is Jena.

Fig. 15: CBRE purchase price to rental income ratio



Source: CB Richard Ellis

For investors with a so-called “buy and hold” strategy, there is little point in restricting investment to a handful of cities. However, compared with the main investment centres, local residential property markets in medium-sized towns can react more sensitively to the development or new construction of large-scale residential complexes.

2 RESIDENTIAL PORTFOLIO-TRANSACTIONS IN GERMANY

Continuing uncertainties in the financial markets and weakened global economic performance have caused a crisis of confidence for many investors, including banks and institutional investors. The returns on alternative investments have either fallen sharply or, under present market conditions, have too high an investment risk. The significantly increased sensitivity to risk was reflected in the collapse of the investment volumes flowing into commercial property in 2008 and 2009. Although it is now more than a decade since institutional investors established residential property as an asset class, residential portfolios have moved even more strongly into the focus of investors since the start of the financial crisis. Residential investments, with their low volatility in values and secure, reliable cash flows, are viewed as a comparatively low-risk asset class. Under current restrictive lending conditions, banks are more likely to be prepared to finance a residential portfolio transaction that, with its relatively secure and steady income flow, presents a lower risk of credit default than the acquisition of commercial property using borrowed capital.

In the last few years, the German housing sector has emerged as a predominantly stable investment market. It therefore differs from countries such as the USA, the UK and Spain, where the housing sector was considered to be the cause of the persistent financial and economic crisis. A positive factor is that, in Germany, there was less speculative spin and no real estate bubble. One of the main reasons for this is the importance of low-risk fixed-rate mortgages and building society savings contracts in private real estate finance, together with the absence of a sub-prime market (a market in private mortgages mainly involving borrowers of doubtful creditworthiness).

2.1 LEGAL FRAMEWORK

Basis of assessment for Grundsteuer (land tax)

In its decision published on 11 August 2010, the federal fiscal court (Bundesfinanzhof) held that a revaluation of real estate for the levying of land tax (Grundsteuer) is required. Without regular revaluations, the current assessed values for real estate are incompatible with the requirements of constitutional law. The extent to which this will have an effect on investment activity involving the existing residential stock remains to be seen. According to latest reports, the federal ministry of finance has stated that a decision on the basis of assessment to be adopted will not be made until spring 2011.

Increase in property transfer tax (Grunderwerbsteuer)

Real estate purchasers in Germany will have to adapt to increased transfer costs. As many as four federal states have increased the transfer tax by the 01.01.2011. Bremen and Lower Saxony have raised the rate of taxation from 3.5 % to 4.5 %. Saarland at least raised the land transfer tax to 4 %. However, they are discussing a further increase in two steps to 5 % by spring, 2013. Baden-Württemberg and Rhineland-Palatinate also want to raise the transfer tax to 5 %. In doing so, they are following the example of Berlin, Hamburg and lately Saxony-Anhalt. All three states raised the rate of taxation from 3.5 percent to now 4.5 percent. Brandenburg, and later on in April also Thuringia, even carried out a rise to 5 % for reasons of budgetary consolidation. Schleswig-Holstein wants to follow as of 2012, planning to also raise the rate of taxation to the record level of 5 %.

Transfer tax (Grunderwerbsteuer), which is payable on real estate transactions, is based on the sale price. Until September 2006, the government established the rate of transfer tax at a uniform 3.5 %. Since then, the federal states have been free to set their own rates.

Considering the tense situation of federal, state and municipal budgets and the decision to cap borrowing, a comprehensive increase in tax rates is an entirely realistic scenario. A study by the RWI economic research institute in Essen estimated the total funding requirement of the 16 federal states at 27 billion € in coming years. From 2020 onwards, the states will not be allowed to incur any additional debts.

Energy saving regulations EnEV 2009 (Energieeinsparverordnung)

The federal government's resolutions for an integrated energy and climate programme (IEKP) have been implemented, in relation to buildings, by amending the energy saving (and heating cost) regulations. The federal government resolved to amend the energy saving regulations (EnEV) on 18th June 2008. On 6 March 2009, the Bundesrat (Federal Council of the German Parliament) gave approval, subject to a few amendments that were adopted by the federal government on 18 March 2009. The amendment to the energy saving regulations came into force on 1st October 2009.

The aim of the amended regulations is to reduce the energy requirements for heating and provision of hot water in buildings by around 30 %. In a further step, under the integrated energy and climate programme (IEKP), as of 2012 the energy standards are to be increased by up to a further 30 %.

A summary of the amendments to the EnEV 2009:

- New buildings: the upper limit for the allowable annual demand for primary energy will be tightened by an average of 30 %.
- New buildings: the energy requirements for thermal insulation of the building envelope will be increased by an average of 15 %, i.e. the thermal insulation of the building envelope must achieve an average 15 % more performance than before.
- Modernised older buildings: when modernisation of older buildings includes major structural changes to the building envelope (e.g. replacement of the façade, windows, and roof), the energy requirements for building components will be tightened by an average of 30 %. Alternatively, the owner/developer can decide to refurbish to 1.4 times the standard required for new buildings. This refers to the requirements for annual primary energy requirements and for thermal insulation of the building envelope.
- The requirements for insulation of upper, non-accessible (attic) ceilings will be tightened. By the end of 2011, the highest accessible ceiling must also be thermally insulated. In both instances, insulation of the roof is accepted as sufficient. The exemption for owners of individual and duplex (horizontally-divided two-family) houses will be retained, provided that the owner was resident in the property on 1st February 2002. On a change of ownership, the purchaser of the property must comply with the requirements within two years.
- In the case of air-conditioning installations that are intended to change the humidity of indoor air, an obligation to retrofit equipment for the automatic control of humidification and dehumidification is planned.
- In larger buildings, electric night storage heaters that are more than 30 years old must be taken out of service and replaced by more efficient heating systems. This affects residential buildings with at least six apartments and non-residential buildings with a lettable area of more than 500 sq m. The obligation to take these heaters out of service will be applied in stages up to 1st January 2020. Provided that the building complies with the requirements of the thermal insulation regulations (Wärmeschutzverordnung) 1995, there is no obligation for replacement if this would be uneconomic or if planning regulations require the use of electric night-storage heating systems (e.g. stipulations in development plans).
- Measures to ensure compliance with the regulations will be tightened: certain tests will be made the responsibility of the head chimney sweep of the district (Bezirksschornsteinfegermeister, responsible for carrying out emissions tests etc.) and the requirement for proof (so-called contractor's declarations) will be introduced when certain works are carried out to the building stock. Uniform regulations for fines, in the event of violation of the central regulations of the EnEV, will be introduced. Violations of certain EnEV requirements for new and older buildings and the provision and utilisation of fake data for energy performance certificates will be sanctioned as regulatory offence.

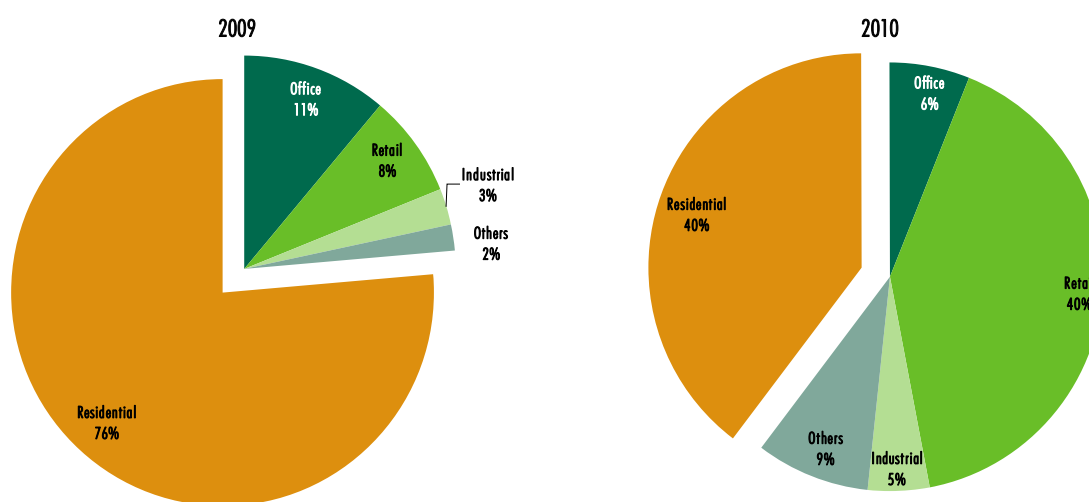
Under the government subsidy programme between 2006 and the end of 2008, which had an investment volume of 35.5 billion €, around 900,000 apartments were either newly constructed for energy efficiency or comprehensively refurbished. The most common energy-related refurbishment works carried out by owner-occupiers, private landlords and companies were thermal insulation, replacement windows, installation of solar panels and the replacement of heating installations. This was the conclusion of a survey of 5,500 private owners and 250 residential companies, who had taken up KfW funding for climate-friendly modernisation, by the KfW-Bankengruppe and the Institute for Economic Research, Cologne. According to the survey, an average owner-occupier spent 288 € per sq m on the refurbishment, private landlords 394 € and residential companies spent 522 € per sq m. After the refurbishment, private landlords increased their rents by an average of 10 % and residential companies by an average of 27 %. However, the main aim of both private landlords and companies was the preservation of the structure of the property and the improvement of its residential standard.

2.2 PORTFOLIO INVESTMENTS: COMMERCIAL VS. RESIDENTIAL PROPERTY

In the sector of portfolio investments in commercial property, 2009 was very heavily predominated by the recession and the consequences of the financial crisis. The total volume invested in commercial property was only 1.14 billion €. Residential portfolio transactions were predominant, registering a volume of 3.67 billion €, 76 % of the total investment volume in the market.

The extent to which this market share is dependent on individual portfolio transactions is demonstrated by the year 2010. As a result, in particular, of the sale of a shopping centre portfolio to the Netherlands-based Corio N.V., the market share of portfolio investments in retail properties rose to 40 %. In the same period, the volume of residential portfolio transactions was around 3.25 billion €: also a 40 % market share and around 12 % less than in the same period a year earlier.

Fig. 16: Investment transaction volume in Germany by type of property

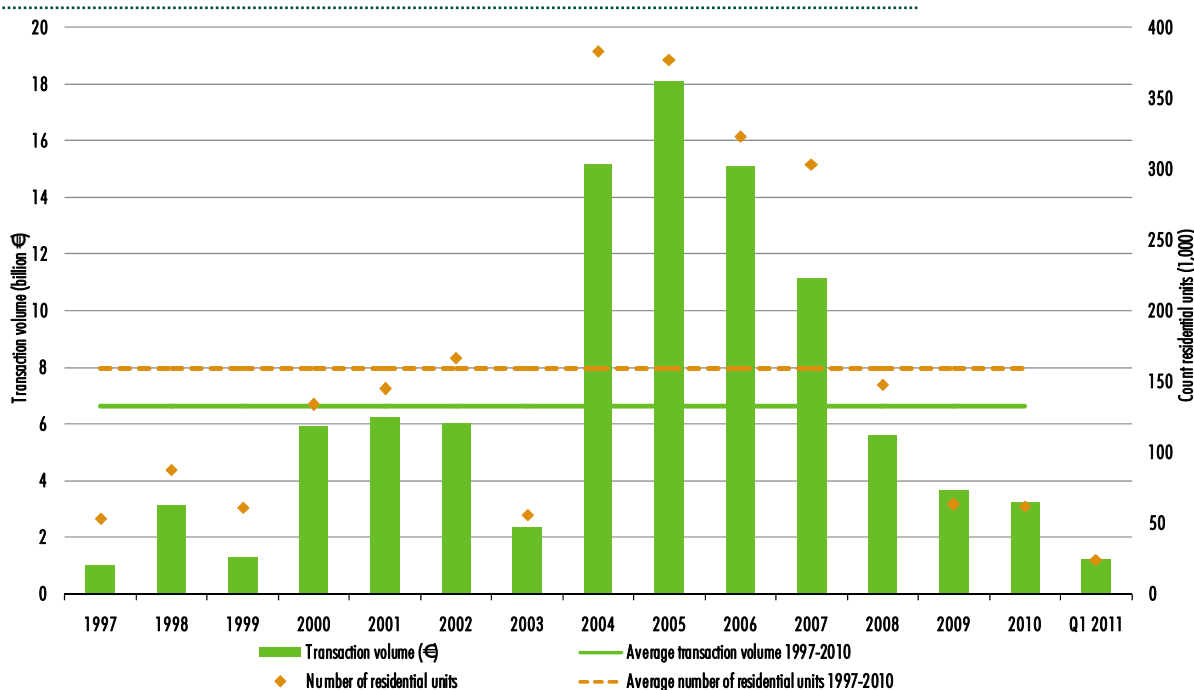


Source: CB Richard Ellis

2.3 PORTFOLIO TRANSACTIONS

In 2010, a transaction volume of 3.25 billion € was registered for the residential property investment sector (sales of more than 100 residential units) in Germany. The previous year's result of 3.67 billion € was not achieved because of a low transaction volume in the second half of 2010. Both the transaction volume and the number of residential units changing hands have therefore fallen for the fifth year in succession and are now well under the long-term average. However, (despite how paradoxical it may appear in view of this trend) if there are any real estate investments that have benefitted from the last crisis, in Germany it would have been investments in residential property. In the expectation of comprehensive government rescue packages in the wake of the financial crisis, a scenario under which the high levels of indebtedness in the budgets of many EU countries will result in increasing inflation is likely. The residential property investment sector is therefore regarded as having particularly high potential, not least because of its assumed high level of inflation proofing² and comparatively constant rental income. In addition, there is currently a shortage of possibilities for alternative investments, due to difficult financing conditions with high risk surcharges, a shortage of supply or unattractive trends of return. A transaction volume of 1.20 billion € in the first quarter of 2011 indicates a result for 2011 above the previous year's result.

Fig. 17: Portfolio transaction volume and number of residential units (portfolios > 100 units)



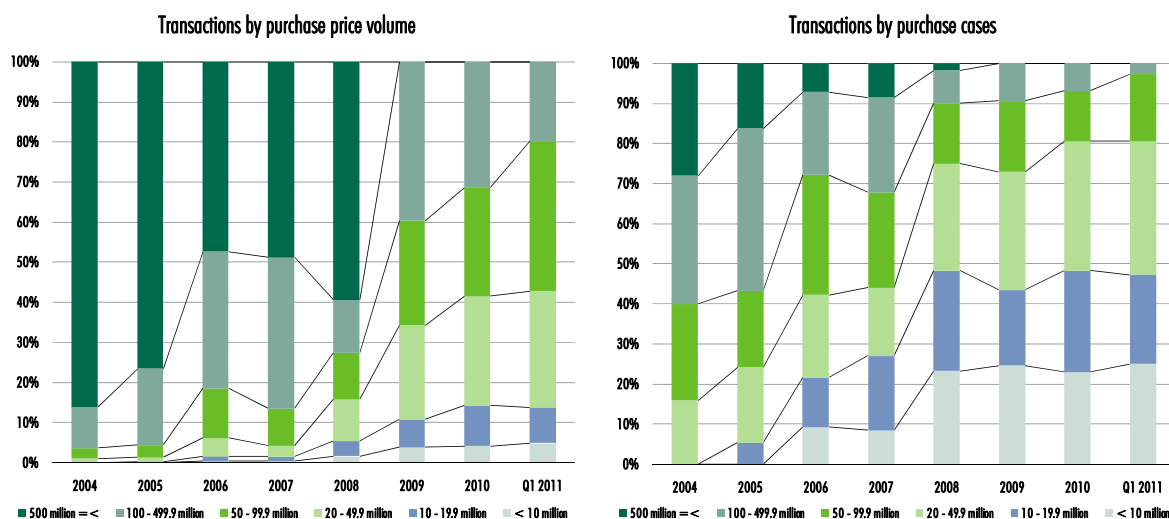
Source: CB Richard Ellis

Since the start of the financial crisis, the residential property investment market has also undergone some changes. During the peak of the last boom, up to 2007, the yield gap between good and poor locations became even narrower, which made the acquisition of larger portfolios even more attractive.

2 See: IWK Köln 2009 (internet: http://www.immobilienekonomik.de/fileadmin/docs/PM_06-Immobilien.pdf, 26.05.2010);
 See: Financial Times Deutschland 2010 (internet: <http://www.ftd.de/finanzen/immobilien/immobilieninvestitionen-warum-wohnungseigner-die-inflation-herbeisehnen/50086886.htm>, 26.05.2010);
 See: Focus 2009 (internet: http://www.focus.de/finanzen/altersvorsorge/tid-14356/immobilien-wann-betongold-vor-der-inflation-schuetzt_cid_395472.htm, 26.05.2010)

Since the crisis has begun, the higher risks have been reflected in higher yields and lower sale prices. Properties in poor locations, or of only mediocre structural quality (and therefore high risk of vacancy and requiring greater outlay on repair and maintenance) now play just a minor part in the market. As a result, the average size of packages sold, measured by the number of residential units included, has fallen considerably since 2008, with corresponding effects on the transaction volume. In terms of the number of sales, in 2010, the main focus of the market activity was on deals between 20 and 49.9 million €. Shortage of supply of such properties was the main reason why there was not a larger number of high-volume transactions. The demand was strongly concentrated on the premium segment, which includes new and refurbished older buildings in cities that are growing in population and economic strength.

Fig. 18: Residential portfolio transaction by size



Source: CB Richard Ellis

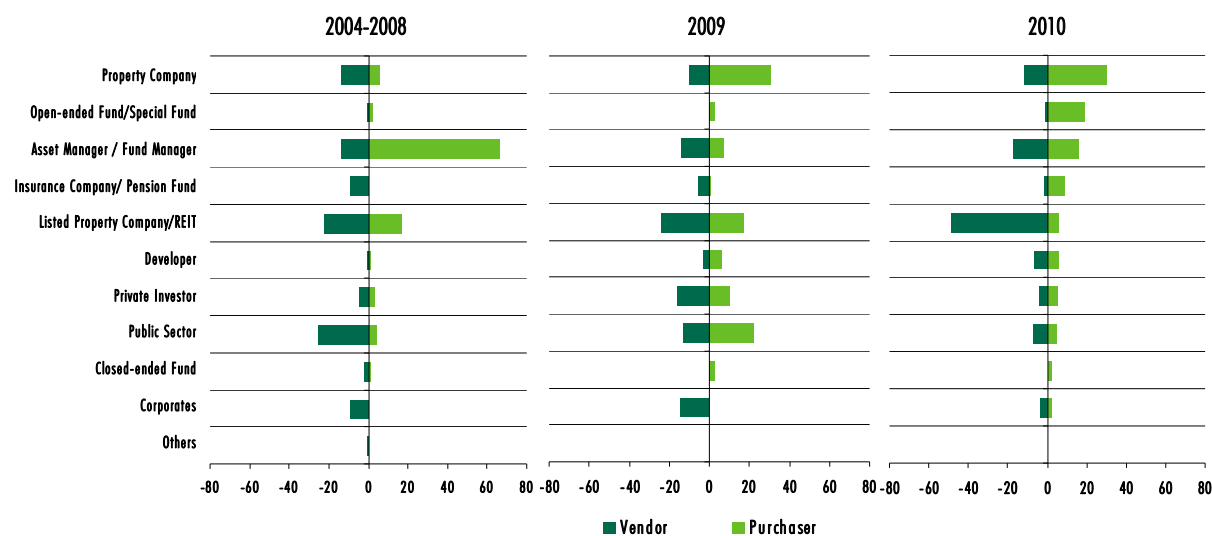
The lack of high-volume transactions in 2010 meant that the average number of apartments in the portfolios that did change hands, 710 units, was well below the 10-year (2000 – 2009) average of around 10,100 units. Up to 2008, portfolio transactions of more than 500 million € nearly always made up at least half of the total transaction volume in the residential portfolio segment. In contrast, since 2009 there has not been a single transaction of this size.

Both the purchaser and vendor sides have changed massively. Up to 2007, investors such as opportunity and private equity funds, following value-added or opportunistic strategies for their residential investments, predominated. Their intention was to achieve higher yields, during a relatively short investment horizon, by increasing rental values and by privatisation. The sought-after factor was potential for value growth, rather than properties that offered the prospect of a continuing income flow from a stable rental income. So far, an exit from this strategy has been hindered by a lack of sale opportunities, resulting from over-optimistic price expectations. Apart from the sale of the LEG-NRW-Portfolio in early summer 2008, the picture has changed considerably since the end of 2007. The German housing companies, many of them with municipal backgrounds, are now particularly active.

The investment focus of the housing companies is on the domestic market: most of them are actually restricted to the regional level. In addition, investment companies are emerging that, by applying professional management to the existing housing stock, are creating stable and predictable long-term returns. This results in the creation of fund vehicles in the residential sector that are being promoted as secure investments including inflation protection and that are currently very successful in generating investment income. The insurance companies and pension funds are also increasingly gaining importance. Often they do not invest directly but rather undertake residential investments through closed-end funds and special funds. This indirect investment route makes it possible to leave the

professional property management to the fund concerned: professional property management is the key prerequisite for the successful implementation of a long-term investment strategy.

Fig. 19: Purchasers and vendors



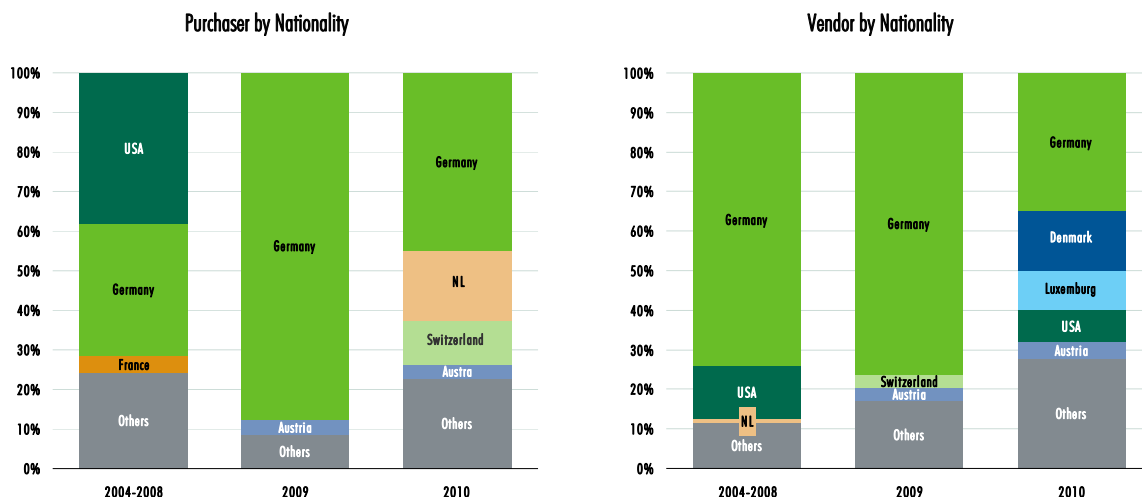
Source: CB Richard Ellis

There have also been sweeping changes on the vendor side. In the formation phase of the institutional residential property investment market – i.e. during the first half of the last decade - the properties on offer mainly originated from privatisations of public-sector housing stock or the portfolios owned by large firms, some of which had a public background. Since then, the proportion of re-sales has greatly increased. Last year, the federal government, states and municipalities, together with companies supported by the public sector, were not only more active on the purchasing than the vendor side for the first time - in fact they became the second-largest group of buyers. The main reason for the decline in sales from public stock is now the strong political pressure standing in the way of privatisation proposals. In 2010, the precarious budgetary position of many municipalities led to some sales, which, however, did not reach the shares of 2004 to 2009 by far. While the public sector could only realise around 173 million € worth of residential portfolio in the entire year of 2010, transactions in the first quarter of 2011 already reached a volume of 249 million €. The precarious budgetary position - particularly in many municipalities – has resulted in a renewed increase in willingness of the public sector to consolidate their budgets with the help of privatisation of residential property.

In 2010, real estate companies were clearly the most important group of vendors with a share of 38 %. In a comparatively weak stock market environment, the sale of portfolio properties is an alternative opportunity to raise capital and thus reduce their debt ratios. The pending restructuring process of the German Landesbanken (state banks) could mean that they will also sell parts of their property assets.

The German residential market continues to be relevant for foreign investors. Increased activity in the market by foreign investors was once again evident in 2010, even more in the first quarter of 2011. Asset and fund managers from the Anglo-Saxon world, who were dominating the market until the middle of 2008, virtually disappeared in 2009. After the recession year 2009, however, a clear increase in activity could be noted for 2010 and, particularly, the first quarter of 2011, which is due to the demand of other foreign investor groups.

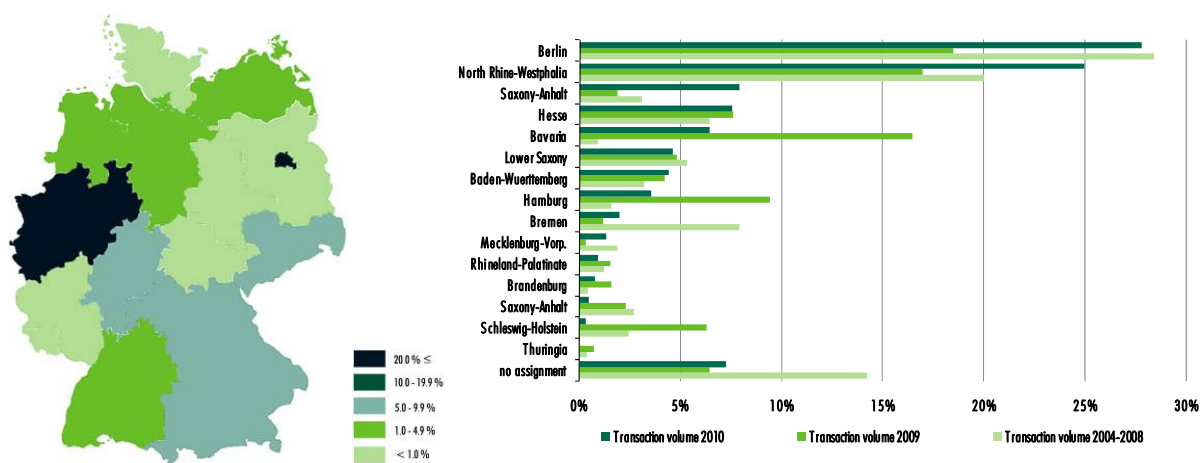
Fig. 20: Purchasers and vendors by nationality



Source: CB Richard Ellis

An analysis of the geographical distribution of residential investments in Germany illustrates that regions undergoing population growth and/or growth in the numbers of households are particularly attractive for residential investments. A breakdown by federal state is therefore too broad a brush for this. The high figures for Bavaria relate in particular to the Munich metropolitan region, those in Hesse to the Rhine-Main region and for Saxony to the metropolitan areas of Dresden and Leipzig.

Fig. 21: Investment focus by federal state³



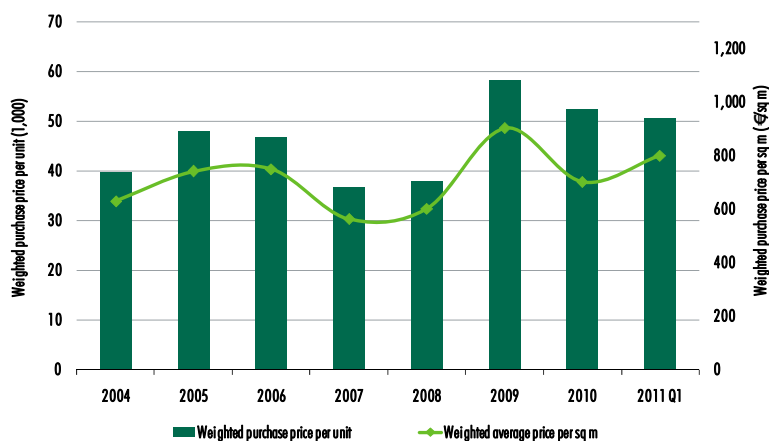
Source: CB Richard Ellis

³ The decline in the "no assignment" category in the 2009 - H1 2010 can be explained by the increase in smaller and medium-sized portfolio packages, making it easier to assign to administrative districts.

Compared with the 2004-2008 average, the proportion has increased, particularly in regions where tenants have notably high purchasing power. Cities like Berlin, Hamburg, Munich, Stuttgart, Dusseldorf, Frankfurt and Cologne, with their surrounding areas, are the special centre of interest. This trend is also a symptom of the change in investment behaviour since 2008: the present aim is to generate cash flow from reliable rental incomes over a long-term investment horizon.

The trend of average purchase prices per residential unit (and per square metre) are less a reflection of the general change in prices in the German residential market and are more dependent on the type of properties concerned. They therefore give an indication of the type of property currently changing hands in the market. Before 2008, large, widely-spread portfolios with a broad range of tenant structures were being traded. Currently, however, residential properties with financially sound tenancy structures in appropriate locations are the centre of attention. This is the main reason why, since 2009, both the average price per square metre and the weighted average sale price per residential unit have been well above the figures recorded in previous years. Another factor is that the prices of smaller portfolio packages tend to be higher. This is, therefore, less an indication of rise in prices but more the result of a change in investment focus.

Fig. 22: Weighted average purchase price per unit / per sq m



Source: CB Richard Ellis

As the list of major transactions on page 30 shows, large-scale transactions mostly took place in the form of share deals, i.e. by the sale of shares in the vendor company. Since 2009, however, as the proportion of large-scale disposals has been well under the long-term average, the vast majority of transactions have involved direct sale of the properties (asset deals). Nevertheless, share deals will be more attractive in the next few years for tax reasons. The federal states of Berlin, Hamburg, Saxony-Anhalt, Bremen, Brandenburg, Lower Saxony, Schleswig-Holstein, the Saarland, Thuringia and Baden-Württemberg have either already increased their property transfer tax rates or announced forthcoming increases. In view of the current strains on the public finances, it is quite possible that other federal states may follow their example. As a result, share deals may well be increasingly used also for medium-sized transaction volumes. Although the expenses involved in a share deal are considerably larger than in an asset deal, using this method means that only a very small proportion of the property transfer tax is due. In some cases the additional transaction expenses may well be less than the property transfer tax effectively saved.

Fig. 23: Important Transactions 2004 – 2010⁴

Year/ Quarter	Market	Purchaser	Vendor	Purchase price million €	Number of units	Price / Resid. unit €	Purchase price €/sq m	
2010 Q2	Asset Deal	Berlin	Corestate	JER Partners	160	2,000	80,000	960
2010 Q2	Share Deal	NRW/Sachsen	TAG	Francono	100	2,000	50,000	830
2010 Q1	Share Deal	Berlin/NRW	BXR	Tower Group	400	5,800	68,000	1.000
2009 Q4	Share Deal	Berlin	Deutsche Annington (Terra Firma)	IMW	200	4,500	45,000	720
2009 Q2	Share Deal	Hamburg, Dusseldorf	Meravis	DAWAG	405	6,000	68,000	1,050
2009 Q1	Asset Deal	Erlangen, Munich, Karlsruhe, Bruchsal	bidding-consortium	SiWoGe	320	3,900	81,000	1,100
2008 Q4	Asset Deal	Nationwide	Merrill Lynch / Colonia RE	Bonner Wohnbau	100	2,000	53,000	740
2008 Q2	Asset Deal	Berlin, Kiel, Munich	RVG	iii	130	2,100	60,000	920
2008 Q2	Share Deal	NRW	Whitehall/ Goldman Sachs	LEG NRW	2,890	93,000	31,000	500
2007 Q2	Share Deal	Northern Germany	Deutsche Wohnen	Gehag (Oaktree)	540	27,000	20,000	310
2007 Q2	Share Deal	Berlin, Hannover, Magdeburg, Kiel	Pirelli / RREEF	Cerberus	1,700	27,000	63,000	940
2007 Q1	Share Deal	Kiel, Wuppertal, Bremen, M'Gladbach	GOAL (Round Hill / Morley Fund)	Blackstone	1,600	31,000	52,000	790
2006 Q4	Share Deal	Nationwide	FDL	Morgan Stanley/ Corpus	2,100	40,000	53,000	810
2006 Q1	Share Deal	Dresden	GAGFAH (Fortress)	Stadt Dresden/ Woba Dresden	1,700	49,100	36,000	680
2005 Q4	Share Deal	Nationwide	Cerberus	BauBeCon	1,000	22,900	44,000	670
2005 Q3	Share Deal	Hamburg	SAGA	GWG	2,820	38,400	73,400	1,130
2005 Q2	Share Deal	Nationwide	Deutsche Annington (Terra Firma)	Eon/Viterra	7,000	137,700	50,000	780
2005 Q2	Share Deal	Northern Germany	GAGFAH (Fortress)	NordLB/Nileg	1,500	30,000	50,000	770
2004 Q4	Share Deal	Nationwide	Fortress	GAGFAH	3,550	82,000	43,000	690
2004 Q4	Share Deal	Rhine-Ruhr	Morgan Stanley / Corpus	ThyssenKrupp	2,100	48,000	44,000	670
2004 Q4	Share Deal	Northern Germany	Blackstone	WCM	1,400	31,000	45,000	690
2004 Q2	Share Deal	Berlin	Cerberus / Goldman Sachs	GSW	2,100	66,000	32,000	490

⁴ Some values in the table are based on estimates, therefore their correctness cannot be guaranteed.

3 OUTLOOK

The demand of national and international investors for German residential portfolios will remain relatively stable also in the further course of the year. By the end of 2011, we are expecting a transaction volume in this area that is slightly above that of 2010. In view of the self-supporting economic upswing, an increase in real wages, imminent inflation risks and a partially strongly limited availability of residential spaces, particularly in prosperous influx regions, we anticipate a further increase in rents and purchase prices.

Further Information - CBRE CityReports

CB Richard Ellis Residential Valuation Market Reports on all 413 German towns, cities and administrative districts are updated biannually. Detailed market information on each individual location is provided for interested clients but is not available for sale.

In cooperation with the GSW, CB Richard Ellis Residential Valuation also publishes a Berlin Residential Market Report at the beginning of each year. It is available free of charge at www.rueckerconsult.de/wohnmarktreport.html.

A residential market report on North Rhine-Westphalia, resulting from a collaboration with the LEG Nordrhein-Westfalen, was published for the first time in autumn 2010. Individual town and city reports may be referred to on the LEG website free of charge. The entire report can be purchased for a token fee.

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CBRE Residential Valuation Germany is one of the market leaders in the valuation of residential property portfolios. In 2010, around 480,000 residential units, with a total value of approx. 25 billion €, were valued. Seven of the top 10 institutional investors in the residential property sector have entrusted CBRE with valuation instructions.

In the last 5 years, the CB Richard Ellis Investment team has facilitated residential property investment transactions with a total value of approx. 14 billion € (around 400,000 residential units). This included successfully advising investment clients on both the vendor and purchaser sides.

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