REFIRE
Real Estate Finance Intelligence Report Europe

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Inside REFIRE

REFIRE is a specialised report focused on providing market intelligence and background analysis to finance professionals in German and continental European real estate investment.

Whatever your particular area of specialisation, we think you'll find timely, incisive information within our pages, helping to inform you of the key deals, the numbers, the markets, the players and the people.

The areas we focus on are:

US Funds in Europe
European REITs
German Real Estate Finance
German Non-Performing Loans (NPLs)
Retail Property Funds
Mortgage Securitisation
CMBS/RMBS
Privatisations
Refinancing
Euro-zone Property Financing

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2014 to see shift in investor sentiment from German housing to commercial

We recently reported in REFIRE on the research study produced by Barkow Consulting and Akselrod Consulting for the German Property Federation ZIA. The report concluded that – and this came as a surprise to quite a few people – on the basis of German real estate owned, publicly-listed real estate companies are, by a margin, the most significant investor group among Germany's indirect investment vehicles, which include the open and closed-end funds.

Peter Barkow of **Barkow Consulting** said at the time that the study aimed to bridge the gap in real estate market transparency. "Listed property plays a much more significant role in German real estate than previously thought. Underestimation has largely been caused by lack of adequate data; aggregate portfolio statistics for the German holdings of listed property companies has simply been unavailable to date."

At the same gathering in Frankfurt, **Alexander Dexne**, the chairman of ZIA's **Listed Real Estate Platform** and in his day job the CFO at **Alstria Office REIT AG**, pointed out that, "measuring the publicly listed sector solely based on market capitalisation, as has been common in the past, is like comparing apples and oranges. Knowing the significance of publicly listed property for the German real estate sector, politicians will obiviously need to take a closer look at future regulatory plans. Adequate regulation of financial markets, for example, is of the essence. If listed property companies are regulated too rigidly, however, stability of German real estate markets could be endangered."

While the bulk of capital raised on the stock market over the past two years has been for the German residential sector (in fact, all of it in 2013), even the open-ended real estate funds own more than 2.5 times as much office real estate in Germany as listed property companies. Dexne believes that, as a result, "Compared to other countries, the German listed property sector exhibits significant growth po-

KGAL owners sell majority stake to French privateers

The trend towards consolidation in Germany's fund industry continued with the move this month by fund provider KGAL to sell itself to two French private investors. Shareholders Commerzbank (45%), Bayerische Landesbank (30%), HASPA Finanzholding (15%) and Bankhaus Sal Oppenheim (10%) sold almostsee page 6

ICSC index sees slowing in shopping centre growth

While anecdotal evidence of more than satisfactory Christmas trading is trickling in to us here at REFIRE from retail quarters, November saw conditions for European shopping centres improve to build on recent trends, according to the International Council of Shopping Centres Europe' (ICSC) latest report... see page 12

Mid-ranking German cities showing greatest dynamism

A close correlation between the degree of dynamism in Germany's cities and a corresponding increase in property prices and rent levels is clearly evident in the latest annual ranking on Germany's cities by business magazine Wirtschaftswoche, this time in collaboration... see page 17

TAG Immobilien buys further 2,900-unit portfolio

Listed Hamburg-based residential property investor TAG Immobilien closed on a deal to buy a residential portfolio with about 2,860 apartments and 57 commercial units for about €70.5m. see page 18

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tential in office real estate markets."

We at REFIRE believe that this will be an important issue on the German market throughout 2014, as the ferocious demand for exposure to German residential slowly runs out of steam. We recently sat down at a round table discussion with a small group of analysts and board members of listed companies to engage in some silver-ball gazing for the coming year. Present were **Torsten Klingner** of **Warburg Research; Jacopo Mingazzini**, board chairman at listed **Estavis AG**; **Frank Schaich**, chairman of the board at listed **Fair Value REIT AG**; and **Helmut Kurz**, Fund Manager at **Bankhaus Ellwänger & Geiger** in Stuttgart.

"In Europe, too, the banks are turning away from the provision of financing for real estate, partly due to much stricter banking regulation. The coming wave of refinancing will be largely resolved by new sources of debt and equity capital"

Klingner of Warburg Research highlighted how differentiated the year 2013 had been for a number of Germany's listed property companies. Among the losers were **IVG Immobilien**, **DIC Asset** and **Prime Office REIT**, while a solid winner had been **VIB Vermögen**. Among the residential listed companies, **Patrizia** and **Gagfah** had performed well, while **TAG Immobilien** was a slight loser in a segment that had generally trended flat throughout the year after last year's euphoria. The market had received a big boost in size and volumes this year with the flotations of **LEG** and then **Deutsche Annington**, but initial yields in the sector have been falling as competition for available portfolios increases.

Klingner's view on the forthcoming rental cap or "*Mietpreisbremse*" is that this is unlikely to affect the big residential players in the medium term, as they would rarely see rental increases of 10% or more on new leases. For them, real rental increases of about 2% will remain the norm. It is likely to have a negative effect on new building, however, as builders who are already facing sizeable cost increases due to the new compulsory energy-saving measures on new buildings are now also looking at capped rental income.

The residential listed sector will continue its phase of consolidation after the merger between **Deutsche Wohnen** and **GSW Immobilien** in early 2014. Possible new groupings could be Deutsche Annington with LEG or Gagfah, or even Deutsche Wohnen with Gagfah – but neither of these would even be big enough to catapult themselves into the DAX 30 list of top German companies. Klingner thinks property shares will remain attractive in this low interest rate environment, with cash flow yields of between 5% and 10% on market cap, with a dividend yield of between 3% and 5.5%. Given the recent run-up in residential prices, he believes residential property shares will provide a better return than investing directly in the underlying property itself.

Jacopo Mingazzini of listed Berlin property company Estavis AG believes the big listed property companies are close to topping out after a heady run. Private and institutional investors can be expected to start rooting round in the lower divisions for companies with business models that offer a bit of a spicier equity story.

Reviewing the year 2013, Mingazzini said that investors had been deeply rattled by the scandals affecting several open and closed-ended funds and the ensuing introduction of the KAGB legislation. This lends further attraction to the listed sector, he believes. In particular he believes that German institutional investors will get involved in their domestic listed sector, which has been largely the domain of international investors to

DEALS ROUNDUP

date (a staggering 95%). Investment in stocks should enable institutions to take advantage of the flexibility of immobile investments in a period of strong growth and low interest rates, while avoiding the risks in direct investment of lengthy delays in exiting from property markets, depending on conditions.

Mingazzini believes that the Mietpreisbremse, or rental cap, will force holders of residential property to take a different approach, in particular to concentrate more on privatising their assets by selling them to tenants. Germany's owner-occupier ratio has been rising steadily, by 4% between 2006 and 2010, and property ownership is increasingly coming to be seen in Germany as an important part of personal pension planning. However, the path of privatisation is fraught with pitfalls and in the current political climate is by no means a no-brainer for larger property holders.

Frank Schaich, an early German REIT pioneer with his stewardship of the country's second-ever qualifying company Fair Value REIT AG, believes that the German residential listed companies have shown the way forward, after years of languishing in the shadow of the more broadly-recognised open and closed-end funds. He sees the forthcoming merger of fellow-REIT Prime Office with **Oaktree** as the forerunner of a new phase of recognition for the commercial listed sector on the capital markets, where size and volume is undoubtedly important. With global pressure on investors to invest, German listed real estate will continue to feature on investors's radars, and even the handful of REITs can be expected to benefit.

Schaich (*pictured, above right*) drew parallels with the US market before REITs became established. The big thrust for REITs came there when property owners could solve their problems by turning to the stock markets. In Europe, too, the banks are turning away from the provision of financing for real estate, partly due to much stricter banking regulation. The coming wave of refinancing will be largely resolved by new sources of debt and equity capital, offering new opportunities for listed companies.

German investors in particular have high expectations of attractive and regular dividends, expectations which have largely been met by the generous payout policies of the German residential listed companies, and even REITS, who pay out close to 70% of their FFO. This has helped to pave the way for a new class of investor, even in light of the payout policies of closed and open-ended funds.

Helmut Kurz of Ellwanger & Geiger pointed out that while the DAX rose by 20.2% between April and end-November, the **DIMAX** (Ellwanger and Geiger's widely-recognised German real estate index) rose only 8%, again largely because of the uncertainty caused by the new

EDITORIAL

Rental caps and landlord taxes part of an enduring German tradition

The talking is over. The SPD grass roots have weighed in with resounding approval of their party's plan to join Angela Merkel in government, and – a full three months after the elections - Germany finally has a workable coalition with a clear agreement as to how the country is going to be governed for the next four years.

The ministerial jobs have been doled out, the old guard have been escorted out the door, and the country's first female defence minister has already donned her khakis to head the mission to bring Germany's finest Christmas *stollen* and *lebkuchen* to the serving troops in Afghanistan.

The negotiations lasted so long because ideologically, the parties were at odds on so many issues. Frau Merkel lacked only five seats for an absolute majority, but given the wipe-out of her erstwhile partners the liberal FDP, and the impossibility of governing with the Greens or the hard left, a Grand Coalition with the left-of- centre SPD was the only feasible option left.

The SPD under the engaging Sigmar Gabriel has been taking its time to make sure the coalition agreement is stuffed full of its pet projects. The party can't afford to repeat the debacle of the last government but one, when after its last Grand Coalition with Frau Merkel, it was subsequently decimated at the polls. Not this time, of that it's going to make sure.

For real estate investors the key issue is the government approach to affordable housing. It's not just the SPD that is committed to introducing a rental cap on German residential housing, the so-called *Mietpreisbremse*. All parties have integrated the measure into their manifestos – although somewhat watered-down from earlier even more radical versions, the latest rental cap enactment is one of the pillars of the new government that they all agree on.

Make no mistake about it. The Mietpreisbremse IS coming in this legislature period, whether we like it or not. The only question is – which investors are likely to be affected by this, and how.

As it stands, Germany's 16 federal Länder are being given an initial five-year right to impose a maximum 10% rent increase above the local rent table in defined areas – areas where there is a 'known' housing shortage. This could apply to almost any of Germany's largest cities, if taken at face value.

Exceptions to this are first-time lets in new-build apartments and new leases after 'comprehensive' modernisation. A possible further exception is that future lease agreements can be 'at least' at the level of the past agreement.

In practical terms, the Berlin government has largely handed over responsibility for the concrete formulation and execution of the new measures to state and local government. These will have to categorise and tabulate all affected neighbourhoods. It goes without saying that this could be a long and complicated process, and might even be contested in the local courts.

However, these potential stumbling blocks also offer a glimmer of hope to many investors that the whole procedure could get so bogged down in murky uncertainty that it's not worth bothering about. If so, they are probably underestimating the political will in Berlin to intervene to discourage profiteering in housing markets – a tradition which has a long and noble pedigree in Germany's history.

Naturally the real estate industry, including its housing and landlord associations, is universally against the measures, with plaintive cries from industry leaders up and down the land that the rent freeze will hinder investment in existing housing, and will reverse the current enthusiasm for new much-needed house-building, which is still so visible across the country.

Landlord associations had been hoping that as compensation for accepting the Mietpreisbremse, the government would reintroduce a regressive depreciation tax measure, which would enable builders to write off their investment faster in the early years. But this deal is now definitely off the table. So there's no succour there.

The reality of the rental cap is not the only disappointment for landlords. In future, at most 10% of any modernisation costs can be passed on to tenants, and THAT only for the length of time it takes to pay the modernisation costs in full. The government has also reserved sweeping rights to impose penalties on landlords where they are grossly negligent in making necessary upgrades. Slumlording is not an option.

A recent FERI study highlights the undesirable side-effects of all this already, even before the introduction of the new laws. These include landlords now constantly raising rents to legally permissible levels (an unusual practice in the past), knee-jerk reactions from landlords to impose special charges on tenants, or selling apartments in multi-family houses to individual tenants.

In other words, the threat of the legislation has already been sufficient to alter behaviour at the expense of tenants. This may be understandable, but it is part of a pattern that is contributing to greater uncertainty for investors. After a sustained positive run of several years, that sentiment could easily go into sudden reversal.

We report in this issue on the study compiled by consultants Wüest & Partners which highlights how moderate rental increases have been in the secondary cities which are less affected by housing shortages. These could indeed turn out to be the hidden champions in 2014 and beyond for investors prepared to spread their wings a little.

In the meantime, we wish all our readers a Happy Christmas and further prosperity in the New Year.

Charles Kingston, Editor

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regulations and potential government interference in the market. With interest rates likely to remain low in 2014, this should benefit companies with a high quota of commercial property.

After the massive influx of investment into the residential sector since the onset of the financial crisis, which drove share prices upwards by as much as 450%, there's been a cooling in recent months. With government coalition negotiations now at an end, it's certain there will be a tightening of regulation on the residential property market. This will also definitely put a brake on investor fantasy of future share potential, Kurz believes.

As commercial property company shares are trading well below NAVs and are even below pre-crisis levels in relation to NAVs. The rebounding economy will drive demand for office and retail space and drag up rents and prices, which should be reflected in more buoyant share prices, helped by a shift out of the residential sector. Also, listed stocks will be less affected by the new KAGB regulations than open and closed-ended funds, according to financial watchdog BaFin. Listed companies have long had to provide the sort of transparency that is now new for the funds sector, and it will take some time for the sector to adapt. The listed commercial property sector is due for a rebound, believes Kurz.

Germany/Acquisitions

Deutsche Annington expected to swallow Vitus Immobilien by year-end

We've almost been expecting to get confirmation of a done deal before Christmas, but at the time of writing nothing has been signed, to the best of our knowledge. A number of reports including from *Reuters* and *Bloomberg* suggested earlier this month that listed German housing investor **Deutsche Annington** was on the cusp of signing an agreement to buy **Vitus Immobilien S.a.r.l**, a German residential landlord part-owned by private equity investors **Blackstone Group** and **Round Hill Group**. A deal is likely to value Vitus at about €1.3bn.

The Bochum-based Annington, which listed on the stock market in July after a stumbling start, has made clear that it plans further growth, both organically through a major upgrading programme of its existing holdings, but also through bolt-on acquisitions, for which it said it could now muster up about €4bn including financing for the right portfolios.

Round Hill, along with a consortium of co-investors including **Deutsche Bank** and insurer **Aviva**, bought a majority stake in Vitus Immobilien in 2007 from Blackstone for €1.6bn, leaving 25% in Blackstone's hands. Blackstone, in turn,

had itself paid about €1.39bn in 2004 to buy Vitus from an assortment of municipal housing companies in North Rhine-Westphalia and northern Germany. Round Hill has been thought to be looking to exit its position for some time.

The Moenchengladbach-based Vitus owns about 30,000 formerly German railway- and government-owned apartments across western German cities including Bremen, Düsseldorf, Wuppertal and Kiel, and like Annington itself, manages a further 20,000 apartments. The company was in the news last year when it refinanced all its senior debt with a €745m CMBS securitisation, managed by **Deutsche Bank London**, in what was the first post-crisis continental European CMBS.

Germany/Funds

KGAL owners sell majority stake to French privateers

The trend towards consolidation in Germany's fund industry continued with the move this month by fund provider **KGAL** to sell itself to two French private investors. Shareholders **Commerzbank** (45%), **Bayerische Landesbank** (30%), **HASPA Finanzholding** (15%) and **Bankhaus Sal Oppenheim** (10%) sold almost 90% of their shares in the fund manager to French private investors **Francis Louvard** and **Gregory Ingram**, while retaining a 10% stake.

The new French owners said in a statement that they supported the Hamburg-based KGAL's growth strategy, which has traditionally been in real estate, infrastructure and aviation. The two are also managing directors at **Thunderbolt Partners**, their Luxembourg-based "private investment vehicle serving as a conglomerate platform to acquire majority stakes in well-established European companies."

Founded in Hamburg in 1968, KGAL managed €25.1bn of assets at end-2012, of which €12.7bn was in real estate. Investors have put €6.4bn in equity capital into its 135 active limited partnership funds, while it has structured and financed more than €30bn of individual or portfolio real estate transactions over the past 45 years, and more recently has carried out numerous investments in aircraft and solar and wind power infrastructure.

KGAL chairman **Georg Reul** will be vacating his seat under the new management, with **Kurt Holderer**, the current CFO, stepping up to the top role in the interim. Reul only arrived at KGAL in August last year from the management board at **IVG Immobilien**, succeeding **Carsten Eckart**, who stepped down as chairman after five years at the helm.

The sale to the new shareholders does not come as a big surprise in Germany. Commerzbank as the largest shareholder originally inherited its stake with the takeover of **Dresdner Bank** some years ago, and as long ago as 2009 had been offering its stake in KGAL to potential buyers. BayernLB has been shedding its non-core activities since receiving state help at the beginning of the finance crisis, while Sal Oppenheim has also been thought to be looking to exit.

Germany/Industrial

AIM-Listed Sirius Real Estate back in profit, plans €40m share placing

London's AIM-listed **Sirius Real Estate**, which owns and operates business parks, offices and light industrial complexes across Germany, *does* seem to be undergoing a reversal in its fortunes after technically breaching its banking covenants three years ago.

The company's latest results show it swinging into profit for the full year, as it announced the placing of a €40m share issue to pay down its debt. This is a dramatic turnaround for the company which saw several large institutional investors, such as **F&C** and **Henderson**, abandon their holdings when the company seemed on the verge of default in 2010. The latest results show a pre-tax profit of €11.0m compared with a €5.5m loss a year ago, largely due to an upward revaluation of its property portfolio following two years of painful write-downs.

The portfolio at September 30 was valued at €434.3 million, compared with €426.2 million at March 31, adjusted for disposals. Sirius said the portfolio was boosted by asset-management activities and the sale of non-core assets. Typical Sirius business parks offer a range of flexible workspaces and services tailored to small and medium-sized enterprises. The company has 33 business parks with more than 1 million sqm of lettable space across Germany.

Recurring profit before tax, which excludes property revaluations and change in fair value of derivative instruments, rose to €6.9 million from €3.9 million in 2012. However, rental income dropped to GBP 23.6m from GBP 23.9m as occupancy levels fell to 75% from 76% in March.

Sirius has agreed new terms in principle with two banks led by **Berlin Hannoversche Hypothekenbank** and another German bank for a new five-year facility of €115m, while also securing a new facility with **Macquarie Bank** in London for a minimum of €32.5m, which will help to pay down existing loans at **BerlinHyp** and **RBS**.

Sirius issued 166m new ordinary shares at €0.24, a slight discount to the prevailing share price, and representing half of the company's market cap. CEO **Andrew Combs** said that the new €40m share issue was oversubscribed by a factor of two. "This fundraising represents the final stage of recovery for Sirius", he commented. "It has allowed us to lower our loan to value ratio to just under 55%, which has in turn allowed us to get better banking arrangements and free up €40m of cash flow a year, which will help with the future dividend." He indicated that the company would recommence paying a dividend after several years' absence after next year's full-year results.

Germany/Residential

Corestate sells €135m repositioned German residential portfolio

Independent Switzerland-based private equity group **Corestate Capital** said earlier this month that it had completed the sale of a German residential property portfolio for about €135m to various institutional and private investors in what it described as 'part of a repositioning programme'.

The portfolio comprises 2,100 residential units spread across 12 German states. Corestate originally acquired the portfolio in a non-performing, distressed state and has since repositioned it by investing capital in asset management activities.

Commenting on the disposal, Corestate COO **Thomas Landschreiber** said, "Extremely scattered portfolios represent a welcome challenge for us. With asset management activities we can accomplish value increases as well as solid and long-term rental income. Increase in value, value retention as well as solid and long-term rental income are ac-

complished through our customised asset management activities. We will continue to create products for our investors, which can serve the high level of demand for stable German real estate.'

Corestate is a management-owned investor and asset manager, with offices now in Zug, Frankfurt, Essen, London, Singapore and Luxembourg and with more than €2.5bn invested to date in Germany. Its approach is essentially opportunistic, but it has been taking an increasingly cautious view on German residential, its main asset class.

Speaking to Swiss investors recently, managing director **Steffen Ricken** commented, "There is huge competition for good quality, long or medium-term rented assets. But if you look for the quality material in Munich or any of the Big Seven cities it's unbelievably expensive, with average quality around 4.5% or 5% net rental yield which is pricey in Germany compared to two years ago."

Germany/Development

UK's Benson Elliot buys Frankfurt high-rise for redevelopment

Benson Elliot, the UK-based private equity real estate fund manager, has bought the *Turmcenter*, Eschersheimer Landstrasse 14, in Frankfurt's central business district from **LBBW Landesbank Baden-Württemberg**. The 23-storey office tower has been unoccupied since **Ernst & Young** vacated the building and refurbishment plans subsequently stalled. The acquisition includes an adjacent mixed-use complex featuring additional office space, a long-let supermarket and over 400 car parking spaces.

The shell property has been somewhat of an eyesore in Frankfurt after a chequered past, which saw the building redeveloped in 1971 and re-started in 2008 before stalling. Benson Elliot has recently been associated with several urban regeneration projects in the UK, and the redevelopment of the potentially prestigious Turmcenter would sit comfortably with the company's other recent projects.

Once the deal is completed Benson Elliot plans to comprehensively re-develop the tower to deliver over 15,000 square metres of efficient, state-of-the-art, environmentally sustainable office space. The property will tap into the growing demand for first class office space from small and medium-sized tenants in central Frankfurt.

Benson Elliot has engaged **dk real estate**, with whom Benson Elliot's senior team worked a decade ago on the re-development of Munich's famed *Maximilianhöfe*, to manage the re-design and re-construction of the tower.

According to **Joseph de Leo**, one of the three senior partners at Benson Elliot (along with **Marc Mogull** and **Trish Barrigan**), "This is going to be an exciting project for Benson Elliot. With a smaller, but highly efficient floor plate,

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CONFERENCE REPORT

Where is New Financing coming from?

At the recent REFIRE London Conference, **John Lutzius** *(pictured, right)* of **Green Street Advisors** moderated a very lively session examining the direction of new financing for real estate investment in Germany.

Lutzius summarised the story of Gagfah, who only a year ago were staring at a giant refinancing. The market felt certain that Gagfah would have had to make major portfolio sales to bring down debt levels. As it turned out, without having to make disposals, Gagfah refinanced over 4bn of debt at very sharp rates, and has seen its stock up 2.5 times in the period.

Curth Flatow (*pictured, left*) of **Flatow Advisory Partners** said that the 4th quarter shows a balanced financing market, with over 50% of lenders reporting an increase in new business. Big banks like Aareal, Pfandbriefbank and BerlinHyp have all raised their new business lending by over 40%, with average LTVs at 69% and margins at 185 bps. Getting finance for A- and even B-locations is not too difficult, nor is financing for any core-type assets, with perhaps more difficulty for niche products like hotels and nursing homes.

Flatow was asked, would there be margin compression in 2014? There is certainly more competition to finance core assets in Germany, he responded, so he expects a gradual lowering of margins from currently about 185 basis points next year, apart from in trickier niche segments.

Dr. Matthias Grund (*pictured, right*) of **K&L Gates LLP** described the market as being in a transition period. We are not experiencing gaps for financing in prime locations, while even in distressed deals, there have emerged several new providers of finance, including family offices and private equity funds. In his practice he still sees a lack of linkage between local expertise and investors sitting in big cities looking to gain exposure to the German market. It's the in-between deals that are struggling to find financing, he believes.

Jacob Lyons (*pictured, below*) managing director at **CR Investment Management**, described the issue with the capital stack as a bit like herding cats. You're trying to get the borrower, the senior lender, the portfolio itself, and potentially a junior lender, all into a room at the same time, which can prove very tricky with the different goals that each are trying to pursue.

As Lyons described it, the hedge fund and private equity fund community is split into two different groups. Big players like Cerberus, Blackstone and other experienced investors are to some extent constrained to looking at very large deals because of their investor expectations. Then there are the American private equity players that may have a discretionary pool of funds that can look at Europe, but for them it often proves too complicated and unfamiliar.

Hence, last year 80% of the largest deleveraging deals were done by Deutsche Bank and Lone Star, he pointed out. Even this year there are still only about eight active players. In short, there are the traditional players, and then a lot of noise, as he put it.

Lyons highlighted two critical features about the German market. Firstly, the Pfandbrief market, which provides for financing around a certain structure, come what may. Secondly, the number of banks. Germany is probably overbanked, he said, but UK is underbanked, with a shortage of addresses to go to. He made the observation that Germany seems to have a number of people to go to on a deal that would normally make sense. In the UK you're often not sure if for example HSBC or Nationwide are really 'open for business' at any particular time. Lloyds, Barclays and others dip in and out, but there is not the same sense of 'stability of model' as in Germany, which he sees as a real strength.

Michael Morgenroth (*pictured, right*), the CEO of **Caerus Debt Investment** described his core business as handling mezzanine pieces between 10 and 30 million.

With banks previously lending 85-90% there was never any real need for mezzanine providers in Germany, so this is a new segment in the business here. There is now a dramatic change in the market, which now needs structured finance. The demand for such financing in deals in the smaller B and C-Cities is really big, said Morgenroth. Cost of financing is on average in the range of 10-12%. His company is acting in the space of 50-80% LTV, depending on the property. He also confirmed that he sees no shortage of senior lending in Germany at very competitive rates.

Morgenroth doesn't see margins on the mezzanine side contracting too fast. There will be new competitors, but it will take time. If the ECB ends Quantitative Easing, and interest rates rise, then availability of financing will shrink, so he doesn't see any immediate shrinking of margins.

Jesse Freitag-Akselrod (*pictured, right*) of **Akselrod Consulting** presented the key findings of his recent study with Peter Barkow showing how the listed space in Germany is not small compared to the open-ended and closed.end fund sector. Listed companies in Germany own gross asset value of about €68bn, while all the funds together have about €69bn, he reminded the audience. The difference is that the funds are generally measured by gross asset value, whereas the listed companies are traditionally measured by equity market capitalisation, so there has been an unequal comparison.

Free float market cap in Germany is about 25% of that of the UK listed property sector, and about 50% of that of the Netherlands, so there is plenty of upward scope, he believes. He gave as an example Deutsche Annington's accessing of capital for refinancing their bonds prior to their IPO as a very innovative approach. Understanding the markets in this way, he said, has opened up whole new market for other participants in the benchmarked bonds segment.

Akselrod said he would not be surprised to see increasing volumes in debt capital markets, à la Gagfah, both in residential and commercial. After the recent wave of IPOs and capital issuance and the strong run on the market, he thinks that investors are now much more selective, So he sees little new issues on the horizon.

Commercial property however has still lots of demand, particularly with the impairment of the open-ended funds. But near term, he said he is advising his clients, don't force your way onto capital markets, get your house in order first. There may be a recapitalisation or a merger here or there, but not like we've seen in the residential space, he believes.

and a new façade design featuring floor-to-ceiling glazing, the new Turmcenter will be ideally equipped to meet the needs of mid-market companies looking for prestigious office space in the centre of Frankfurt."

Germany/Non-Performing Loans

EY still bullish on near-term future for NPL sales

We hesitate to report on yet another study issued by consultants **EY** (formerly **Ernst & Young**) on the subject of German non-performing loans, since it appears to us that almost annually at around this time, the group's researchers issue a bullish forecast on the wave of NPL portfolios due to come onto the market the following year.

This has materially failed to happen over the past three years, as is widely known. NPL insiders must be smiling patiently at the release of the latest study on German and Austrian loan transaction markets by EY which – true to form – predicts that sales of NPLs will definitely pick up in the near future as the banks face up to the inevitable, and finally shift bad assets off their balance sheets.

The reality over the past few years is that only a small number of larger deals have been done, generally quietly, while others have fallen well below the expected size and volume. The largest loan deal in the last two years was the sale of a €5bn UK commercial real estate loan portfolio to a team of US lender **Wells Fargo** and private equity firm **Lone Star**.

According to the EY researchers, part of the reason for the limited turnover is the low proportion of bad loans on German bank balance sheets. The study quotes **Oxford Economics** statistics that show non-performing loans accounting for just 3.2% of gross loans in 2013, with that figure is expected to drop slowly to around 2.8% in 2014."The German banking sector is one of the strongest

in Europe and has a better lending quality and lower NPL ratio than elsewhere in the Eurozone," EY said. In addition, banks have been unwilling to take losses by selling loans at discounts and have been holding on until pricing recovers. Where transaction have taken place, it has generally been a signal that the bank is exiting from international markets, as in the case of Commerzbank."

"While it appears impossible to predict when the German NPL and non-core market will pick up speed again, we continue to maintain the opinion that the need for potential sellers to clean up their balance sheets and the strong interest among investors to acquire German assets in these asset classes will eventually result in very active trading activity in the near future."

EY says there is plenty of evidence that the gap between what buyers are prepared to offer and sellers will accept has indeed narrowed, as demand for NPLs remains high, while the drive at German banks to sweep ahead with further cost-cutting measures in their workout costs should entice them to offer more assets to the marketplace.

Meanwhile, a study just released by the **Bundesvereinigung Kreditankauf und Servicing (BKS)**, the German association for special and loan servicers, seems to confirm that the volume of NPLs coming on to the market has been stagnating, largely because of the upturn on real estate markets, but is expected to increase over the coming year.

According to BKS president **Dr. Marcel Köchling**, "It's mainly down to the stable economy that the transaction volume of NPLs in 2013 has more or less remained at last year's level." The association's 98 survey respondents did however confirm that trading was lively in many segments, particularly in corporate and consumer credit sub-markets – but in the real estate sector, NPL volumes were negatively affected by rising price levels particularly in the large cities.

Europe/Retail

ICSC index sees slowing in shopping centre growth

While anecdotal evidence of more than satisfactory Christmas trading is trickling in to us here at REFIRE from retail quarters, the month of November saw

conditions for European shopping centres improve to build on recent trends, according to the **International Council of Shopping Centres Europe' (ICSC)** latest monthly reading.

The ICSC survey tracks key performance indicators monthly for the European shopping centre industry. Its key ICSC **Euro-Shop Index** combines two sub indices in equal measure – the **Euro-Shop Current Conditions Index** and the **Euro-Shop Expectations Index**.

The association's latest pan-European *Shopping Centre Executive Opinion Survey* shows a rise in the flagship Euro-Shop Index in November over the previous month, although the index shows occupancy and visitor traffic actually down for the month (although well higher than a year ago). The pace of growth was seen slowing, with retailers showing renewed resistance to accept landlord terms on new leases.

According to ICSC research analyst **Sarah Banfield**, "While their confidence remains higher than last year, and shopping centre executives across Europe surveyed for the index remain upbeat about current and future business conditions, they are not underestimating the challenge ahead with economic growth across much of Europe remaining stubbornly low - 0.1% in third quarter.

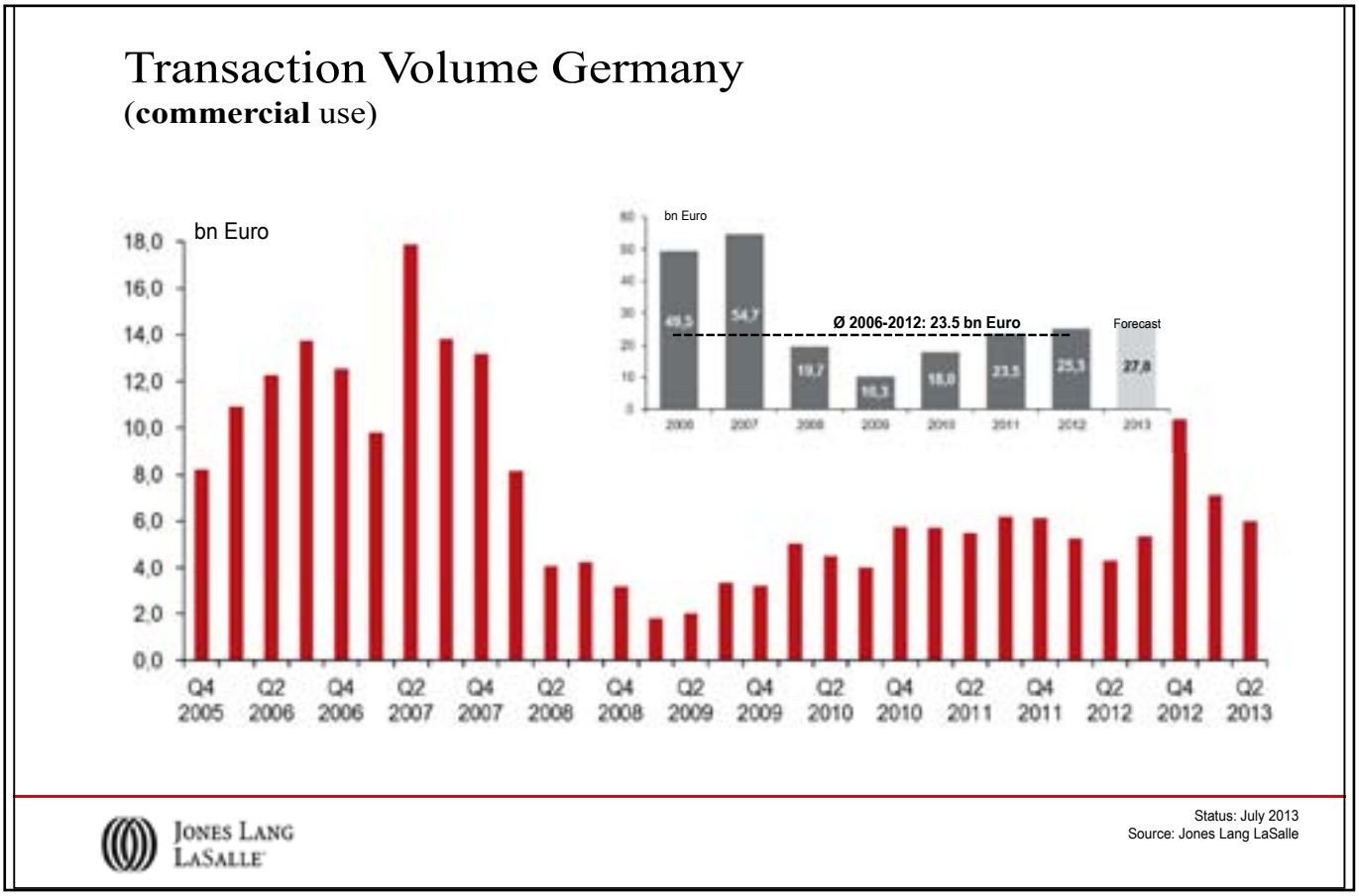
Despite the fact that Eurozone unemployment has fallen for the first time since February 2011, to 12.1% in October, the association is still cautious about the medium term. "Looking further ahead, the European Commission forecasts growth of 1.1% for 2014 and 1.7% for 2015, highlighting the fact that recovery is expected to be a slow process", commented Banfield.

Germany/Study

Immonet study sees Leipzig topping German city list

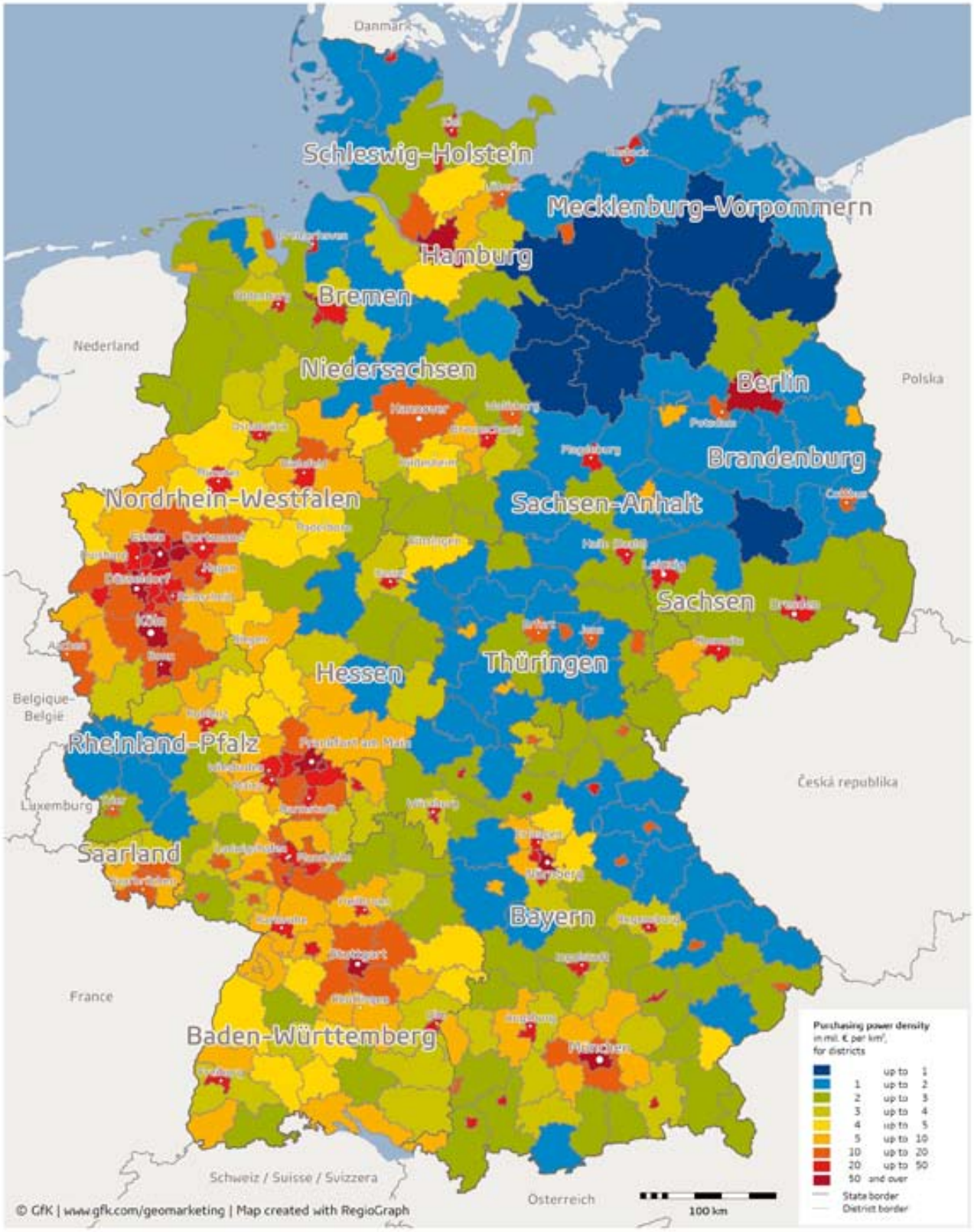
With Germany's residential housing markets still bubbling along for at least the fourth year in a row, all manner of housing and investment-related indices have sprung up in Germany to track the market's progress. A new study published by property portal **Immonet** and carried out by market research institute **GfK** attempts to quantify some of the more emotional aspects of the location decision – in other words, what do residents actually look for when deciding where to live and what factors do they deem most important.

The researchers questioned 1500 residents across 15 of Germany's largest cities: Hamburg, Bremen, Hannover,



Source: Jones Lang LaSalle

GfK purchasing power density 2014



...see page 13

CONFERENCE REPORT

German residential described as a "safe spot in a safe haven"

Residential property is a strong sector in a very strong real estate market, the REFIRE London conference heard.

But 10-12 years ago there had been a combination of small rent increases, the need for intensive management and little appreciation in value, said **Peter Starke**, (*pictured, left*) a director and head of the Berlin office of **Aengevelt Immobilien**.

'There was reason enough for pension funds and insurance companies to sell out of their large residential stock,' he told the conference in London. 'Now 10 years later we know they couldn't have been more wrong, and they know it themselves because they are buying back into the residential market.'

In the early 2000s unemployment was five million and rising in Germany when it was falling in other countries. But reforms under Gerhard Schröder meant low unit labour costs had given Germany a competitive edge in the world market and unemployment was now at an all-time low of 5.8%.

As a result real estate prices had risen and volumes, which peaked at €110 billion in 2006 and 2007 before the Lehman crisis brought them down to under €40 billion in 2009, had climbed out of the hole.

'We are seeing in 2013 volumes of about €60 billion. So rest assured there is no bubble in Germany,' said Starke.

While yields in all real estate asset classes have fallen, rents have appreciated, he said. 'In 2012 the rent of €5.80 per square metre per month in Berlin is roughly what it was 12 years ago in Stuttgart, Düsseldorf, Frankfurt and Hamburg. This is one of the reasons why there's so much interest in Berlin.'

How would the market develop? Some 80% of households in Germany are occupied by one or two people, especially in the cities. By 2030 another 200,000 plus households are expected in Berlin where there is 'no vacancy' in real estate. In Germany s a whole, the prediction is for 730,000 more households in the next 12 years.

Ralf Kind *(pictured, above)*, a partner of **Dr Lübke and Kelbe** and board director of **Arbireo Capital**, said rents had been increasing at a reasonable pace of 2% to 3% over the last 10 years.

There was a very resilient occupier base who had, on average, seen an increase in wealth in real terms over the past 10 years 'so rents are still affordable'.

Kai Schubart, director of international client management at **Corpus Sireo**, said Germany's federal structure gave the opportunity to invest in more than one hub. 'It's not just one city,' he said. 'It's not just the top five or seven that are interesting for real estate but especially residential investment.'

The conference heard there are 70 cities in Germany with more than 100,000 inhabitants, a stable market where above average returns could be made.

The panellists discussed the possible impact of tighter rent controls by the incoming coalition. But it was pointed out that these would apply only in the hub areas of housing shortage, for example Berlin, Munich or Hamburg.

There were so many other opportunities in Germany for investment in residential real estate. Germany was, said Kind, a 'safe haven and residential is even a safe spot in the safe haven.'

Berlin, Leipzig, Dresden, Dortmund, Essen, Duisburg, Düsseldorf, Cologne, Frankfurt, Nuremberg, Stuttgart and Munich. The questioning related to residents' satisfaction with living in their city, and what they considered most important to their quality of life.

Among the main findings of the survey: The key factor affecting residents' well-being was the "perceived quality and safety" of their neighbourhood. About 86% preferred plenty of greenery around them to any "urban hip" factors. Leipzig has the highest satisfaction rating of any German city. Duisburg and Nuremberg have the highest number of dissatisfied residents.

The proximity to green spaces emerges as the key desirability factor among those surveyed, with only 20% favouring a trendy hip scene in their neighbourhood over closeness to parks and other green areas. Other factors such as closeness to place of work (65.2%) and availability of schools and kindergartens (35.8%) came further down the rankings.

immonet.de
Wir sind Immobilien

The 'perceived quality and safety' of their neighbourhood, the single most important factor affecting respondents' well-being, is commented on in the report by Dr. Sebastian Zenker, Immonet's expert for housing and urban development. "Where you live is an important part of your identity, and we are always being socially compared with others. Hence it's important for our self-image to come from a well-reputed neighbourhood – along the lines of "Tell me where you live, and I'll tell you who you are."

The study concludes that the right mix of factors proves to be decisive – with Leipzig, Cologne and Munich having the best

Guest Column:
Jürgen Scheins, Managing Director of VALTEQ

Anecdotes from the field – or technical due diligence with surprises

www.valteq.de

Professionalisation of the real estate industry has led to the establishment of numerous standards, as well as effective and transparent processes, particularly in technical due diligence. This was however not always the case, as a few anecdotes from our everyday work may show:

Today, it is difficult to imagine that even as recently as 2008, it was sometimes not possible, or even allowed, to conduct a proper building inspection – the sales and acquisitions were all to be completed in incredibly secretive and swift processes. It was therefore not unusual for property lists to include addresses that either didn't exist at all, or which turned out to be a dilapidated office or a refugee centre, rather than the listed retail building.

Back then, the very fact that at least visiting the listed properties could reveal something useful was proven when we pulled up to an address in the sale portfolio of a conservative German insurance company. Once on site, we discovered the retail property had burned to the ground two years earlier – something that nobody on the sales team was aware of. In another case, the manager of a supermarket in a top Munich location had not been visited by anyone from the owner's side since the 70s and had always been very happy with his rent of 3.80 Euro per sqm.

Indeed, the visit can even be rewarding for the inspectors: at any rate, there was no shortage of volunteers to inspect the building of a Ferrari dealer. The showroom space and offices were inspected in great detail, but, at first, a separate unit for an "Institute for psychosomatic role play" was not to be looked at. It was only after we pressed the point that we were given access and could assess the condition of a first-class sadomasochism studio. The fixtures and fittings, however, were excluded from the analysis.

Nonetheless, we also shouldn't forget the risks that are faced during the absolutely typical, detailed property visits carried out today: for example, during one such inspection, one of our colleagues had his trousers ripped from top to bottom by a broken wooden security cabinet, but, because the time schedule for the inspections could not have been more demanding, was unable to change into a new pair the whole day long. Then there are our colleagues who, after arriving at a less-frequented airport, happily accepted the Sixt upgrade to an S-class but ended up wishing they'd stuck with the booked Golf-class car when they pulled up at the target property in a seedy location in East Germany. The not exactly friendly attention of residents loitering in front of the building with beers and dogs prevented its closer inspection...

As you can see, property inspections present numerous challenges, even today. We are more than happy to face them when serving our customers. We therefore wish you all the very best for your projects in 2014 and that you have a good and healthy start to the New Year.

overall mix leading to their residents' highest satisfaction ratings. Leipzigers praise the high green content in their city, Leipzig's general standing, high-quality facilities for children and elderly people, and a good urban infrastructure. Not surprisingly, Cologne's residents rate factors very highly that promote sociability and togetherness - proximity to family and friends (62.7%), abundance of cafés and restaurants (63.9%) prominent among the scores they give. Munich, despite its climate and countless opportunities for socialising, gives its highest ratings to its green spaces and its high safety factor, with the city enjoying the lowest degree of social problems in Germany.

Not surprisingly, others of Germany's biggest cities also score well, including Hamburg, Berlin and Dresden. Perhaps a little surprising is the high scores given to the city by the residents of Hannover, pushing the city into 4th place (partly because of the high scores achieved by the city's public transport system).

Germany/Study

Mid-ranking German cities showing greatest dynamism

A close correlation between the degree of dynamism in Germany's cities and a corresponding increase in property prices and rent levels is clearly evident in the latest annual ranking on Germany's cities by business magazine *Wirtschaftswoche*, this time in collaboration with leading German property portal **ImmobilienScout24.**

Among the big winners in this year's survey were the mid-sized cities of Wolfsburg, Ingolstadt and Erlangen, which were right up there with Munich at the very top of the table for economic dynamism. These cities had the most attractive job markets and the highest quality of life of the 71 cities included in the survey, with their success mainly attributed to the above-average exposure to the export sector of the local industries (**Volkswagen** in Wolfsburg, **Audi** in Ingolstadt, **Siemens** in Erlangen).

Not surprisingly, rents in Wolfsburg and Ingolstadt have risen by more than 30% over the past five years – according to ImmobilienScout24, as a result of strong inward flows of workers into the cities for comparatively well-paid jobs. The high rents prevailing in Munich, with its booming economy, have long extended way out into the suburbs.

The *Wirtschaftswoche* rankings indicate that the dynamic in many eastern German cities, so much a feature of the last years, is definitely slowing down as the gap to western German cities is closed. At the bottom of the table, both in existing levels and recent dynamism, are many cities in Germany's

Ruhr region with its stagnating economy, including Oberhausen, Gelsenkirchen and Bottrop.

The methodology of the *Wirtschaftswoche* study, this year appearing for the tenth time, is to work with researchers from the **Institut der deutschen Wirtschaft** in Cologne in analysing the relevant cities (this year 71, many more than the typical 50 cities analysed in the past) under 50 different criteria relating to economic structure, labour market, property market and 'quality of life' factors. This time the survey incorporated market data from ImmobilienScout24's comprehensive database.

Meanwhile, a new study has just been published by **Vitus Immobilien** (featuring elsewhere in this issue as the subject of a possible takeover by Deutsche Annington) which examines the development of yields in Germany's so-called B-cities, i.e. those outside the Big 7.

The study was carried out by Swiss-based real estate consultancy group **Wüest & Partner** on behalf of Vitus Immobilien, and concludes that investment in German residential property in the secondary cities can lead to an average of 2.6% higher yields than in the biggest cities, with the risk for investors either comparable or in many cases less.

If the current yield available in Frankfurt is 5.8%, the study claims by way of comparison, then the yield at the same risk in a secondary city should be higher, with examples given of Bremen at 7.4%, Leipzig at 7.7% and Mönchengladbach at even 8.1%. According to **Ben Lehrecke**, CEO at Vitus Immobilien, commenting on the study, "Investors and residential property owners will find that many secondary cities will provide a sustainably higher yield, largely due to their more balanced risk-yield profile" – yet many of these cities are overlooked or underappreciated. Not all these cities would offer such returns, he concedes, pointing out that risks associated with a location are often very dependent on a mere handful of factors and can hence be very volatile. "Investors with very short investment time horizons also need to be aware of the lower liquidity that secondary cities may offer", he said.

Karsten Juengk *(pictured, right)* at Wüest & Partner said he sees the value of the study as primarily helping investors to avoid blanket judgements. "The purpose of the study was also to cast some new light onto the frequently very intransparent markets of the secondary cities", he added.

The study examined the risk-return profiles of 81 German cities with more than 100,000 inhabitants from a residential property investor's perspective. Factors analysed included rental levels, percentage of income spent on housing, unemployment rate, availability of affordable housing, vacancy rates, and historic local demographic and household trends.

Germany/Listed Companies

TAG Immobilien buys further 2,900-unit portfolio

Listed Hamburg-based residential property investor **TAG Immobilien** closed on a deal just before Christmas to buy a residential portfolio with about 2,860 apartments and 57 commercial units for about €70.5m.

The assets are in 12 eastern German cities, including Rostock, Dresden and Berlin, where TAG's main other holdings are concentrated, while the single biggest 'blocks' are in Cottbus (416 units) and Chemnitz (660 units), cities in which TAG also has a strong local presence. The total lettable space of the portfolio is 170,000 sqm, with the average rent roll about €8.6m annually.

According to TAG, the housing stock in the new portfolio is mainly of a refurbished standard, and with a vacancy rate of 12.6% and a somewhat complicated provenance, there is plenty of upward potential. The non-refurbished part of the portfolio will require about €3m capex over the coming years, but should ultimately yield a higher annual rent roll

CONFERENCE REPORT

Investors in Germany must have long-term orientation, conference hears

Investors considering approaching the German office property market must consider it a long-term proposition, the REFIRE 2013 conference in London was told.

Michael Montebaur (*pictured, right)*, principal of Hanseatic Funds, said that the biggest sector of Germany's real estate market benefited from low interest rates and moderate rental levels but yields had been compressed and overseas investors faced strong domestic competition.

'Germany has always been a low yield market,' he said. 'That's part of being a stable market.' But there was little product and so an ever-greater risk of overpricing. There were investment opportunities, 'but bear in mind that Germany has always been a long-term decision'.

His views were echoed by Stefan Boehme (*pictured, left*) principal of wealth managers. boehme & co. His firm has been concentrating on the top five or seven cities, but had been finding over the past two or three years it was 'difficult to put money down'.

They had switched their definition of prime as only the location but, borrowing the phrase 'managing to core' coined by Rüdiger von Stengel of Art-Invest, he said they were sweating to make returns needed.

Torsten Hollstein (*pictured, right)*, partner in CR Investment Management of Berlin, said liquidity was a problem outside the leading cities where the international investment community already had networks in place.

'If you look at what you can buy for a given amount in London and you want to spend the same amount of money in Germany you get considerably more stones.'

But buying more property meant investors must look at the market liquidity on exit as well as when buying. It was difficult for international investors to buy in smaller markets where there was no established network of advisers. Very often domestic investors were quicker and more convincing to local banks providing financing and working with local authorities.

Douglas Edwards, managing director of Corpus Sireo, said he would expect 'only modest growth in the core seven markets' where 70% of new space was pre-let. 'From my perspective rental growth in the core cities will be moderate to limited.' But he took a 'contrasting view' of regional markets, predicting rental growth of 2% to 3% and picking out such locations as Hanover and Erfurt.

James Knox, a partner in lawyers Berwin Leighton Paisner, noted that international investment in the market had begun in 2003 with the crises in open funds which sold off big portfolios, and then grew with debt-fuelled deals in 2006/2007 when some funds were being closed down.

'In any jurisdiction where you can get an influx of different nationalities and different skill sets it can only be a good thing,' he said of this diversified market.

Boehme, asked if 'green is the new core', noted that clients once took an 'emotional' view of architecture but this was now a necessity. Retailers in particular had changed what they wanted from their spaces. Today, being green was part of the toolbox for mitigating rising costs. But he would rather see a continuous green attitude than a certificate that fixed the building to any particular date.

Knox spoke of 'raised eyebrows' from international investors at some aspects of the German legal framework, for example fixed 10-year leases with a nine-month break clause. His advice: ask a tax lawyer.

So who WAS investing in German office real estate? Edwards said sovereign wealth funds and national funds from the Middle and Far East were investing in core cities, while hedge and other leveraged funds sought opportunistic deals. This was a dumbbell-shaped market with core plus investors steering away.

Hollstein said that while Berlin, for example, was catching up on the expectations of 10 years ago, rents would not rise excessively. This was because 'in the inner city part of Berlin we can build the entire office stock of Frankfurt'. Whenever rents began getting to attractive levels, he said, 'someone will build'.

from page 18

of well above €9m. The bulk of the assets will be transferred to TAG's books as early as the 1st January next month.

This latest deal brings TAG's holding up to over 70,000 apartment units and should give a sustainable boost to the operating cash flow and funds from operations, said CEO **Rolf Elgeti** in a statement. "This deal emphasizes one of TAG's strategic competitive advantages. With such wide geographic dispersion the number of potential competitors is limited, but it plays into our hands because of our existing network and infrastructure. We can leverage our local expertise for the acquisition, and at the same time use our regional network of banking contacts to arrange good financing, as well as benefiting from economies of scale in our administration, and all by using our own existing team of people."

Germany/Study

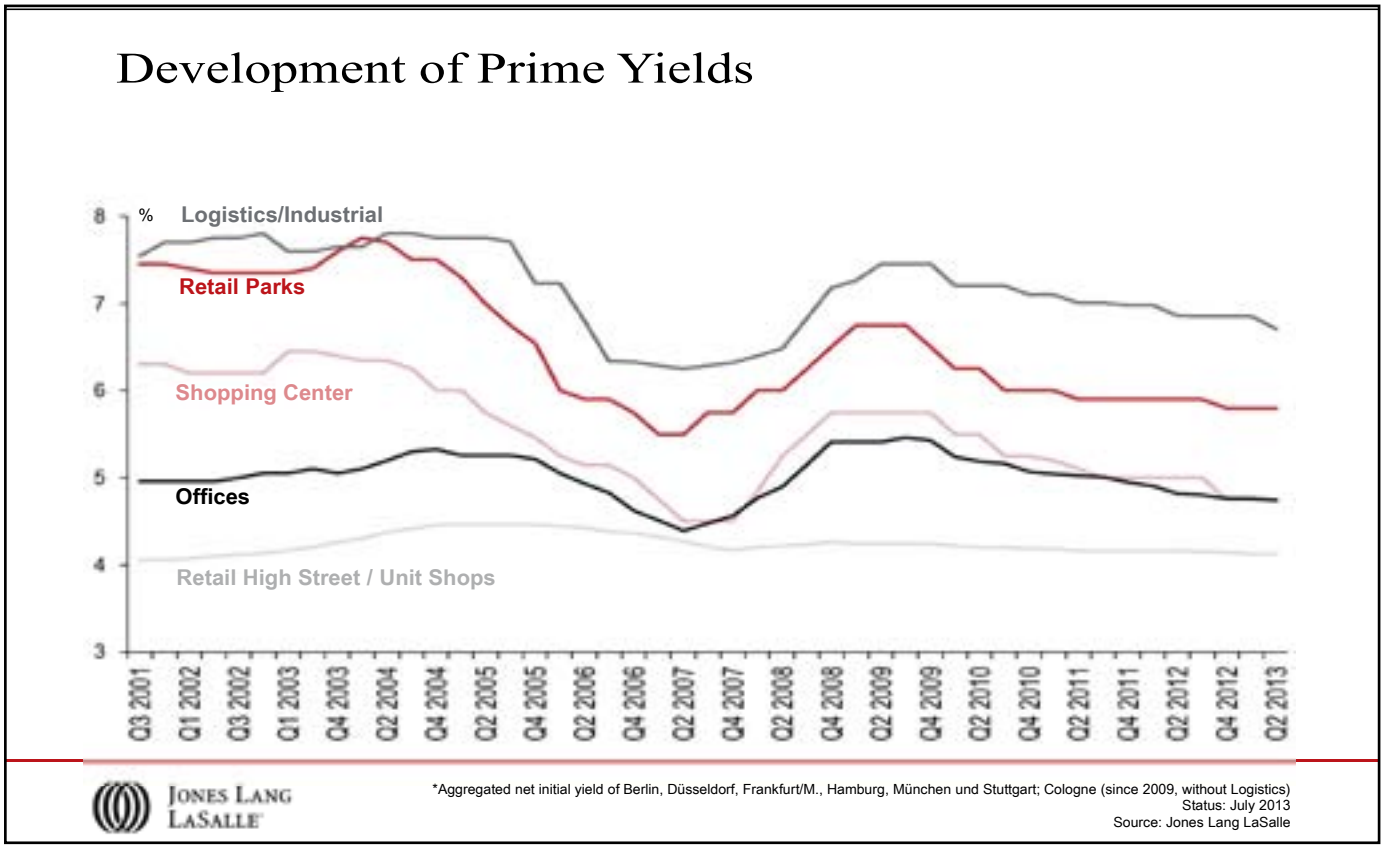
Software, gaming industries increasingly key in German office sector

The latest German market report from property advisor **Colliers International** highlights the increasing demand from the TMT sector and creative industries, and their growing impact on both the German office market and wider economy. The research reveals that these sectors accounted for 14% of leasing agreements signed in Germany over a five year period (2008 – 2013), around 1.7million sqm take-up, the second-highest number of lease agreements in the German office market after consulting businesses.

The report states that the key influencers in demand are rents and location, and as such creative businesses are currently leasing smaller office space compared to other industries, with rental levels recorded at an average of 7% below the overall market average.

The software and gaming industry has dominated creative sector office requirements, accounting for almost half (47%) of take-up in the last five years. This was more than double its nearest competitor, the advertising industry, which had only 21%, followed by the design industry with 9%.

The report reveals – not surprisingly - that Munich is the so-called capital of the creative industry, with the highest number of rental agreements (870) and take-up volume (535,500 sqm) over the time period and a market share of 16%. Of this, the software and gaming industry took more than 50% of take up. In Munich, creative businesses can also expect to pay the highest rents - on average recorded at €15.58 per sqm, although this



is 7% below the overall market average.

Other cities indicated lower rental prices but showed different strengths in other sectors. Dusseldorf was ranked second most expensive at €13.67 per sqm, but is the strongest city for the design industry in Germany, with almost 40 per cent (80,200 sqm) of total take-up volume.

Andreas Trumpp, head of research at Colliers International in Germany, commented, "The creative industry is a prominent pillar of the current German office market. A range of different focal points have been identified in each of the different city locations, as each location associates with different industry specific needs.

"The overall demand in the creative industry is robustly increasing as it becomes a more popular market. As a result of this, we expect to see the software and gaming industry particularly benefit, as its high degree of innovation strength and the on-going digitalization of work/life become more significant to the leasing market in the future."

Germany/Funds

Union Investment entering debt and 'repositioning' fund sectors in 2014

German heavyweight investment manager **Union Investment** said that it expects to launch a range of new investments for institutional clients next year, including debt funds and repositioning fund, to broaden its product offering and build on the expanded range of products it introduced throughout 2013.

The Hamburg-based Union Investment raised nearly €1.4 billion of new capital this year for its institutional funds, and introduced six new products, including a fund for budget hotels and an infrastructure fund for renewable energy.

According to **Dr Christophe Schumacher**, board member at Union Investment Institutional Property GmbH, most of the acquired capital has already been invested in assets. "The start-up phase of our new products has been highly successful in the hotel segment, but also in terms of office real estate in mid sized German cities", he said.

As the '800-pound gorilla' in the sector, Union Investment with its enormous distribution clout has undoubtedly been a beneficiary of the demise of the weaker open-ended funds in Germany. Banks, foundations and other institutional investors have this year ploughed in 421 million into the two of the group's open-

UPCOMING EVENTS AND CONFERENCES

EVENTS/ CONFERENCES Jan-Feb-March 2014

December 3rd-4th, Tuesday-Wednesday
9th annual New Europe GRI, Warsaw
This year bringing together board and C-level real estate investors, developers and lenders active in CEE. The usual GRI format of open discussions with local and international real estate players.
More at www.globalrealestate.org

February 4th-5th, Tues-Wednesday
ULI Europe Annual Conference 2014, Westin Hotel, Paris, France
The 18th ULI Europe Annual Conference will be themed 'Rethinking, Reinvention and Recovery', reflecting the continued improvement in sentiment towards Europe's real estate markets. The conference is being chaired by Giancarlo Scotti, CEO of Generali Real Estate.i
More at www.parisconference.uli.org

February 11th-12th, Tues-Wednesday
24th Quo Vadis, Adlon Kempinski Hotel, Berlin
The 24th edition of the Heuer-Dialog managed early-year conference for the Gemran real estate industry, the German-language event normally attracts about 300 visitors from the top ranks of German real estate. Will Germany remain the focus for leading institutional investors?.
More at www.heuer-dialog.de

March 11th-14th, Tues-Friday
MIPIM, Cannes
The 25th staging of the annual world's commercial property fair. Last year with 19,000 sqm of exhibitors on 40,000 sqm of space, 2,000 exhibinting companies from 80 countries, 20,000 individual participants, 3,000 CEOs and chairmen, 4,300 investors, 460 journalists, and more. Firmly established as one of the key events of the real estate calendar.
.More at www.heuer-dialog.de

ended funds, **UniInstitutional European Real Estate** and **UniInstitutional German Real Estate**. The latter is a new Germany-focused fund, accounting for €100 million of the total, and was heavily oversubscribed in its second subscription phase. Altogether, Union secured new capital commitments of about 222 million for its six special real estate funds throughout the year.

Union also raised about €224 million for its service mandate business, where the group acts on behalf of pension funds and insurance companies. A further €500 million of new investment capital was raised to enable investors pull the real estate investment into one place, and, with service mandates and pooling vehicles now valued at about1.1bn in place, Schumacher said that expanding this side of the business was a priority.

The plan for a new repositioning fund was hatched out of the company's own experience in refurbishing buildings from its own property stock – with the former Unilever headquarters in Hamburg being a prominent example. We reported in an earlier issue of REFIRE this year that Schumacher (*pictured, above*) had indicated that the group was looking seriously at a move into the creation of debt funds for some time, after several institutional investors had suggested that Union would be a preferred partner for them.

The group has also had success this year in raising money for its sustainable renewable energy fund – with several investors coming back for a second helping. The strategy focuses exclusively on onshore wind energy parks in Germany and neighbouring European countries, including France and Ireland to date. The fund may also invest very selectively in photovoltaic plants, and is expected to reach its target size of €300 million equity by 2016, giving it firepower of nearly €800m with leverage.

Germany/Funds

Internos sees Germany as key to resurgence in funds sector

Our most recent issue of REFIRE included notes on a meeting we had recently held with **Paul Muno**, head of Internos's operations in Germany. The thrust of that conversation had to do with Internos's own drive to reach the kind of critical mass in Europe that would make it a serious partner for Asian and other sovereign wealth funds – specifically, to increase assets under management from their current €4.1bn to €5bn by the end of next year.

The latest issue of Internos's in-house publication *The Decisive Eye* highlights what the company sees as a "complicity of positive trends which have transformed prospects for real estate funds in Europe." The content, penned by Internos's CEO **Andrew Thornton**, emphasises the new approach that several American, Asian and even Australian institutional investors are taking to what they see as first-class opportunities in Europe - albeit arising from the beaten-down nature of European markets against a background of bank unbundling. In particular, he points out how "intelligent but still cautious" investors are focusing on secondary real estate away from glamorous centres towards higher yielding areas of the UK, France and particularly Germany.

Germany, says Thornton, will play a fundamental role in the resurgence of European real estate funds. Here we quote directly from the Internos document, which looks at Germany as both an investee and an investor nation:

"Europe's dominant economy has not pulled a fair share of cross-border capital. The reasons for this are clear: Germany has a dispersed economy with no dominant metropolis. Strategic asset management scarcely exists at the managing agent level unlike, say, in the UK. The outside investor has to pick a city, grasp the heft of local businesses(the much lauded *Mittelstand*) as well as national or global

...see page 25

CORPUS SIREO
REAL ESTATE

A BOOMING MARKET SEGMENT: 100 NEW MEDICAL SERVICE CENTRES CREATED ANNUALLY

Guest essay by:

Douglas Edwards, Managing Director, CORPUS SIREO Investment Management S. à r.l.

CORPUS SIREO expects rapid growth in this market segment of healthcare real estate, creating challenges for both project developers and asset managers alike.

Medical Office Buildings (MOBs), the properties housing the new medical centres, represent a growth driven segment in Germany's real estate market, assisted by the emergence of a new and dynamic tenant base – the "Medizinische Versorgungszentren" (MVZ). Between 2006 and 2011, the development and growth of MVZs, assisted by proactive legislation, tripled in number, climbing to around 1,800, whilst the number of physicians employed in these facilities doubled to an average of six per MVZ during the same period of time. CORPUS SIREO expects a long-term annual completion rate of circa 100 new MVZs, which will continue to drive demand for the development of new MOBs.

Recent publications by the German National Association of Statutory Health Insurance Physicians (KBV) substantiated the sustained growth of the MVZ segment. Totaling around 1,800 facilities by the end of 2011, their number increased several fold since the introduction of the 2004 legislation which allowed for their creation. This growth trend is expected to continue in the wake of the 2012 Supply Structure Act (VStG). There is also a defined upward trend in the scale and networking intensity within the existing MVZ segment, in particular when they are co-sponsored by a hospital organization.

MVZ: A growing tenant base

What sets MVZs apart from the traditional medical centers ("Ärztehäuser") and medical service centres ("Gesundheitszentren") is mainly their organizational and legal form. In the former two types, physicians rent out office space in their own right. Resident physicians operating within an MVZ, are by contrast, jointly organized in a private limited company (GmbH) or a private partnership (GbR). An MVZ is able to be a multi-disciplined organization having

within its operating structure a variety of healthcare professionals, other than just physicians, all of whom seek are able to offer patients with their ambulatory care needs. MVZs are frequently operated by hospitals, the idea being to expand their service spectrum. These cooperative business models generate organizational and financial synergistic benefits, whilst patients benefit from direct contact to an array of specialist physicians and healthcare professionals within a single entity.

MOBs: Continued rise in demand

The properties housing MVZs are referred to as "medical office buildings" (MOB). The current rise in demand for these assets, which is forecast to continue to expand given Germany's demographic trend, represents a real challenge for project developers and asset managers alike, due to the specials requirements associated with purpose-built properties of this type.

An MOB typically accommodates 10 – 25 tenants on a net lettable area of 3,000 to 5,000 square meters. The investment volume for this type of property can range from €5 – €30mn, which creates a need to aggregate and manage the assets on a regional, sub regional basis, ensuring economies of scale and ability to attract institutional capital into the sector. The current project developers constructing MOBs still tend to be regional or city focused, meaning an investor has to be able to reach across a number of markets to facilitate a wider investment strategy in the sector. The fact that the MVZs are rooted in their local communities, and the MOBs housing them tend to let space to them on leases as long as 15, or even 20 years, makes investment in this real estate segment highly interesting for safety-conscious, income driven, investors. The US market has seen the strongest development by far in this field of healthcare real estate, with numerous listed REITs and institutions operating within the MoB sector.

Having been active in the "healthcare real estate" segment for many years with its own institutional funds, CORPUS SIREO now intends to step up its commitment in this market.

For more informations, please go to: www.corpussireo.com
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entities and get more involved in driving continuous asset improvement then in the UK. This is not a simple endeavour and it takes German feet on German ground to master the complexity. This is particularly so because, for those sensibly seeking German assets to balance a portfolio, the prime office scene in the top six cities is crowded out by home-grown capital. Opportunity for the foreign investor lies, for example, in regional retail or specialist real estate. Here lies the appeal of a fund manager with the German asset team able to operate 'close to the dirt'"

Thornton refers to the recent German penchant for institutions to favour indirect investment in real estate via funds rather than investing directly (up from 46% to 60% recently). He says "Diversification from the retrenchment scenario of 2008 is the name of the game and, though some of the diversity cash will head away from Europe, fund managers are increasingly helping German institutions elsewhere in Europe or to establish footholds in 'alternative' real estate both within and outside Germany. None of this is surprising given the grim yields available for more liquid investments made within German borders, for sovereign bonds especially."

The Internos view is clearly not an outlier – there have been a number of major fund closings over this last quarter all targeting European opportunities. **Orion Capital Managers** recently announced the closing of its latest vehicle at €1.3bn, with a mandate to "invest in the full spectrum of real estate assets, loans, portfolios or real estate companies across Europe.

Just this week **Tristan Capital Partners** said it is finalising its fund raising for its **European Property Investors Special Opportunities III Fund**, which could hit €950m. The fund is set to target "value-add investments and distress opportunities arising from the shortage of debt and equity capital."

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Germany/Listed Companies

Postponement of LEO I deal contributes to Patrizia profit shortfall

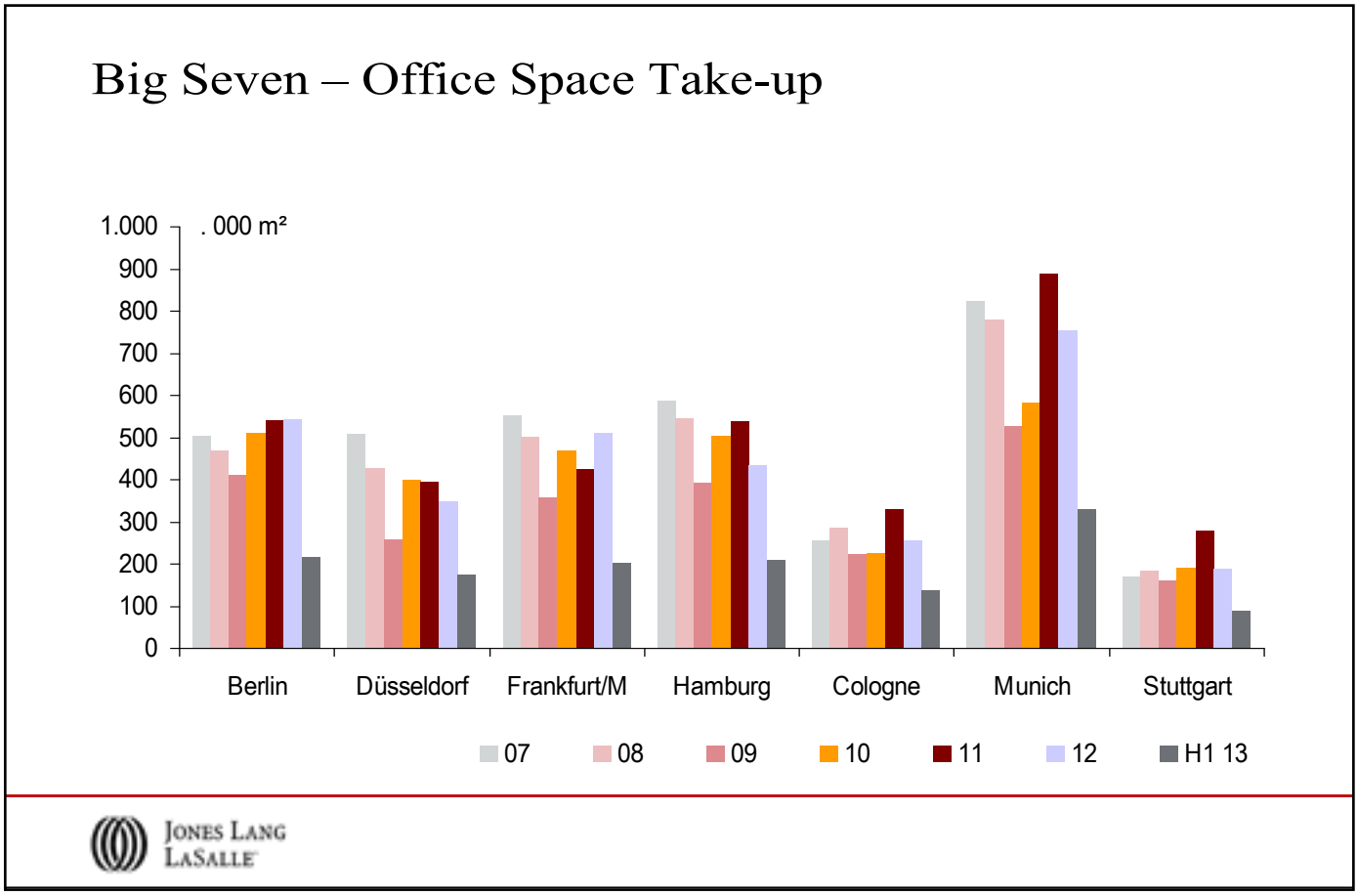
The postponement of a major deal announcement , along with what it described as the costs of complying with the European Union's AIFM directive, led to the listed Augsburg-based **Patrizia Immobilien** issuing a warning that it would miss its profit guidance for the full year, but it nonetheless said it sees the company back on track by early next year.

The company said it was now expecting an operating profit for full-year 2013 of between €38m and €41m, well below the previously forecast expectation of at least €47m, issued as late as November. However, it forecast an operating profit of at least €50m for 2014. For 2012, the company booked an operating profit of €43.9m.

In analyst circles in Frankfurt there was a certain amount of disgruntlement about the profit warning so late in the day, although a number of sources were quoted in the German business press as saying the company had been somewhat reticent about its second-half performance, as it transitions from being a property investor to being a fund initiator and property manager.

As part of this transition, Patrizia has been involved in some of the biggest deals of the year in Germany, increasing its assets under management to about €12bn from last year's €7bn. By pooling cash from insurance companies and pension funds, Patrizia bought Bavarian landlord **GBW AG** for €2.5bn in the biggest residential for five years, after similarly pooling investors together to buy the residential housing division of Stuttgart bank **LBBW.**

It has been an open secret for some weeks that a consortium led by Patrizia has been in talks to buy a distressed portfolio of offices from **FMS Wertmanagement**, the 'bad bank' of failed lender **Hypo Real Estate**. The portfolio, known as **LEO I,** is part of the assets that the bad bank is winding down of Hypo Real Estate. The portfolio consists of 18 buildings leased to the state government of Hesse and included the finance ministry in Wiesbaden and the police headquarters in Frankfurt. CEO **Wolfgang Egger** (*pictured, previous page*) had said after the third quar-



ter that the company would need a big deal to go through to meet its full year targets, so the delaying of this deal into the next quarter would seem to explain the missed full year targets.

In September, Patrizia itself bought the **LEO II** portfolio for €800m from Austria's **CA Immobilien AG**, which is currently lightening up on its German office holdings to pay down excessive debt.

Germany/Banking

Aareal Bank takes over Corealcredit Bank from Lone Star

Turnaround specialist Lone Star has been seeking a buyer for its commercial property finance provider Corealcredit Bank AG for some time, and it has now concluded a deal with Aareal Bank to sell its charge for a preliminary purchase price of €342m.

The Wiesbaden-based Aareal Bank said the transaction would be completed during the first half of next year, after gaining the necessary approvals from the financial authorities.

Lone Star bought over the nearly-defunct AHBR bank in 2005 after that bank had been brought to its knees by disastrous interest rate speculation. Under Lone Star's protective wings, the bank has been gradually rehabilitated and repositioned as a specialist financier for domestic investors in commercial property. The bank actually returned to profit in 2007. The bank has total assets of €7.6bn, with commercial property financing volume of €3.6bn.

The price Aareal Bank is paying is at a discount to Corealcredit's book value, with Aareal saying in a statement that it was financing the deal from its own resources. The positive effect on earnings per share for Aareal will be more than €3.00, with Aareal's medium-term return on equity of 12% pre-tax remaining unchanged, said the statement.

Since its rehabilitation, the Frank-

CONFERENCE REPORT

Ignore technical due diligence at your peril, conference hears

Investors in German real estate are taking a more active role in managing their assets, the REFIRE 2013 conference heard.

John Atkins, (right) head of clients at **Arcadis**, was arguing that technical due diligence can drive better performance and produce more sustainable returns.

Investors and tenants were more environmentally and socially aware, demanding when they renewed leases 'more energy and workplaces which reflect their corporate social responsibility requirements'.

Research to be published shortly by Arcadis would show that Hamburg and Frankfurt had emerged as places where you could increase the value of stock through a major refurbishment programme. Doing nothing, he said, risked damaging your asset values.

You could take almost any building in Germany and improve on its energy costs. Investors were looking for long-term value over, say, 10 to 15 years and the way to do this was by developing key performance indicators for the asset.

Dr Thomas Herr (*pictured, below)* managing partner at **VALTEQ**, took a differing view. 'My impression is that investors are still more focused on rent - not risk - when it comes to technical due diligence', he said.

Dr. Herr pointed to six key issues in technical due diligence:

1. Fire protection, especially in large, empty office buildings of the 1970s and 80s. 'It's not only our experience that they don't meet the future requirements, it's that they nenver met the current requirements.' This could make it difficult to obtain permission for re-use of a building.
2. Energy savings. From next April if you touched more than 10% of the area in a building renewal, it must comply with the new energy saving codes.
3. Water quality and sewage disposal.
4. Concrete repairs needed after damage caused by salts. As an aside he noted that many car park bays were 2.30m wide but cars were getting bigger and bigger, so no longer fitted.

5. Replacement of building managements systems. Components are often unavailable for older systems.
6. Disposal of hazardous building materials. These could be 'a killer' by adding 3 to 5% to refurbishment costs.

In addition, he said, the lifetime of buildings was getting shorter – down from 40-50 years to 20-30 years now. Tenant turnover was more frequent. The coalition discussions to form a new government were talking about increasing from 2% to 4% the accepted rate of depreciation. This would have an impact on investors' capital expenditure needs.

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furt-based Corealcredit Bank has been mainly financing commercial properties with maturities of up to 10 years, financing volumes of 10m and upwards, and as a Pfandbrief-issuing bank, can normally lend up to 75% of an asset's market value. It has 175 staff, with offices in Frankfurt, Berlin, Hamburg, Düsseldorf, Stuttgart and Munich.

Germany/Study

UK insurer on real estate implications of shrinking German population

It is widely known that Germany's population is shrinking, as the Germans have too few children and the population ages. Current rates of immigration are not enough to sustain the population, and even at higher rates of net population inflow, the country is likely to face a fall in population by nearly 10.2m or 12% over the coming 40 years.

Now UK-based insurance company and property manager **Aviva Investors** has issued a new study on the real estate implications in Europe's largest country as it faces up to its demographic shrinkage.

The Aviva researchers point to how Germany's working-age population is forecast to fall by 27% through 2050, driving a sharp rise in Germany's dependency ratio. For every 100 people of working age, the 51 people of non-working age is forecast to reach 83.

Not all of Germany's sixteen federal states are faced with the same demographic dilemma – with wide variations depending on region. For example, by 2025 the eastern German state of Saxony is set to shrink by 9.6% while Hamburg's population is expected to grow by 7% for instance.

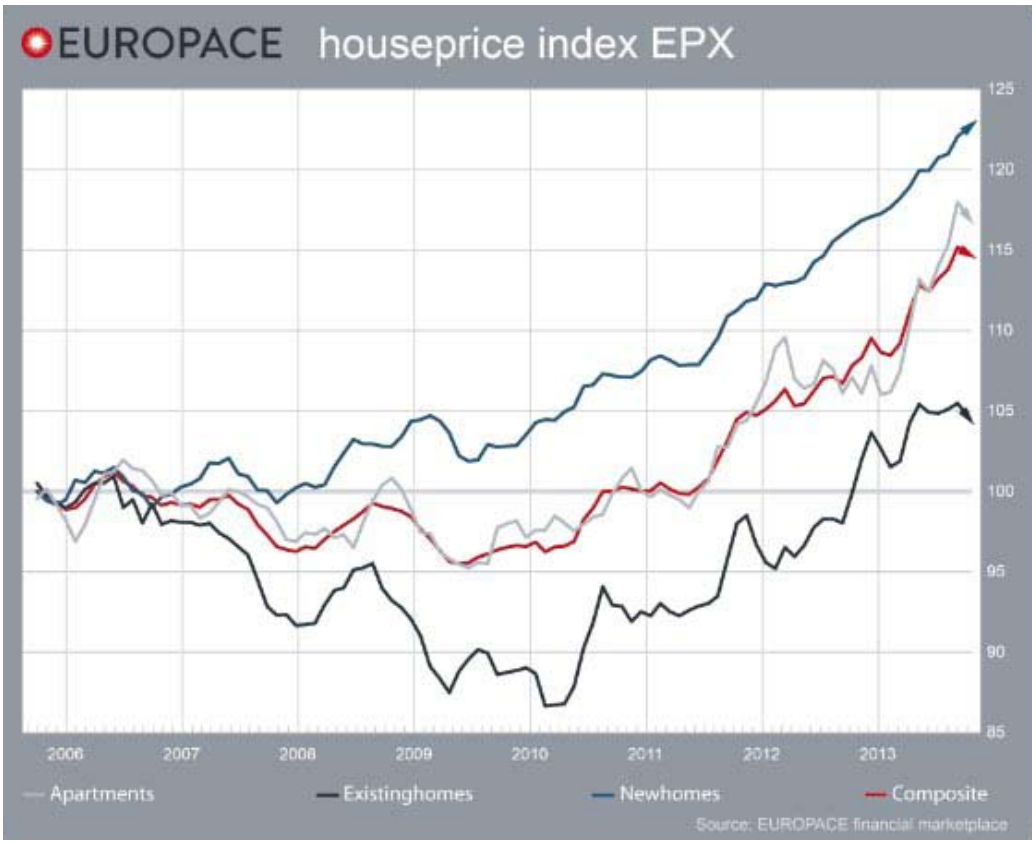
According to **Darren Sriharan**, a researcher at Aviva, "At a state level there seems to be an East-West divide… With the exception of Berlin, the eastern states in Germany will see a greater fall in total population and working age population and a steeper increase in the dependency ratio. The rate of change is less dramatic but still evident in western and southern states."

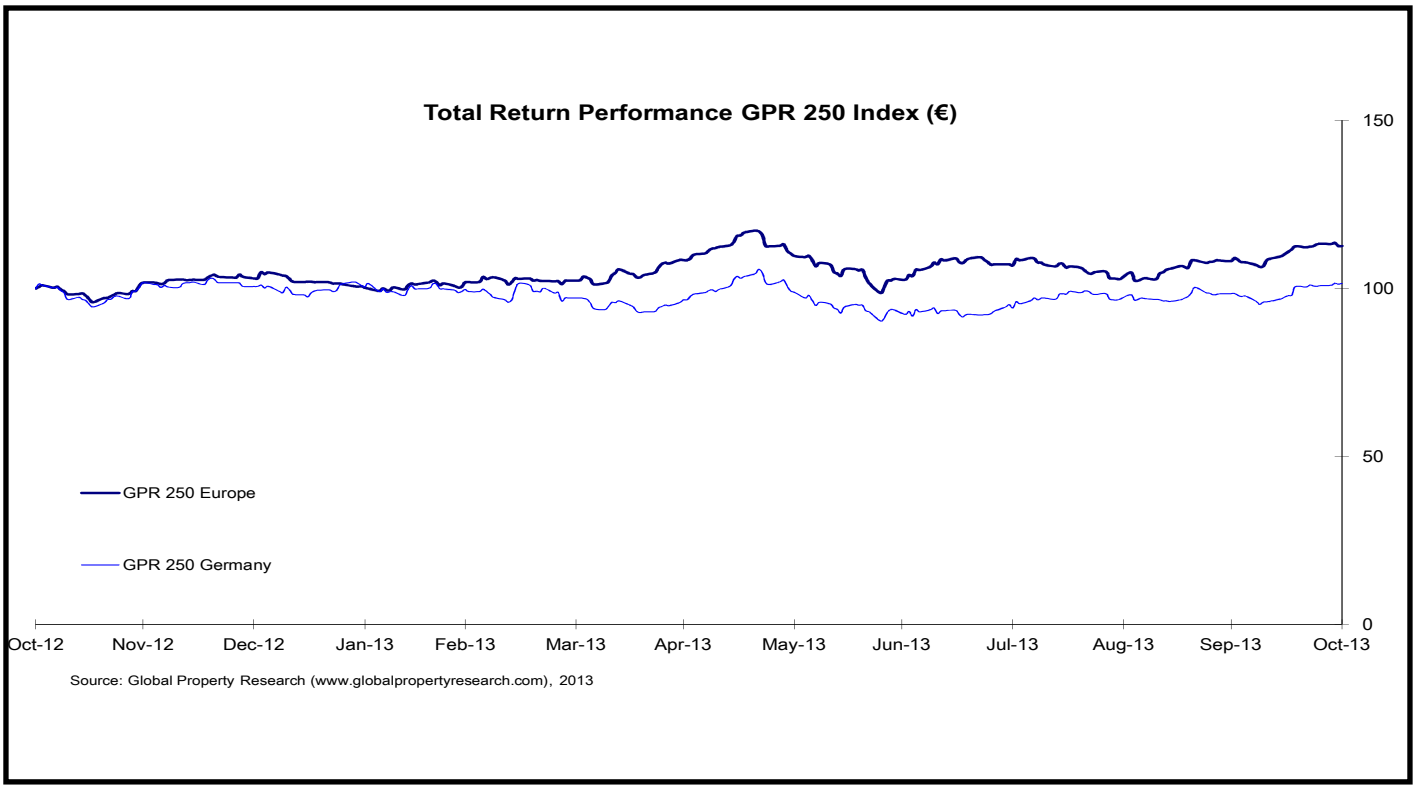
Demographic changes can have a major impact upon real estate. Reflecting changes in consumption, requirements and habits, the need for certain types of real estate rises and falls as people age. With the German non-working age population set to increase, Aviva Investors predicts there will be a shift in demand for different types of real estate.

Not unsurprisingly, healthcare property will benefit from greater infrastructure required to care for an aging population. „The expected rise in the number of older people over the long term will present investment opportunities in the healthcare sector, including hospitals, nursing homes and other medical facilities," it said.

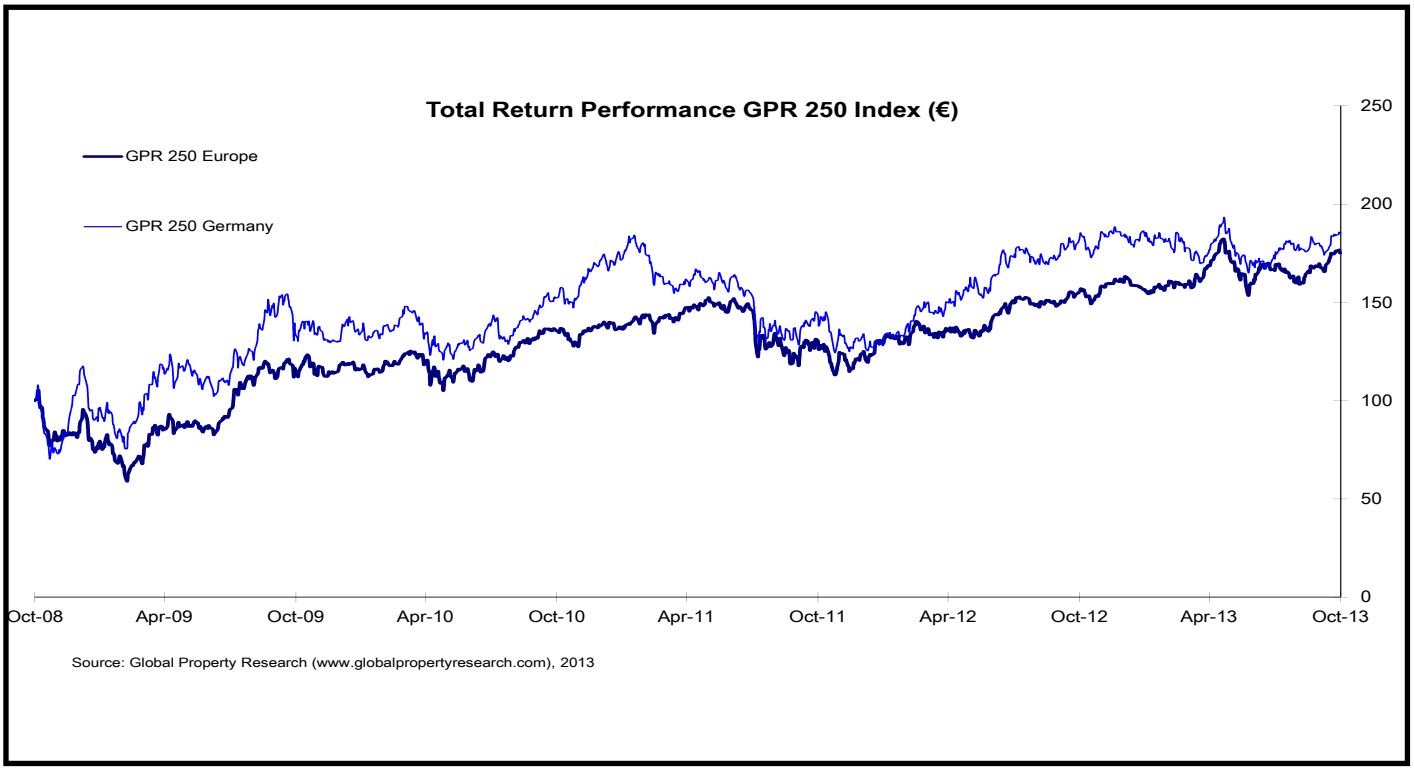
In retail, the sector will have to reposition for a different client base. "Retailers and retail locations that rely upon young fashion to drive high levels of sales will suffer from the declining youth population. Older households tend to spend less of their consumption budget on clothing .. and therefore the outlook for the non-food retail and brands sector look weak… This trend however creates an opportunity for shopping centres to capture an older spend by adapting communal areas and readjusting their tenant mixes."

In housing, rising demand for smaller units means a greater demand for smaller residential properties. In office, fewer people of working age implies less demand for space. With the working-age population in Germany set to fall by 14.8m by 2050, the labour supply is likely to tighten and demand will fall.





Graph of Total Return Performance of Europe and Germany in € currency over the past twelve months



Graph of the total return performance of Europe and Germany in Euro currency over the past five years
REFIRE charts courtesy of GPR, Global Property Research

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Our readers are global investors in real estate, asset managers, REITs and other real estate investing vehicles, lawyers, private investors, public sector authorities – in short, anybody who is interested in staying up-to-date with and learning more about real estate finance in continental Europe.

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