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

REFIRE has an extensive network of contacts in the field of continental European real-estate finance, which enables us to bring you the latest and most relevant news. However, we always want to know more about what's going on in this dynamic sector, so make sure your company is keeping us informed of your moves. Send your media communications to news@refire-online.com for our consideration.

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Annington issues formal Gagfah offer, speculation on further listed takeovers

Deutsche Annington kicked off its campaign the week before Christmas to win the hearts and minds of rival Gagfah's shareholders, who have until 21st January to decide on Annington's takeover for their company. The company tabled its official offer for Gagfah, which values Gagfah at €3.9bn, or €18.00 per share, a premium of 16% on the share price prevailing at the time of the offer at end-November.

That the takeover will go ahead is not considered to be in much doubt, with Gagfah and Annington's top management clearly in agreement as to the likely future direction of such a merged residential housing giant. The new company will have 350,000 apartments and a valuation of €21bn, polevaulting it into position as Europe's second-largest real estate company behind **Unibail-Rodamco**.

Annington has spoken of synergy effects of at least €84m annually by combining the two huge companies' resources, after a one time charge of about €310m. These savings can be realised, says Annington, by refinancing Gagfah's debt on more favourable terms, achieving scale effects in centralised buying and in lowering personnel costs. A report in this week's *Manager Magazin* suggests that the bulk of the job losses will come in the Essen-based Gagfah's head office administration. Gagfah has 1500 employees, while the Bochum-based Annington has 3400.

Bracing itself for its new size, Annington last week issued a €1bn perpetual hybrid bond with a coupon of 4% and a first call date in 2021, which was well over-subscribed. **JP Morgan** was the sole book runner for the placement. The bond is structured in such a way that it will be treated as 100% equity under IFRS accounting and as 50% equity for 7 years by rating agency S&P. Annington's CFO **Dr. Stefan Kirsten** commented, "This successful placement underlines that investors view our planned combination with Gagfah as positively as we do."

Terra Firma planning €2bn sale of Tank & Rast in 2015

A recent Bloomberg report suggests that Terra Firma Capital Partners, the private equity firm founded by Guy Hands, is laying the groundwork for a sale of the German autobahn service station chain Tank & Rast GmbH, in a deal that could value the business at more than €2bn. see page 2

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CR wins €350m+ bid for ex-Treveria German portfolio

Independent London and Berlin-based financial advisor, investor and asset manager CR Investment Management managed to clinch the 127-unit "Project Sunrise" German retail portfolio for a price thought to be more than €350m. The deal will see note holders in the outstanding securitised Talisman 6 CMBS loan fully repaid. page 6

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The Lilien-Carré in Wiesbaden has become a landmark building since its construction in 2007, both for its elegant and distinctive architecture as well as its location right next to the main train station and terminus for thousands of commuters travelling daily to work in nearby Mainz or Frankfurt.....see page 6

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Trade publication *Immobilien Zeitung* last week reported on a note issued by the analysts at **Bankhaus Lampe** about future possible mergers among German listed real estate companies. The analysts conclude that Annington's bid for Gagfah focused on the housing portfolio that "would have been the target or potential merger partner for any of the remaining large German residential housing companies". In other words, the Nr. 2 in the industry, **Deutsche Wohnen AG**, "has thus probably missed out on its most ideal takeover target", suggest the analysts, and at this stage if it attempts a merger with any other smaller candidates in an attempte to keep pace with the Annington-Gagfah monolith, it could actually weaken the company.

"In fact, Deutsche Wohnen could itself become a target for the new massively-integrated Annington-Gagfah combine, which the analysts now view as having the size, resources and presence to take over anybody"

The Lampe analysts see a Deutsche Wohnen takeover of **LEG Immobilien** or **TAG Immobilien** as being its best bet of gaining further critical mass in its drive for growth. LEG has all of its housing stock of 110,000 units geographically focused in North Rhine-Westphalia, while the Hamburg-based TAG Immobilien has most of its assets in northern and eastern Germany. TAG would be the preferred option, say the analysts, largely because of the geographical spread which would involve only a minimum number of job losses at headquarters through duplication. The downside to such a takeover, however, would be the relatively low density of TAG housing in the big cities, which would endanger the so-called 'urban profile' with which Deutsche Wohnen can command a premium for its share price over its NAV – currently at a sizeable 32%. Any dilution of this premium would lower the company's enterprise value and possibly turn it into a takeover candidate itself.

In fact, Deutsche Wohnen could itself become a target for the new massively-integrated Annington-Gagfah combine, which the analysts now view has having the size, financial resources and nationwide presence to absorb almost any company. A possible further takeover by Annington of LEG Immobilien could make sense, although LEG too is trading at 19% above NAV. Given the current enthusiasm for consolidation in the residential sector, the analysts point out, the average share price premium over NAV is 22%, with only TAG trading at a modest 4% premium. For real value, say the analysts, you have to look at the listed commercial property sector, where the opposite applies, with most companies trading at a discount to NAV and likely offering better value at this point.

Germany/IPOs

Terra Firma planning €2bn sale of Tank & Rast in 2015 – report

A recent *Bloomberg* report suggests that **Terra Firma Capital Partners**, the private equity firm founded by Guy Hands, is laying the groundwork for a sale of the German autobahn service station chain **Tank & Rast GmbH**, in a deal that could value the business at more than €2bn. The report cited a number of unnamed individuals who said Terra Firma had been meeting with potential advisors with the goal of selling the Bonn-based Tank & Rast in the first half of 2015.

According to Tank & Rast's own website, the company operates 390 service stations and 350 petrol stations and 50 hotels throughout the German autobahn network, giving it about 90% of the market, while its food and drink conces-

sions serve about 500m visitors annually. The highly cash-generative operating model is underpinned by long-term government concessions, which allows it to generate revenue through retail, restaurants, toilet facilities (a visit to the ubiquitous *'Sanifair'* toilets now costs €0.70) and petrol sales.

The outlets now have 210 bakery counters, along with more than 250 **Segafredo**, **Lavazza** and **Dallmayr** coffee bars. (A notable exception is **Starbucks**, whose negotiations with Tank & Rast ended fruitlessly earlier this year). Other well-known brands offering their onsite products include **Burger King**, **McDonalds** and seafood restaurant chain **Nordsee**.

Terra Firma paid about €1bn to buy a majority stake in Tank & Rast in 2004. It subsequently sold half of its interest to **Deutsche Bank** subsidiary **RREEF Infrastructure Management** in 2007, using a €2.27bn leveraged loan financing to back the buyout. Both companies completed a €1.45bn debt refinancing last December.

Germany/Residential

Helaba report sees German housing remaining dynamic through 2015

The latest **Real Estate Report** from Frankfurt-based landesbank **Helaba** sees little change on the German housing market over the next twelve months, with housing construction continuing to lag demand in the larger cities.

Strong demand, insufficient building activity and the unchanged interest rate environment still argue in favour of a continued rise in house prices, say the Helaba researchers, even if individual indicators are suggesting the opposite. While construction activity continues to expand, it is still likely to lag behind demand next year. Using the latest data available, the population in the seven largest cities grew by 113,000 over the last twelve months, but only 30,000 housing units were completed. With an average household size of less than two persons, the gap between supply and demand continues to widen, and is reflected in price rises in those cities.

The researchers also point to low mortgage interest rates and the lack of investment alternatives as further grounds for continued support, despite regular warnings from the **Deutsche Bundesbank** of overheating in individual subsectors. Conservative financing practices and only a moderate rise in overall credit volume for housing financing over the past four years continue to mitigate against the bubble-developing argument, they say.

The Helaba researchers also comment on the lack of a consistent picture being presented by a variety of different price indicators. Some suggest an end to the uptrend, others to the rate of increase slowing down, while yet others point to an unchecked upward price trend. The more frequently the indices are updated, the greater the volatility in that index's readings, they remind us. The bank's own view is that the uptrend will continue through 2015, albeit somewhat slower

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EDITORIAL

Germany gets the green light for more of the same in 2015

One of the key reasons cited in Germany for the non-existence of a residential housing price bubble is the moderation with which German banks have been extending finance for property investment. The Deutsche Bundesbank's oft-cited fears that property may be up to 25% overvalued in certain quarters in the larger German cities are frequently allayed by critics who point to the low interest rate environment, long-term lock-ins of loans at these fixed low rates, and the higher level of equity that many German buyers have been stumping up to realise the dream of owning their own roof and four walls.

Here at REFIRE we've been following the German domestic housing market as part of our brief for the last ten years. We witnessed the demise of the 100%-plus financiers such as ING, GMAC-RFC, and a Deutsche Bank subsidiary muscling in on what looked like an emerging lucrative sector back in 2006 when the privatisation mania in Germany was beginning to take hold – just prior to the global financial crash.

Since then we've largely been hearing the moral tale of sound German financing practices, the need for high levels of personal equity to maintain investor probity, and how there is little danger of overheating because of the stable levels of bank lending into the sector.

We're now certainly witnessing a much bigger push into the provision of home loans by Germany's banks as the downside of low interest rates means fixed-income investments are much less attractive. According to Barkow Consulting, the margin on mortgages averages 1.2% compared to less than 1% on government bonds, hence the banks are shifting resources to grab a bigger share of the one segment that's doing well, although overall the mortgage lending market surprisingly seems to be actually shrinking.

According to the Bundesbank, sector lending to homebuyers was €168bn for the first ten months of 2014, down 0.4% in value terms from a year ago, but up 2% in number of mortgages from a year earlier. So what's really happening is what Germans like to call a *Verdrängungswettbewerb*, where ever more competitors compete for a larger share of a fixed pie. With 2015 shaping up to be just as competitive as 2015, several big lenders are taking steps to gain an edge on their competition.

The housewife's favourite, Deutsche Postbank, which is part of Germany's largest bank Deutsche Bank, is doubling its number of home loan advisers to 600 and creating a borrower-friendly website where customers can apply for a home loan. It plans to reduce rates to attract new customers, offering a 10-year mortgage with a rate of 1.5% fixed for 10 years, on a 60% loan-to-value ratio.

Rival Commerzbank, with more than 12% market share, is also making a big thrust into more home lending by aggressively targeting its existing customers with loyalty discounts and other preferred customer benefits, including the option of getting approval for government subsidies for energy-saving improvement while still in the loan application process. Commerzbank is offering 1.3% fixed for a 10-year, €100,000 loan.

Other banks, including ING-DiBa, are actively looking at reducing rates in cities where competition from other banks is highest, and where prices have risen the most, such as in the biggest seven cities. And still, if the figures from the European Central Bank are to be believed, the share that Germans who take out mortgages spend from their household income on loan repayments is no more than 12.8%, compared to 17.4% in France and 20.5% in Spain. The evidence is that Germans really *are* taking less risk, stumping up more equity and paying off principal faster than in the past, at interest rates fixed for longer periods.

It is little wonder then, if this reflects the emerging model in Europe's biggest housing market, that a fundamental seachange may be underway that will see Germany emerge from a nation of renters to one where owner occupiership starts approaching levels seen in neighbouring European countries. It may take a while, but it's moving in that direction.

As we head into the Christmas period, Germany's DIFI Index on financing sentiment, managed jointly by property adviser JLL and the ZEW (Centre for European Economic Research) has just reached a new all-time high, despite what the latest report describes as "remarkable in view of current tensions in the overall economic situation… and where almost all German economic indicators for the current year have been adjusted downwards." Financing conditions for all sectors – office, retail and logistics – have improved strongly over the past six months, boosted by expansive monetary policies and Germany's good showing in the recent bank stress tests.

For these researchers, the prognosis for 2015 is clear: Germany's biggest cities are heading for a further year of real estate price rises, particularly in the office and residential sectors. All the lights seem to have turned green. This would normally disturb us, but we too are looking forward to the break. We wish all our readers a peaceful Christmas, and look forward to a productive new year in 2015.

Charles Kingston, Editor

next year. Individual cities, depending on supply and demand conditions, may see an end to the upward trend, while in certain market segments, such as the very luxury end, the zenith has probably already been reached, they say.

Meanwhile the **Europace House Price Index EPX**, which we follow closely at REFIRE based as it is on actual prices transacted, rose in November by 0.13% on the previous month, to 117.24 points on its own proprietary scale. The sub-index for private apartments (condominiums) rose by 0.56% to 115.55 points, almost exactly where it was one year ago (end-November 2013). Existing single- and two-family homes held stable over October at 109.09 points, but show a rise of 4.52% over a 12-month period. For new-build single- and two-family homes the EPX index dipped slightly, for only the second time this year.

Thilo Wiegand, the CEO of Europace commented, "Even if we're seeing a momentary dip in the EPX sub-index for single- and two-family homes, the fact is that demand for residential housing is still not being met. We see no trend reversal in any segment of the housing market. The ongoing low interest rate environment simply makes investing in property still too attractive."

The EPX Index is measured monthly by **Hypoport** subsidiary Europace, and measures transactional data from properties actually financed across the Europace electronic matching platform, which covers about 15% of all real private real estate transactions in Germany. The index was set for all sub-categories (apartments, new homes, existing homes) at 100 in August 2005

Germany/Listed Companies

TAG lightens up on Berlin holdings in end-of-year sale

The MDAX-listed **TAG Immobilien AG** has been taking advantage of frothy prices in German residential to lighten up on

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part of its Berlin holdings in an end-of-year balance-sheet cleaning-up operation. It recently sold 2,600 apartments to housing association Howoge, and has now followed that up by selling a further 920 residential properties in Berlin totalling €76m to local housing associations, for a book profit of about €6m.

At the beginning of December, TAG sold a portfolio of 218 residential units totalling 16,300 sqm in Berlin's Staaken district for €21.5m. The price equates to 18 times the current annual net 'cold' rent. TAG had managed the properties for several years, and the vacancy rate was 1.8%.

Last week, the Hamburg-based TAG sold another 702 residential units in the Neukölln, Lankwitz and Charlottenburg districts with a total area of approximately 43,000 m², for a price of €54.5 million, or roughly 19 times the current annual net cold rent. The buyer was **Stadt und Land Wohnbauten Gesellschaft**. The portfolio has an average vacancy rate of 5.3%. TAG said it expects about €30 million in net cash inflow from these two transactions.

Given the high price rises over the last few years in Berlin, TAG said that both portfolio sales were well above the book value of the properties. The released equity is to be reinvested in further acquisitions with higher initial returns in TAG's core regions with development potential. Based on the acquisitions and sales, the company confirmed its FFO forecast for the financial year 2015 is confirmed, as the portfolios newly acquired in recent weeks compensate the FFO reductions from sales.

TAG Immobilien's chief operating officer **Claudia Hoyer** commented: "We were able to significantly reduce vacancy in our residential units again towards the end of fiscal 2014. While vacancy at year-end 2013 was 8.9%, and 8.6% at the end of Q3 2014, vacancy in December 2014 is down to 8.1%. Further vacancy reduction successes were achieved especially in the Salzgitter region where vacancy is now 15.5% (Q3 2014: 16.6%; previous year: 18.6%)."

Germany/NPLs

CR wins €350m+ bid for ex-Treveria German portfolio

Independent London and Berlin-based financial advisor, investor and asset manager **CR Investment Management** managed to clinch the 127-unit **"Project Sunrise"** German retail portfolio for a price thought to be more than €350m. The deal will see note holders in the outstanding securitised **Talisman 6 CMBS** loan fully repaid.

The **Orange Loan**, previously known as the **Treveria Silo E Portfolio**, which we've reported on in these pages a number of times, was originally the loan tranche securitising the retail portfolio owned by the insolvent Treveria when servicer **Hatfield Philips** turned down a request by the German retail specialist for a second 12-month extension on the loan, after LTV and occupancy targets to secure the extension failed to be met.

Trade journal *CoStar Finance* reported that CR acquired the portfolio through **Sunrise Properties UK Ltd**, an investment vehicle separately owned by CR's shareholders and majority financed by Swiss-based **HFS Helvetic Financial Services**. Private equity group **Cerberus** was reported to be an underbidder for the portfolio.

The Project Sunrise portfolio is comprised of mainly commercial real-estate assets across prime locations in Germany including *Gloria Galerie* retail complex in the heart of Berlin, two shopping centres in Wilhelmshaven and Solingen and department stores in Brühl, Euskirchen and Koblenz.

Hatfield Philips International, as special servicer on the defaulted Orange loan, instructed property advisor **JLL** to sell the German property portfolio in August, which is one of six remaining securitised loans in the fruit-themed Talisman 6 CMBS. The Orange whole loan is comprised of a remaining €335.48m senior loan balance in the **ABN Amro**-issued Talisman 6 CMBS, and a €40.23m B-Loan which was previously owned by **Blackrock** in its Anthracite CRE CDO.

CR's €350m purchase price will fully repay all Talisman 6 note holders and the majority of the B-Loan, and reflects a sub-10% discount on the €375.7m unpaid whole loan balance. The portfolio was last valued at €394.9m by **BNP Paribas Real Estate** in May 2012, based on the original slightly larger 142-strong portfolio. The achieved price comes in at the upper end of HPI's broad estimation of net recoveries for the original portfolio of between €300m and €380m.

Separately, earlier in December Hatfield Philips together with its affiliated company **LNR Partners Germany GmbH** said it had managed to fully recover €92.2m for noteholders on the largest loan in German CMBS **Portfolio Green**, a securitisation pool. The loan related to closed-end fund borrower group **G13**, and had been secured by a single office property centrally located with close proximity to major public transportation in Munich totaling 74,833 sqm, and is fully occupied primarily with a single 'blue chip' tenant. Noteholders will receive payment in January 2015.

Germany/Acquisitions

Landmark Wiesbaden shopping centre bought by Orion

The *Lilien-Carré* in Wiesbaden has become a landmark building since its construction in 2007, both for its elegant and distinctive architecture as well as its central location right next to the main train station and terminus for thousands of commuters travelling to their daily work in nearby Mainz or Frankfurt am Main. The centre itself has been in insolvency since the end of 2010, and previous attempts to find a buyer had failed.

Now, the London-based **Orion Capital Managers** have stepped in and bought the centre, allocating it to its **Orion IV Europe-**

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an 22 and **Orion IV European 23** funds, both part of its **Orion European Real Estate Fund IV.** The price paid, while not named, is thought to be around €100m.

The Lilien-Carré has 36,000 sqm of lettable space, of which 25,000 is retail, with leading tenants being grocer **REWE**, **Toys'R'Us**, electronics retailer **Saturn**, and drugstore **Rossmann**. The centre also includes a 186-room **Motel One** hotel and a 3,000 sqm office building.

While the centre has been in insolvency, the Berlin-headquartered **Acrest Property Group** has been acting as asset manager for the centre. Acrest has been developing a complete new concept for repositioning the underperforming centre, including enlarging the size of the stores for some of the larger tenants, and integrating a food court on the upper level.

According to insolvency administrator **Hans-Wilhelm Goetsch**, "Acrest was developing the new revitalised and re-positioned concept in very close collaboration with the main lenders and our own insolvency administration, and as all of this was about to put into action, it was exactly the right time to entrust the ownership of the centre to a future-focused investor. This is the successful culmination of a streamlined sales process over the last few months."

According to **Karsten Nemecek**, responsible for corporate finance and valuations at **Savills** in Germany, who advised the insolvency administrators on the structured sales process, "The new holistic and tailor-made repositioning concept for the centre is all about converting it to a hybrid, family-friendly centre to completely exploit the potential of the centre. The centre is combining the strengths of a shopping centre with the advantages of a retail park, in a manner which has been completely supported by the centre's key tenants since Acrest began its implementation. The re-positioning will be completed in 2016."

Orion has wide experience in shopping centre investment and project development, with various of its funds owning 13 shopping centres across Europe, with more than 1m sqm of lettable space under management. According to Orion founding partner **Van Stults**, "Our business plan is based fully on the plans developed by Acrest and the new lease agreements signed with our key tenants."

The original centre manager in 2007 was **Multi Mall Management Germany**

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GmbH, with Irish investor **Donal O'Mahoney** as principal owner. The owners then filed for insolvency in December 2010. A proposed sale to an American investor fell through in 2011, with Acrest then taking over as centre operator in July 2012.

Germany/Hotels

Hotel studies forecast further steady German hotel growth

We reported in the last issue of REFIRE on the German hotel market, in particular how in the budget sector Germany is rapidly playing catch-up with other European markets as a host of new players enter the market. The latest issue of the **Investment Barometer** from trade publication *hospitalityInside* in conjunction with German fund manager **Union Investment** addresses the issue of hotel investors' expectations, and warns that implementation invariably takes longer than anticipated.

The 3rd edition of the jointly-produced Investment Barometer concludes that brand hotels are quick to announce rapid expansion, but in reality, they rarely implement these plans as quickly. The main reasons, according to 40% of respondents to the survey, are lack of availability of properties, inadequate financing, and a frequent mismatch between investors' and operators expectations.

According to Union Investment Real Estate's hotel investment director **Andreas Loecher**, "The answers demonstrate the immense need for communication between operators and investors and once again underline the peculiarities of the hotel special segment." Union Investment is itself a major owner of budget hotels and hospitality services.

Nonetheless, market sentiment among investors and hotel developers remains highly optimistic, with the autumn barometer survey index climbing by 1.54% due to good prospects for developments and overall positive conditions for growth among brand hotels. Especially good expansion prospects are predicted for budget hotels (44%), followed by serviced apartments (25%).

The latest study from hotel advisory group **Hotour** offers an optimistic view of the sector in Germany, and attempts to defuse fears that the market is becoming saturated, with over-exaggerated growth prospects. The consultancy's CEO, **Martina Fidlschuster**, concedes that in certain segments of the Big 7 German cities there will be losers among the new entrants as they battle for a foothold in a crowded market, but in all the biggest cities the number of guest overnight stays grew last year at a much

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Residential Property in - Vienna

Austrian property developer Soravia Group has just opened up an office in Munich to service the German market. The family-owned business was established in Vienna 25 years ago and has plans to develop several major projects in Vienna in the coming years with a total of more than 160,000 m2 in floor space, including one of the tallest residential towers in in either Germany or Austria at over 150m high.

In addition to its core property development business, the Soravia Group also holds ownership interests in numerous companies, from the world-famous Dorotheum auction house to outdoor advertising specialists Megaboard as well as ifa AG, an Austrian real estate investment consulting company, along with a stake in the Ruby Hotel chain. Mark Thiel is the managing director of the new Soravia Capital Gmbh in Munich, and not surprisingly, bullish on the prospects for Viennese residential real estate.

Thiel believes that Vienna's market will continue to grow at an above-average rate through 2015. "Residential real estate prices in Vienna were already up by 8.1 percent year-on-year across all price and quality segments in the first quarter of 2014. The subsequent three quarters have also been strong. We see no reversal to this trend in 2015. Continuing demand for prime location properties might even push prices per square meter above the €10,000 level."

Forecasts from most of the big broker groups indicate that 2014 will mark a record year on the Austrian real estate market. Third-quarter investment volumes of €770 million reflect around 48% year-on-year growth, according to CBRE Austria. Between January and September, approximately €2.1 billion were invested, with a cumulative total of around €2.9 billion of real estate investments being forecast by the end of 2014.

"Austria's real estate market has enjoyed an exciting autumn season. Vienna is no exception in this context," comments Thiel. Demand for real estate in the Austrian capital has continued unabated, as investors continue to regard stock markets with a critical eye. Foreign investors, scrambling increasingly to find value in London, Paris and the larger German cities, are starting to eye up the Vienna market for investment opportunities at more attractive buying prices and better returns.

Given comparatively moderate average prices for newly-built real estate, at around €3,873 per sqm according to the latest 2014 real estate survey published by the Austrian Chamber of Commerce, residential properties in Vienna are sought-after investment assets – especially compared with those in major German cities such as Munich. Relatively low buying prices offer attractive rental yields averaging around 3% At the same time, rising demand for residential real estate is continuing to drive Vienna's property prices up, ensuring sustained value appreciation for super-secure bricks-and-mortar assets. Average per sqm prices for newly-built owner-occupier apartments have increased by 45% during the past five years alone.

"Rising prices for owner-occupied apartments primarily reflect the fact that living space is in ever shorter supply in Vienna," says Thiel. The population in Vienna is growing by 20,000 to 25,000 inhabitants annually. Between 8,500 and 10,000 new residential units need to be created every year in order to keep pace with this growth. Thiel says new residential construction is stagnating against a background of rising demand, leading to higher prices in both new-build and existing stock, which he believes will go on for a while yet.

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faster rate than the number of new beds coming on stream.

2014 has seen a record number of bed nights in Germany, and 2015 is shaping up to be even bigger. At 420m guest nights in 2014, this is 22% more than in 2000, with cities like Berlin up 150% while the number of beds has grown 126%. Comparable figures for Hamburg are 145% with 104% increase in available beds, for Düsseldorf 90% with 68% more beds, Frankfurt 87% with 68% more beds, Dresden 86% with 51% more beds, and Munich 72% with 52% more beds. Cologne, at 86% with 81% more beds, is the only city where the supply of new beds and the demand for overnights are more or less balanced.

Perspective of 2% growth in 2015 are justified, says Ms. Fidlschuster, given a number of new developments planned for 2015. Among these are the opening of the new second terminal at **Munich Airport**, boosting the capacity of the airport from 11m passengers annually to 36m. The new **Cruise Centre CC3** in Hamburg harbour will permit the docking of the latest generation of giant cruise ships and boost the overall passenger numbers using the port. Plus there are several major new cultural events and the Champions League football final in Berlin's Olympic Stadium.

Meanwhile, in new hotel transactions, France's **Foncière des Régions (FDR)** has entered into a joint venture with insurers **ACM Vie** and **BNP Paribas Cardif** to buy hotel properties. The company said that the majority shareholder in the new venture, **FDM Management**, is FDR subsidiary **Foncière des Murs**. The plan is to acquire hotels run by the sector's major operators. Currently, an effort with other institutional investors to raise equity capital is in progress, and will reportedly enable an investment capacity of €300mn.

Exclusive negotiations for the first two purchases totaling €104mn are underway. They are nine hotels in Germany for €49mn and a hotel project near the airport in Paris for €55mn. The properties in Germany are to be operated in the **Louvre Hotels Group** as budget hotels under the **Première Classe** brand.

Separately, fund manager **Deka Immobilien** has acquired two hotels in central Nuremberg from **GBI** for about €19mn. The hotel ensemble on Bahnhofstrasse comprises a newly opened **Hampton by Hilton** and a **Holiday Inn Express** with

Pinpoint Investment in Class-B Cities

How to enter the German market beyond the Big Seven as an international investor

- by Ulrich Jacke -

International investors are quite right in considering the German housing market as one of the most attractive worldwide. So far, however, many of these institutional investors have almost exclusively focused on the country's so-called Big Seven cities. Why was that?

For one thing, the Big Seven did not seem to pose a liquidity risk and were rated as permanently stable. Adequate market data for them permitted qualified investment decisions. They were assumed to have balanced risk-return ratios, obviating the need to ponder future exit strategies. Moreover, they permitted very large-scale investments suitable for geographically concentrated asset management.

So investors used to be well served with their commitments in Germany's metropolises. You could barely go wrong investing in residential property here in recent years. Rental growth combined with rising multipliers almost anywhere you looked.

But it is always risky business to simply carry past performance forward into the future, and yield rates in these locations have noticeably declined lately. Once you factor in the location risk, the rates of return on such investments have ceased to be sensible for many market players. Indeed, they have often declined to the point where a risk-adequate yield rate is no longer in the cards.

This is the upshot of the Risk-Return Ranking developed by Dr. Lübke & Kelber, which matches the achievable yield with the corresponding exposure for 50 German cities. Many secondary or "Class B" cities in Germany, such as e.g. Wolfsburg, Lüneburg, and Mannheim rank well ahead of Munich, Stuttgart and Hamburg. Investors are therefore well advised to take a close look at Class B cities.

What often stands in the way of such a reorientation is the lack of local market expertise. Many of the Class B cities are simply uncharted territory for international investors or else are deemed negligible. This means that existing earning potential, appreciation tendencies and exit strategy options have been, and continue to be, overlooked. Or else investors see no way to act upon their insights because they lack the market access and the necessary acquisition and/or asset management resources. As a result, profitable investment opportunities are missed.

In order not to lose out on such chances to invest you need a partner on the ground in Germany with a nationwide footprint and both knowledge of, and access to, local real estate markets. Ideally, your partners know-how will be rooted in first-hand asset management and transaction experience. Better yet, your partners detailed market expertise should be complemented by a successful network built up over decades in the business, as it might open up lucrative off-market deals to the investor.

Our company, for instance, facilitated more than 750 million euros worth of off-market transactions involving a total of 7,800 residential units during the past twelve months, and audited more than 5,000 units within the framework of due diligence mandates.

Our extensive long-term experience in the residential investment business enabled us to build up portfolios with a total investment volume of up to 240 million euros for international investors within the framework of acquisition / asset management mandates, and to support their asset management for many years.

But how will Germany's contemplated rent control legislation commonly called "rent freeze" ("Mietpreisbremse") affect investment decisions?

In a way, investors are affected by the rent freeze. But it is important to know: For the areas to be declared "strained housing markets" in order to qualify them for the application of the rent freeze will mainly be the metropolitan districts in the Big Seven most coveted by tenants and investors. Conversely, many Class B cities are likely to be spared the introduction of the rent freeze even if they are prospering towns with positive or at least stable economic and demographic growth.

So it will make Germany's Class B locations all the more interesting for investors.

Author Ulrich Jacke is Managing Partner of Dr. Lübke & Kelber GmbH in Frankfurt am Main

a total of 204 rooms, both operated by **Foremost Hospitality**. They will be held by **West Target Select Hotel** addressed exclusively to institutional investors. The two houses had been handed over to Foremost in mid-November.

Germany/Industrial

BEOS adds three new assets to *Spezialfonds* for €135m

The Berlin-based **BEOS**, which develops and manages mixed-use light industrial properties throughout Germany, has just bought a further three assets for its second *Spezialfonds*, the **BEOS Corporate Real Estate Fund Germany II**.

BEOS paid €134.3m for the three assets, which it had itself originally developed on behalf of international investors, and which it has now secured for its much-in-demand funds. The assets are located in Hanover, Schwalbach im Taunus (near Frankfurt) and Ulm.

The biggest property is the *"Alte Röhrenwerk"* in Ulm, which was completely sanitised and converted in 2012-2014 into a 55,000 sqm property including office, laboratories and warehouse space. The main tenants are the French technology company **Thales Electron Devices** and the criminal investigations department of the Baden-Württemberg police.

The asset in Schwalbach is like an industrial park with 32,260 sqm, of which 65% is warehouse and 35% office space. Completely renovated this year, the property has 25 separate tenants. Among the largest are **BIT Analytical Instruments GmbH** and **Siemens AG**, which runs an R&D department for laboratory diagnotics there. The third property is the Lilienthalcenter in Hanover, which was built in 2001-2003, has 16,500 sqm of lettable space equally divided between office and warehouse, and has 20 separate tenants.

Along with these latest buys, BEOS, under the very focused eye of CEO **Stephan Bone-Winkel (***pictured, below***)**, has now invested €527m in 18 separate properties over the past two years, investing 81% of the committed equity capital in the funds along the way. Seven of these assets started out as BEOS project developments, while eleven were bought on the open market.

Germany/Acquisitions

Arbireo-led consortium buys €100m German office package

The Frankfurt-based independent investment manager **Arbireo Capital** has joined with local German group **denkmalneu** and a German family office to buy a Germany-wide office portfolio for about €100m from an unnamed seller. The package consists of four properties in four cities with 110,000 sqm of lettable space.

Arbireo board member **Ralf Kind** (*pictured, right*) said that Arbireo acted as an advisor and also co-investor on the deal for the four properties, all of whom share a single tenant, a DAX-30 industrial company. "A part of the portfolio is suitable for conversion into residential properties. In addition, we are verifying the possibility of developing residential pojects on some of the land plots embedded in the portfolio. The other part of the portfolio is yielding stable cash flows from a strong tenant."

Kind, a veteran of several sizeable residential portfolio deals from his time at **Barclays Capital**, said that his team was working on several other investment deals of this sort. "Our pipeline for this product category alone comprises currently around €300m, which we want

to realise together with investment partners", he said.

Along with operating partner, the residential property advisory **Dr. Lübke & Kelber i**n Frankfurt, Arbireo offers services in asset management and specialist advice on M&A and capital markets, mainly for the buying and selling of real estate.

Germany/Funds

New venture plans €300m of new Germany residential buys

Berlin-based residential property specialist **Kauri CAB Management** and Stockholm-based **Apeiron Capital** have formed a joint venture with an international sovereign wealth fund to invest in German housing. With initial equity capital of €100m, the joint venture plans to buy portfolios and individual property assets across Germany, initially targeting a portfolio size of €300m, including debt.

The JV has already closed on a first acquisition of 1,675 residential and 105 commercial units across 61 separate buildings in Berlin and Magdeburg for €130m in an off-market deal from Erlangen-based residential specialist **ZBI**, the companies said. About 70% of the so-called **Zeus portfolio**, most in period-style buildings, is located in Berlin, with 30% in Magdeburg. Senior financing for the deal was provided by **UniCredit Bank**.

"German residential property continues to be an attractive proposition," said Kauri CAB's managing director **Hagen Kahmann**. "Our new joint venture

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brings together a group of investors with a strong track record in this space. This deal is exciting because of the multiple routes for optimisation that the portfolio offers. Berlin offers an attractive long-term structural demand-supply imbalance for rental housing and is one of the fastest-growing capital cities in Europe."

The principals of Apeiron added: "The returns on offer from northern European residential property make the asset class increasingly attractive to investors and we are seeing a growing number of excellent investment opportunities particularly across Germany. With the backing of a major global sovereign wealth fund we are well placed to capitalise on these."

Since its foundation in 2008, Berlin-based Kauri has managed about €200m of residential assets. In 2011, it teamed up on a €120m JV on Berlin apartments with **Pramerica Real Estate Investors**, the London-based arm of US insurer **Prudential Financial**. The joint venture sold a chunk of this (25 separate assets) for €78.6m earlier this year. Apeiron is a private principal investment and asset management firm focusing on real estate in the UK, Germany and the Nordics.

Germany/Healthcare real estate

Belgian Cofinimmo makes first foray into German healthcare market

Listed Belgian real estate company **Cofinimmo Group** has made its first sortie into the German healthcare sector by buying a revalidation clinic located in the spa resort of Baden-Baden in southwest Germany.

Cofinimmo paid €10.91m for the asset, which it rents to the operator **Celenus** under a 25-year lease, and expects an initial rental yield of 7.64%. The asset itself has a surface area of 4,400 sqm and comprise 46 revalidation rooms, physiotherapy

Guest Column:
Dr. Thomas Herr, Managing Director of VALTEQ Gesellschaft mbH

Dear Portfolio Owners: Look at your real estate!

www.valteq.de

Owners of commercial real estate are not investing enough in their portfolio properties and therefore risking drastic depreciation. This is not a claim being made by German tenant associations or left-wing politicians, but rather in a study by the real estate team of JP Morgan Asset Management Europe and the IPD research service.

When reading this recently published paper, it can be seen that prior to the financial crisis in 2008 around 3 to 3.5 percent of a property's value was invested in its upkeep or in repair measures. This value has since fallen to around 2 percent. This is not a major problem in itself, particularly for office real estate, since tenants can still be found depending on its micro and macro-situation. In the long term however, according to JP Morgan, this investment backlog will lead to increased letting risks, particularly because newly developed or revitalised properties will become substantially more attractive by comparison.

The authors of the study fear that the market will need quite some time to catch up with this backlog of repair investments. On the other hand, the good news is that project developers, investors and portfolio owners will find it easier to secure tenants or buyers for recently completed or revitalised properties.

In light of this study, we at VALTEQ have two recommendations. First of all, every property owner should invest sensibly in order to ensure that their real estate retains its value. In this regard, what counts is the right combination of local market needs and technical feasibility – and a partner that can bring market and feasibility together in equal measure to produce the optimum solution. For example: The repair requirements for a well let property in the centre of Munich must be assessed and planned differently to those for a vacant building on the outskirts. Our second tip: Conduct a careful technical due diligence review before every transaction. This is the only way to identify and evaluate the risks that lurk in a property or in real estate portfolios. To put it briefly: Take a really good look at your real estate and not just at the Excel spreadsheets.

spaces, gyms, a pool and a sauna.

Celenus specialises in revalidation and psychological care and manages a total of 2,600 beds spread over 15 sites throughout Germany, so it is likely that Cofinimmo will be looking to do further deals with Celenus as operating partner.

The lease is a "double net" lease, meaning that the landlord is responsible for the repair and replacement of the boilers as well as maintaining the upkeep of the outer shell of the building (including walls, window-frames, and roof) while the tenant Celenus is responsible for al other maintenance. The rent is indexed annually at 50% of the rise in the consumer price index.

According to **Jean-Edouard Carbonnelle**, Cofinimmo's CEO, "After Belgium, France and the Netherlands, Cofinnimo is now extending its healthcare portfolio to Germany, where we plan to increase our presence and to partner with new operator tenants. Our strategy definitely includes diversifying our healthcare portfolio geographically." He added that geographical diversification is intended to minimise the risks linked to possible legislative changes related to reimbursements in healthcare or the accommodation of elderly people, which could affect the operator tenants of the buildings.

Germany/Acquisitions

Canadian broker Avison Young clinches second German deal

Fast-growing Canadian commercial property advisory **Avison Young** tied up its second deal in Germany recently on behalf of two Canadian pension funds. The company has wasted little time in getting active in Germany since opening a new office in Frankfurt to service the market as recently as three weeks ago.

The Toronto-based group has now concluded two deals in Germany on behalf of the two Canadian funds, following on from an earlier acquisition in May of this year. This latest deal involves a mixed-use, six-storey building located in Cologne-Sülz, for which Avison Young will handle the asset management and be the leasing agent. Property manager will be **IC Property Management GmbH**. The seller of the asset was advised by **SVP Global** and represented in the transaction by **Nexus Capital Advisors GmbH & Co.KG** and **McDermott Will & Emery**.

Anchored by a **Real** hypermarket, the building is currently 96% occupied. It is located next to various key Cologne public transit routes and the University of Cologne and comprises a total leasable area of 24,200 sqm, including 13,200 sqm of retail space, 68 apartments and 4,700 sqm of office space.

Amy Erixon, a principal at Avison Young, said the deal

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represented another important step in the company's expansion outside North America. "Acquisition of this high-quality, mixed-use property at a discount to replacement cost complements our existing German portfolio by providing retail exposure and critical mass for our apartment holdings. We continue to look for well-located, credit-tenanted properties that can be acquired at better cap rates than are available for comparable properties in Canadian markets," she commented.

The Frankfurt office, headed by Commerz Real veteran **Udo Stoeckl** (pictured) is Avison Young's first location in continental Europe, and only its third office outside of North America, after opening offices earlier this year in the UK, in London and Thames Valley. Stoeckl has been working for Avison Young since 2011 advising both European and North American capital markets clients on their cross-border activities.

Germany/Retail real estate

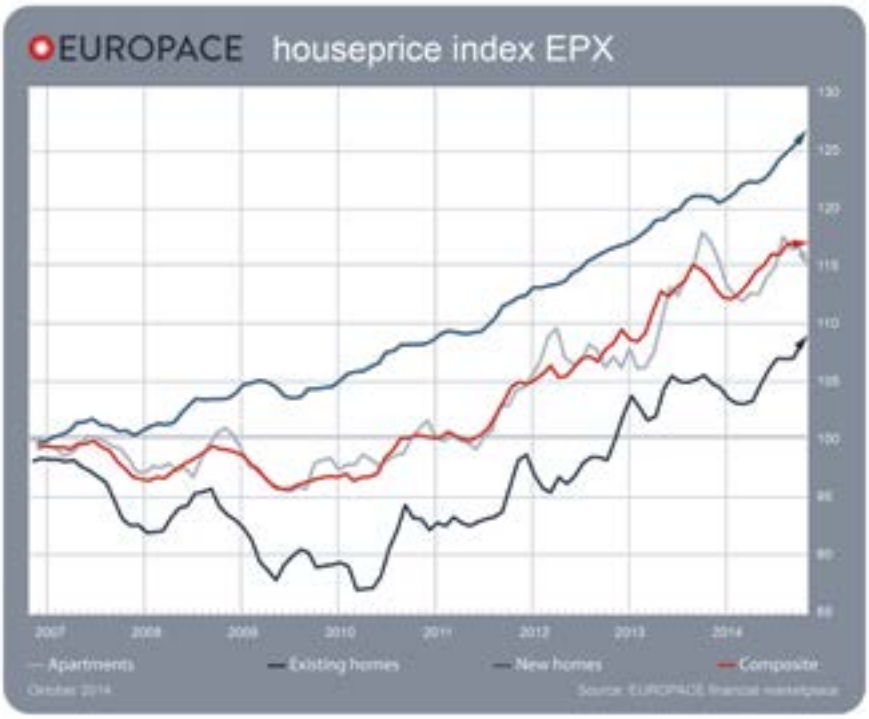
New Schroder German retail assets yielding 5.9%

Schroder Real Estate, the property arm of the London-based investment manager, earlier this month bought a retail portfolio in Hamburg and Berlin for €51m, offering an initial yield of 5.9%. The portfolio is being bought on behalf of its open-ended fund **Immobilien Europa Direkt**, an investment group of Zurich Investment Foundation, which invests on behalf of various Swiss occupational pension funds.

The deal includes three freehold retail properties, dominated by the *Tondo Retail Centre* in Hamburg, anchored by grocery retailer **REWE**, a 13,000 sqm multi-let commercial centre with an average unexpired lease term of 8.5 years and reversionary potential.

The two Berlin properties, totalling 8,500 sqm, are the *Cladow Center* in Kladow, near Spandau in Berlin's western district, and a *Kaiser's* grocery store and centre in the Gatow neighbourhood. Both are fully-leased with Kaiser's supermarket as an anchor tenant, with weighted average lease terms of 5.1 and 7.5 years.

According to **Tony Smedley**, Schroder's head of continental European investment, "Berlin and Hamburg are two of the strongest cities in Germany and a core part of our tactical allocation strategy. Diversifying into relatively defensive, grocery-anchored retail assets is entirely consistent with our house view, and will further improve the income performance of Immobilien Europa Direkt."



Germany house price development

Germany/Study

End of year German property sentiment stabilises – Deutsche Hypo

The latest reading of the monthly **Deutsche Hypo Property Climate Index** shows sentiment in the German real estate market stabilising after a notable drop in August, when a number of political factors seem to have combined to scare investors.

The property climate sentiment reading, gleaned from a survey of industry experts, gained 0.6% in November and the investment climate even rose 2.7% on October. Bank board member **Andreas Pohl** expects another rise in the full-year transaction volume in Germany this year. "Should the forecast €35bn, last year's figure, be beaten again, pre-crisis levels are not too far off any more. But they come with more secure framework conditions than in 2008," he said.

The positive indicators come despite the mixed economic prognoses towards the end of the year, said Pohl. The latest forecasts for 2015 have been positive however, predicting rising export figures and consumer confidence, which are set to provide a fillip to GDP growth. While the investment climate indicator rose, that for returns fell by 1.7%. On the asset sub-in-

dices, the Office Climate gained 2.4%, returning to growth after three months of losses, and Industrial 0.5%, continuing its positive development over recent months. Both the Retail and Residential climate fell by 0.9%. Deutsche Hypo is part of the Hanover-based landesbank **NordLB**.

Europe/INREV Study

Sharp rise in number of funds heading for liquidation

The latest research into fund terminations from **INREV** shows a sharp rise in the number of funds heading for liquidation. The European non-listed funds association's **Fund Termination Study 2014** found that almost one in two participating funds (47%) due to terminate in the next two years is expecting to liquidate, compared to nearly one in three (32%) last year.

Liquidation has now overtaken extension as the preferred method of termination for European real estate funds ending in the next two years, according to research by the Amsterdam-based INREV, whose findings show that investors are "increasingly prepared to liquidate funds that fail to deliver the expected level of return".

The INREV Fund Termination Study 2014, the ninth such annual study, analysed termination decisions for 145 closed-ended funds with a combined gross asset value of €59.1bn. The vehicles had original termination years between 2009 and 2015.

The survey, which also looked at a smaller sample of 64 funds due to terminate in the next two years, found an increase in the proportion of funds having already chosen liquidation or having planned to do so. Almost one in two participating funds (47%) expect to liquidate, compared to nearly one in three (32%) in INREV's survey last year.

Henri Vuong, INREV director of research and market information, said there would be a peak in upcoming terminations next year with 42 funds – representing almost €17bn – due to terminate. "This may help ease the burden on investors looking for quality assets at a time when demand is increasing due to higher levels of capital raising," he said.

The proportion of funds looking to extend has fallen to 34% from 54% last year. Half of the assets owned by funds, in extension or due to extend, are in Western Europe, with 28% in the UK. Spain and Portugal account for 21%

CORPUS SIREO
REAL ESTATE

GERMAN B CITIES: COMMERCIAL RENTS INCREASE BY 1.7 PERCENT

The stronger investor interest in second-tier cities of the commercial real estate market in Germany is accompanied with rising rents. In conjunction with empirica, CORPUS SIREO has analysed the offered rents at 14 German potential locations for the seventh time. In the second quarter of 2014, the average offered rents were approximately 8 euros per square metre. This is equivalent to an increase of 1.7 percent compared with the fourth quarter of 2013.

With its study „GERMANY 21 – Regionaler Büromarktindex“ (Germany 21 - Regional Office Market Index), CORPUS SIREO is analysing the German top-7 cities (Frankfurt, Hamburg, Munich, Cologne, Berlin, Düsseldorf, Stuttgart) as well as 14 regional cities (Aachen, Bonn, Bremen, Dortmund, Dresden, Essen, Hanover, Karlsruhe, Leipzig, Mainz, Mannheim, Münster, Nuremberg, Wiesbaden). The current issue focuses on Wiesbaden.

The average offered rents at the second-tier locations are between 6.55 euros per square metres in Leipzig and 9.84 euros in Bonn. On average, they amount to 7.99 euros, which is equivalent to an increase of 1.7 percent compared with the fourth quarter of 2013 (7.86 euros).

At the top-7 locations, the average rents range between 10.59 euros in Cologne and 15.22 euros in Munich. With an average figure of 12.78 euros, they are thus at the level of the fourth quarter of 2013 (12.80 euros). As expected, in terms of the age categories of the buildings in B cities, the leading positions are occupied by old buildings (built before 1945) as well as modern new buildings (less than three years old). The average rents for new buildings amounted to 12.20 euros per square metre in the second quarter of 2014. At present, there are not many old buildings in prime locations on the market; this is the reason why there are hardly any changes in this segment. Office premises built in the 1970‘s and 1980‘s have to a large extent not benefited from the positive market development. In general, properties during this period are to be found in the low-price market segment, and are therefore hardly able to benefit from rising rent levels.

City in focus: Wiesbaden

The office market in Wiesbaden is of an average size, with 2.8 million square metres. In terms of prices, the regional capital of Hesse belongs to the leading group, with average quoted rents of 9.70 euros and top rents of 13.80 euros per square metre. The vacancy rate in Wiesbaden is currently approximately 6.0 percent. The office market is mainly characterised by administration and insurance groups, and is stable and not very dynamic. In addition to the small-scale


Wiesbaden

city centre, the Mainzer Landstraße and the Abraham-Lincoln-Straße are the main areas of the office market in Wiesbaden. For instance, four new properties are currently being built in the Mainzer Landstraße, the corridor between the city centre and the motorway link. Further project development has been initiated in the Abraham-Lincoln-Straße, the location which is dominated by insurance groups. The completion of these projects is likely to be accompanied by a further increase in the top rents in Wiesbaden and also increasing vacancy levels in older properties. In future, it is expected that Wiesbaden will also see a process whereby office buildings from the 1970‘s and 1980‘s will be revitalised or increasingly converted into residential properties.

The complete report „Germany 21: Regionaler Büromarktindex“ (Germany 21: Regional Office Market Index“) can be downloaded free of charge from:
www.corpussireo.com/downloads

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of assets, showing a confidence in the countries' respective recovery. Last year, southern Europe represented 52% of the assets being liquidated. The region represented less than 30% this year.

INREV said investors also appear keen to hold on to student housing and leisure assets – which together account for 4% of assets in liquidating funds, a significant drop compared to last year (11%).

Fund performance and market conditions continued to be the key deciding factors, INREV said. On a 13-year, annualised performance basis, funds that opted to extend achieved aggregated total returns of 5.11% a year. "This is in stark contrast to liquidated (or liquidating) funds," INREV said, pointing to total returns of just 0.57% on a 10-year, annualised performance basis. "On a five-year return basis, the differences in returns are more extreme."

Funds that opted to liquidate achieved total returns of -9.62%, while those that opted to extend delivered positive returns of 0.39%.

The 2014 study suggests that greater macroeconomic stability may also be having an impact on termination strategies. In the 2011 and 2012 studies, 10% and 6% of funds, respectively, had reached a decision two years prior to termination. These numbers have risen to 26% in 2013 and 19% in 2014, with a "less turbulent climate helping more investors make earlier decisions".

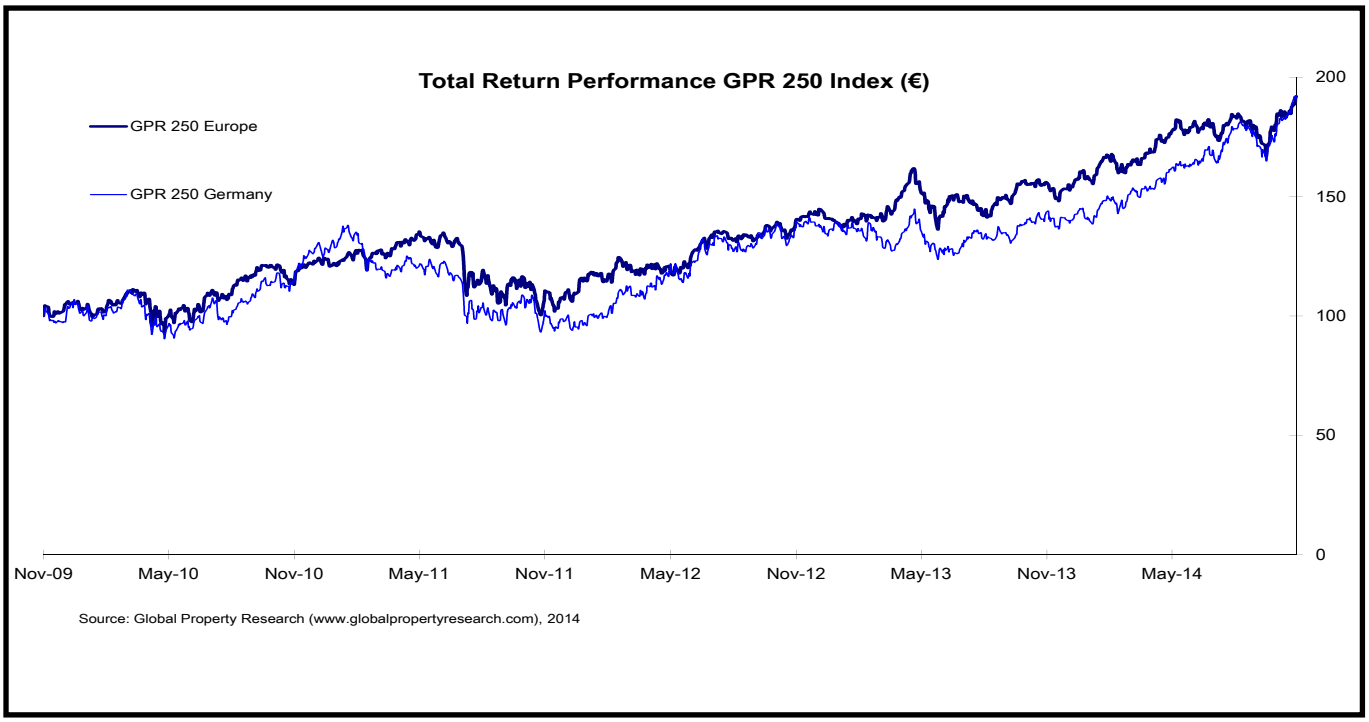
Another potential sign is the drop in the proportion of funds citing liquidity as a key consideration (21% in the 2014 study, down from 33% last year).

Europe/Debt finance

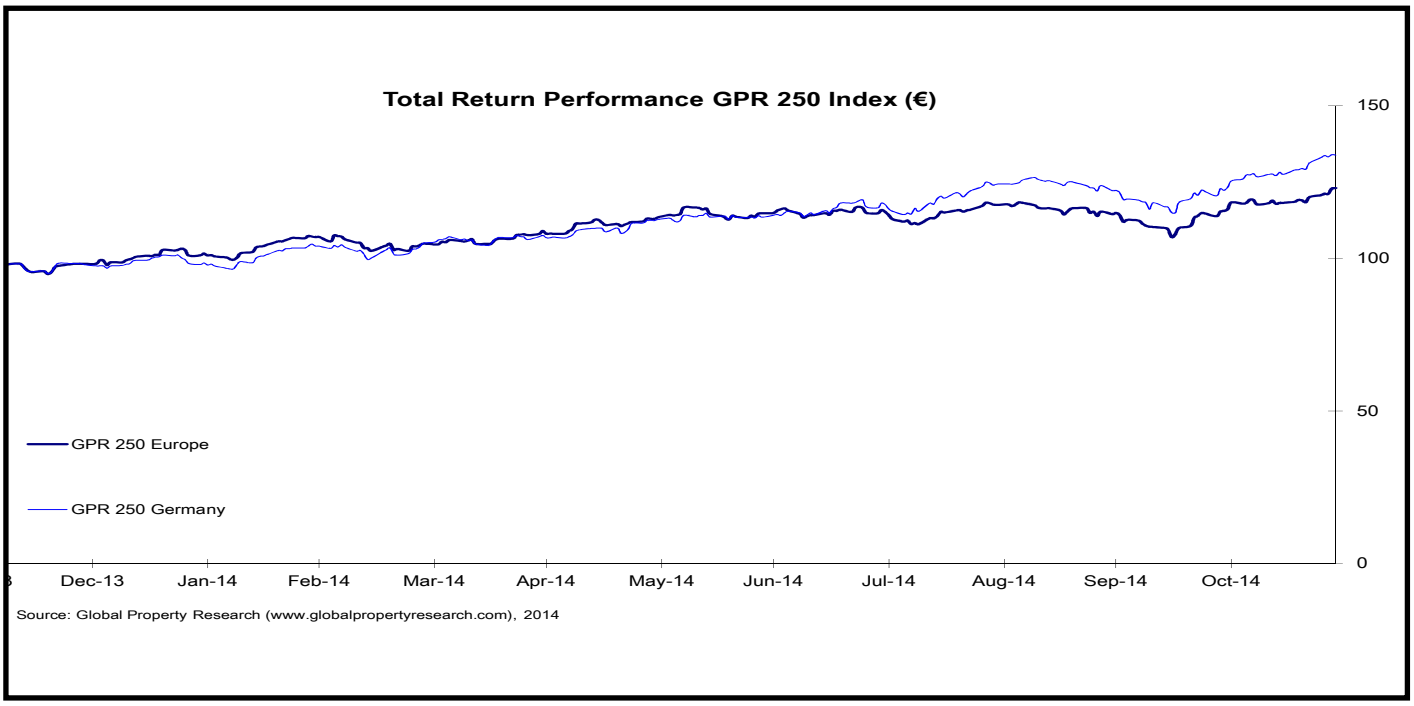
Zurich Insurance to provide debt finance, boost own property holdings

Zurich Insurance Group, Switzerland's largest insurer, is getting into the market for European direct lending to commercial real estate projects, including infrastructure lending, as low interest rates bite into the company's earnings from fixed-income investments.

Zurich's CIO **Cecilia Reyes** said the insurer would initially invest "hundreds of millions" of euros, starting from early next year, in a manner similar to Germany's largest public pension fund the **BVK Bayerische Versorgungskammer** which also lends to commercial real estate projects. Zurich's new direct corporate lending will be focused mainly on Germany and euro-denominated private debt in other European countries, said Reyes. The insurer also wants to increase its directly-held real estate holdings which currently make up about 5.5% or $12bn of its assets.

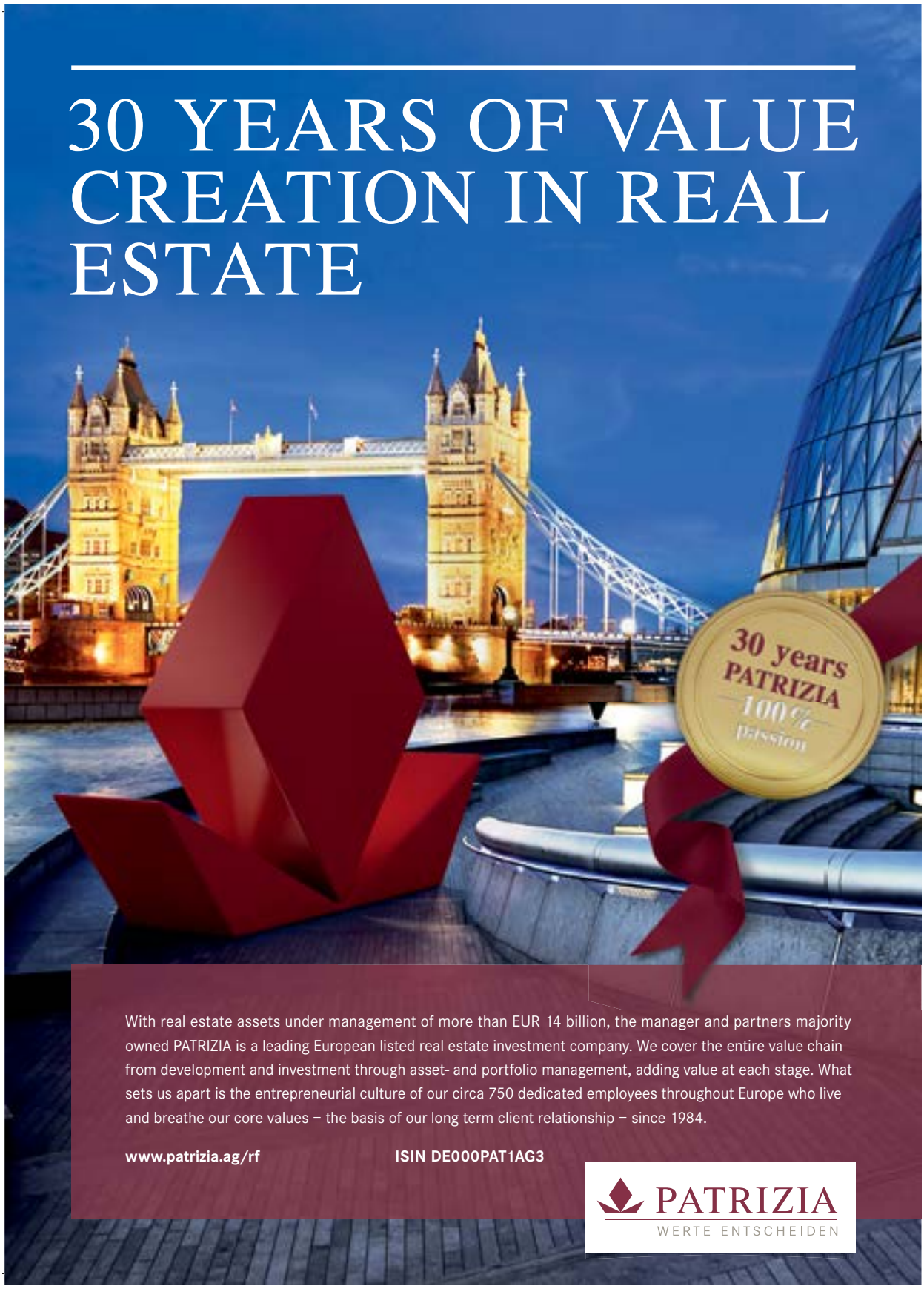


Graph of the total return performance of Europe and Germany in Euro currency over the past five years
REFIRE charts courtesy of GPR, Global Property Research



Graph of Total Return Performance of Europe and Germany in Euro currency over the past twelve months
Charts courtesy of GPR Global Property Research

30 YEARS OF VALUE CREATION IN REAL ESTATE



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Guest Column: George Salden

German property market: If you want profit, you need to value right - Part I

Whether it starts with a highly complex collection of data or a "gut feeling" – every property investment begins with a valuation of the investment property. Yes, the "gut feeling" can sometimes be right. But I am sure that only a robust breakdown of the opportunities and risks presented by an investment allows a sustainable ranking of investments. I have been applying the methods proposed by the legislator myself for some time and also those preferred by the English-speaking property industry. To cut a long story short: none of them convinced me, because they all only reflected some aspects of the reality of the market.

Why is that the case? There are two reasons for this. On the one hand, they recognise that cash flow does not come out of nowhere, it relies on tenants. A secure cash-flow is not automatically bundled with the purchase of a property. Revenue does not flow into the owner's bank account uninterrupted and at a constant level. Rental revenue is a dynamic variable which is determined by a number of factors which can change on a cyclical basis. Only when these fluctuations are recognised and then anticipated can an investment return the best possible revenue on an ongoing basis. On the other hand, the established valuation methods are limited when it comes to analysing rental cycles. Or, to put it another way: They do not reflect or predict market values in real time. In the best-case scenario, the established methods can reflect the macro-cycle with a slight delay. This is hardly a suitable basis for a long-term investment decision.

Whether a method is any good for valuing a property or as a basis for increasing revenue can be measured based on whether it provides robust answers to three important questions:

1. What is the current value of the property?
2. What will the property be worth at the end of the period of investment?
3. How can I increase the start value to the end value?

The established property valuation methods only determine the value of a property at a specific point in time, but neglect the market dynamics. Because calculations on the market price, loan value and insurance value are not relevant in terms of increasing revenue, they do not do the job, even though they can contain interesting information. In the German property market, there are three "classic" methods which are most commonly used to value a property: the comparative value method, the rebuild value method and the revenue value method.

The comparative value, for example, is still highly regarded when it comes to determining the market value of a property. To do this, it analyses previous sales of properties of a similar size and in a similar location. As the comparative value is based on actual purchase prices paid in the market, the method is considered to be very close to the market and reflect current market conditions.

Many property experts would certainly agree that the comparative price method is one of the best methods of determining market values in Germany. However, there is less unity in academic research when it comes to the range of the comparative value method. While some experts believe it is suitable for developed plots and primarily for freehold apartments, others would restrict its applicability to undeveloped plots. Who is correct? Research is more sceptical about the comparative value method for the valuation of revenue properties in Germany which are often purchased in line with a property investment. But here, too, there are isolated specialists who believe the comparative value method is the ideal method for the valuation of rented residential property.

When I am asked about my experiences with the comparative value method, I answer that while there is light, there are also shadows. There is no doubt that the benefits of this method include that it derives the market prices from actual market conditions. I also share the view of many experts that it is particularly well suited to undeveloped plots. But: comparative values are a lagging indicator which do not reflect short-term, current, and future market developments. The fewer comparable properties are available, the more constructed and distant from the market the resulting market prices become. This is not infrequently the case as in reality there are only rarely sufficient comparative properties available.

Next, we come to an old favourite in the German property market: the rebuild value method. A method - and I say this often - which is entirely unsuitable for all types of property investment in Germany. It is essentially different from the comparative value method. Unlike this, the rebuild value method does not determine the market value of a property based on actual prices achieved in the market, instead, it focuses on the costs which would be incurred to rebuild the property. In simple and concise terms, the rebuild value method determines the value of a property based on the question: How much would it cost to rebuild the property in its current condition?

The rebuild value method is primarily used in Germany for valuations of the intrinsic value of residential property with a high level of owner occupation and by the insurance industry. It is no surprise, as for private owners using their own properties, the intrinsic value is mainly an issue because the preservation costs are an important argument when making the decision to buy a property. On the other hand, the insurance industry is primarily concerned with the restoration costs. Normal production costs (NHK 2000) form an important basis and contain tables of the relevant construction costs. Naturally, this does not consider the revenue-driven perspective. The rebuild value method does not include a separate calculation method to determine the value of the land, so the comparative value method has to be applied at this point.

At first glance, the rebuild value method is a simple, clear method of deriving the market value of a property. However, when it is actually used, some doubts arise as to the practicality of the method. On the one hand, the NHK 2000 data still has some striking gaps. New, modern building types, such as low-energy houses in Germany, are not included, and even traditional buildings such as a combination of residential and business spaces are not in the database.

As the data in NHK 2000 is often unable to reflect the complexity and individuality of different properties, experts are forced to amend the data. The same applies to regional factors. Good experts are able to compensate for the intrinsic inadequacy of the rebuild value method. But if they can't, they can't...

So, is the whole rebuild value method useless? No! If it is explicitly a case of determining the restoration costs, then it can, in the best-case scenario, work well. But if it is a question of earning and increasing revenue, I can only recommend steering clear of the rebuild value method!

The revenue value method promises to be the right option for valuing properties in Germany where the focus is on revenue - or at least it is considered so by the specialist literature. In the residential property sector, the properties which are bought as revenue properties based on their performance are primarily apartment buildings.

While the comparative value method and the rebuild value method derive the value of a property based on past prices, the revenue value method promises to determine a "future success value", i.e. a value which takes the development of the property into consideration. The revenue value method sees the property as an economic asset and the economic value is therefore calculated - not the technical value. So far so good! But: in practice, the best possible, normal and sustainable profitability is always assumed for the property. This is where the revenue value method reaches its limits, because it can not adequately reflect the interaction between the property and the market. In the different models of the simplified and general revenue value method, only the long-term rents which can be achieved in the area are factored in. Differences to actual rent are calculated as additions or deductions. But the revenue value method does not consider potential rent increases, perhaps because the rent achieved by the property is below the normal rental level. It also does not include the potential in properties which are overrented and underrented. The differences between the rental level and the actual and statutory rents are simply calculated and the revenue level for the property reduced accordingly. My greatest criticism of this method is that the massive potential for value increases resulting from an adjustment of the rent to the market level is not considered at any stage during the revenue value method.

As you have read, my many years of experience with the traditional property valuation methods have left only a few positives - for good reasons, I think. In the next edition, we will look at important valuation methods from the English-speaking world. Maybe they have more to offer?

George Salden is the author of the book "Die Dynamische Methode" [The Dynamic Method] based on his 19 years of experience as an expert and manager in property and transaction management which highlights the way towards a whole new method of determining the profitability of properties. He was previously a director at alt +kelber Immobilienmanagement, a subsidiary of conwert Immobilien Invest SE, where he was responsible for major international transactions. He then took over as International Head of M&A at AK Holding GmbH & Co. KG. He is now Head of Transaction/Executive Board Member at Dr. Lübke & Kelber / Arbireo.

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