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.

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The areas we focus on are:

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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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KKR and DIC bundle German real estate interests to create sizeable new force

In a number of statements last year about the future of Germany's listed commercial real estate sector, Ulrich Höller, the head of the listed Frankfurt-based DIC Asset AG forecast a likely wave of consolidation in the sector, similar to what the German residential sector is experiencing.

Höller was likely speaking with an insider's understanding of how such steps would be realised in practice. Earlier this month **Deutsche Immobilien Chancen (DIC)**, one third owner of DIC Asset AG and likewise headed by Höller, announced that it was partnering in a new investment vehicle with prominent US private equity firm **KKR** to invest in Germany's office and retail sectors. The new company, **GEG (German Estate Group)**, is likely to become a significant investor in German commercial property.

GEG will invest its own capital as well as third party money, and will be KKR's sole route into German real estate. The primary focus will be core property, but it will also invest in riskier assets and project developments.

The new group will be headed by Höller, and will see Deutsche Immobilien Chancen, which is backed by investment companies and insurance firms, transferring its operational business to GEG, including about 40 professionals who will continue to manage its major current project developments *MainTor* in Frankfurt and the *Opera Offices* in Hamburg.

Höller will resign as CEO of Deutsche Immobilien Chancen Group, but will remain as head of DIC Asset until the end of 2015. DIC Asset manages more than €3bn in assets for itself and third parties in a fund division launched three years ago. It posted FFO figures for 2014 of €48m, up 5% on 2013, while buying property assets for €180m and selling assets worth €162m.

In a statement, Deutsche Immobilien Chancen said, "GEG will be an active investor across the core sector, oppor-

SEB in further portfolio sell-off, NorthStar enters Europe

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tunistic transactions with appreciation potential, and development transactions. GEG will invest its own capital and third-party money."

"The creation of GEG is a continuation of KKR's commitment to German investments, having built a successful investment track record, with more than $4.4bn of equity deployed in 15 German companies since 1999," the statement said. It is also an important step for KKR's real estate platform which has committed over $1.6bn of equity to 26 deals worldwide since its launch in 2011.

In the first phase DIC will hold a 75% majority of the new business, but KKR says it plans to acquire further shares in the medium term and become a 50% joint partner. A report in *Reuters* suggested that KKR plans to pump at least €5bn over the next five years into the German office and retail segments.

Ralph Rosenberg, KKR's global head of real estate, commented: "With this new platform, we will be able to accelerate our access to investments in Germany across the risk spectrum."

"The creation of GEG is a continuation of KKR's commitment to German investments, having built a successful investment track record, with more than $4.4bn of equity deployed in 15 German companies since 1999,"

At a press conference in Frankfurt two weeks ago, Ulrich Höller said that the listed DIC Asset AG, primarily responsible for asset management, would not initially form part of the new GEG vehicle. "DIC Asset is not part of the deal as return expectations from the US were too high. However, joining may be an option for the future as consolidation will be a major theme in the overall commercial real estate market going forward."

As for GEG's investment strategy, said Höller, GEG will focus on investments in trophy assets above the €80m mark and, investing alongside other institutions, on opportunistic investments – as soon as that market picks up again in Germany, he added. GEG will also seek €50m-plus developments, including high-end residential, in the 10 largest German cities. "We will start slowly this year but we're seeing offers already coming in."

Germany/Open-ended funds

SEB in further giant portfolio sell-off, NorthStar enters Europe

The big news around the turn of the year was the December acquisition by US REIT **NorthStar Realty Finance** of a €1.1bn office portfolio from Frankfurt-based **SEB Asset Management**. This was the American group's first foray into Europe, and they have topped that off with a further deal worth reportedly about €500m from German insurer **Provinzial NordWest**.

The deal made headlines both because of its size but also for its complexity, spanning seven different countries and tax regimes, and the fact that, in comparison to earlier large-scale deals, there was no 'volume discount' given the size of the portfolio. Additionally, the sale went through including an asset management mandate for the seller, which is unusual.

The structured sale by SEB Asset Management, which is in the process of unwinding its international German open-ended fund, involves 11 'Class A' European office properties are in London, Paris, Hamburg, Milan, Brussels, Rotterdam, Amsterdam and Gothenburg. The portfolio consists of 186,300 sqm with a well-diversified mix of market leading tenants and includes high-profile office buildings such as *Condor House* and *Portman Square House* in London, *Drehbahn/Dammtorwall* and *Valentinskamp* in Hamburg, *Issy-les-Moulineaux* in Paris

EDITORIAL

Pressure to invest is helping investors to overlook Berlin's politics

There's no stopping Berlin. Scarcely has the city announced new political measures designed to make investment in Berlin property even more restrictive, than international investors vote Berlin to be the most attractive property market in Europe.

The annual study of European markets carried out by consultants PwC and the Urban Land Institute has just seen Berlin displace last year's incumbent Munich from the top of the list, relegating the Bavarian capital to 11th place thanks to excessively high prices. Berlin jumps to the top, ahead of Dublin, Madrid, Hamburg and Athens in the Pwc/ULI Emerging Trends 2015 list.

Berlin has its attractions. Its future looks bright, its economic fundamentals are improving, and it's cheap by the standards of other European cities – despite a rise in apartment prices of 13.8% last year, according to ImmobilienScout24. That's after rising 15.1% and 16.9% in 2013 and 2012 respectively, along with corresponding rent increases of 5.4% last year and 8% annually before that.

While investors are determined to drive Berlin's prices up to a par with other German and European cities, the forces of resistance to higher rent levels and further gentrification are also gathering strength. Legislation to cap rents is well advanced, as is a change in the law as to how brokers are recompensed for their services, both of which are designed to protect tenants from the ravages of the marketplace and ensure that the red teeth and claws of capitalism are held safely at bay outside the front door.

Now the so-called *Milieuschutzgebiet* regulation, a local ordnance designed to ensure that the character of a Berlin neighbourhood remains unthreatened by encroaching gentrification, is spreading its tentacles out beyond the central districts of Mitte, Friedrichshain-Kreuzberg, Prenzlauer Berg, and Pankow, to allegedly protect tenants from greedy landlords.

Even within these desirable living areas, more and more neighbourhoods are falling into the clutches of local politicians, intent on currying voters' favour. In their sights is the key issue of the status of a building, whether it is designated as a 'rental' property or whether its units may be 'privatised', or sold as condominiums.

A decree by Berlin's senate is about to enshrine a host of new restrictions on landlords into concrete law. The lawyers are licking their chops at the potential to file charges on behalf of the state, or maligned landlords, or both. Investors, be warned.

Because yet again, excessive meddling is certain to awaken the ghosts of unintended consequences. As if smaller landlords weren't being faced with enough restrictions with the impending rental freeze, or *Mietpreisbremse*, they are now being effectively prevented from making improvements to their properties, such as adding an extra bathroom, extending the balcony or even polishing up the building's façade.

About 10% of Berlin's apartments now fall into the category of *Milieuschutzgebiet*, covering about 300,000 people across 21 designated areas in the city, but the number is rising fast. Much faster, in fact, than the number of Berlin apartments whose status managed the change from 'rental' to 'condominium', with that number doubling over the last four years in a bid to stay ahead of the politicos. In 2013 nearly 10,000 Berlin apartments were granted this status – with the corresponding ability to charge an adequate rent for a much improved dwelling. The new laws are designed to drastically limit this figure.

At the heart of these changes is the still-prevalent belief among handout-hardened politicians that Berlin is a city of renters, and that housing has traditionally been protected, if not outright subsidised. The real estate industry counters with the argument, the new restrictions are robbing willing tenants of the right to buy their own apartment and thus to build some even modest wealth for their own retirement.

At most the new laws might protect 10% of tenants living in such protected housing, goes the landlords' argument. Hardened privatisers, such as Jürgen Kelber of Dr. Lübke & Kelber, or Jacopo Mingazzini of Berlin's Accentro Real Estate, part of the listed Estavis group, point out that, at from €1,500 per sqm, property in older buildings is half as cheap to buy as in newly-built housing.

So preventing tenants from buying properties where they have spent years and want to remain, simply narrows supply and drives the price of the property up, currently by at least 10% a year, according to local observers. This all plays further into the hands of the big professional landlords, rather than the much more typical small landlord, whom experience shows has been much more modest in driving through legally permissible rent and ancillary charges than the 'faceless' corporation.

While the mega-mergers such as Deutsche Annington's takeover of Gagfah, and Deutsche Wohnen's swallowing of GSW Immobilien grab the headlines, the thousands of smaller landlords whose motivations are more geared to providing a decent yield and an adequate pension are being thwarted by 'well-meaning' politicians at every turn. It is a credit to Berlin's popularity that investors are still flocking to put their money down, without really understanding what the politicians have in store for them.

Charles Kingston, Editor

and *Maastoren* in Rotterdam.

The average age is eight years and the portfolio is currently 93% leased with a weighted average remaining lease term of six years, including periodic rent reviews. Prominent tenants include **BNP Paribas**, **Cushman & Wakefield**, **Chartis Europe**, **AIG**, **Barclays**, **Invesco UK**, **Ernst & Young** and **Deloitte**. About 50% of the rent from the portfolio comes from London and Paris.

The sale was to **NorthStar Realty Finance** and **Cale Street Partners**, a London-based real estate finance and investment firm backed by sovereign wealth capital which will provide part of the financing and helped to source the deal. NorthStar said it anticipates an initial leveraged yield of 13%. The price reflected the book value of the assets in SEB's books, in which the 93%-let portfolio was held across the German open-ended fund **SEB ImmoInvest**, as well as funds **SEB ImmoPortfolio Target** and **SEB Global Property.**

SEB will retain an interest in the portfolio through its asset management mandate for the properties and hence has an ongoing interest in adding value to the assets. SEB's CEO **Barbara Knoflach** commented, "The huge interest shown by global institutional investors shows that we were offering a very attractive investment product. Our portfolio strategy will see us continuing to offer attractive core and value-added products to the international investment market."

The deal was obviously not a one-off – albeit on a major scale – for NorthStar, who are clearly intent on kicking off their European engagement with a wide footprint. Although still unconfirmed, several reports suggest that NorthStar has paid between €450m and €500m for the so-called Trias portfolio owned by insurer Provinzial NordWest, in a structured bidding process.

The **Trias** portfolio is spread across nine European countries and includes 260,000 sqm office, retail, hotel and logistics properties. The assets, including

properties in London, Paris, Berlin, Madrid and Lisbon, have been asset-managed by IVG, Deka and Internos.

Germany/Closed-end funds

Trouble ahead for German closed-end funds with Swiss borrowings

The recent revaluation of the Swiss Franc versus the Euro will cause mayhem for countless German closed-end property funds, according to a new study by the Berlin-based rating agency **Scope**. At the very least the forecasted yields for numerous funds who took out Swiss Franc-denominated loans are heading for a disastrous plunge, the agency says.

The prospect of German closed-end funds having to force-sell many of their assets is a distinct possibility, the agency says, where fund initiators borrowed in part in the Swiss currency (CHF). The good news, says Scope, is that of the 600 closed-end funds it monitors, only 10% or 60 funds took out exposure to the Swiss currency, although using the loans for investing in assets in the eurozone.

CHF loans taken out by closed funds between 2004 and 2006 amounted to €1.3bn, and Scope estimates that the amount of debt of that outstanding is around €1bn. Given that the loans were mainly of 10-year duration, that would see most of them looking for loan extensions around about now, which Scope describes as "an extremely unfavourable starting position for imminent discussions about new loans."

During the years 2003-2007, borrowing in CHF for closed end funds was very popular, given that interest rates on the Swiss currency were at least 150 basis points lower than in the eurozone at the time. This helped fund initiators to raise the prospects of higher dividend payouts. In the years 2003-2007 the average Euro/CHF exchange rate was 1.57, while between 2010 and 2014 it averaged 1.25. The current exchange rate is nearly parity.

As LTV covenants at many of the funds are now likely to be breached due to the strengthened Swiss currency, triggering the right of lenders to demand more security, liquidity at these funds is likely to come under severe pressure. The immediate effect of this will be to block dividend payments to investors, while potential payouts are diverted to the minimum liquidity reserves to satisfy bankers. This will cause many funds to collapse, says Scope.

Another factor threatening the viability of many funds is the parallel need to secure a new tenant lease agreement after ten years. Refinancing can then prove doubly difficult, as the security for any new lender is now further endangered. Should funds find that their liquidity reserves are not sufficient to bear the brunt of the new currency repayment burden, the result will inevitably be a wave of forced sales, concludes Scope, without naming any of the funds most likely to be negatively affected. "We are currently scrutinising the particular situation of individual funds", say the analysts. Given that last year again saw at least a third less new closed-end property fund issues than the previous year, this latest blow comes at a tough time for German fund initiators.

Germany/Acquisitions

IVG sells Silberturm to Samsung, cancels Squaire sale

It's one of the most prominent buildings in Frankfurt, starting life as Germany's tallest building and changing hands several times over the last few years, while

undergoing a major facelift and modernisation that will ensure it remains a landmark for years to come.

The "*Silberturm*", or Silver Tower, (*pictured, left*) near Frankfurt's main railway station, once the headquarters of the now-disappeared **Dresdner Bank** is now in the proud ownership of an investor group led by South Korea's **Samsung SRA Asset Management**.

The 166-metre tall building was sold by **IVG Institutional Funds** for an unnamed price (but thought in Frankfurt media circles to be around €450m). The current tenant of the property's 32 floors and 50,000 sqm is **Deutsche Bahn**, along with its in-house IT service provider **DB Systel**. Deutsche Bahn's lease contract remains unaffected by the change of ownership.

A separate adjoining property with 22,000 sqm, housing "board and executive headquarters" and likewise leased to Deutsche Bahn, is part of the Samsung ensemble. **Commerzbank**, which swallowed rival Dresdner Bank several years ago, sold the property to the IVG consortium in 2012.

The American group **Hines** acted as investment manager for Samsung and will handle asset management for the property, which holds a DGNB Silver status after its complete refurbishment in 2012.

Meanwhile, **IVG Immobilien AG**, which emerged from a self-managed insolvency last year after a process which had seen it go from Germany's largest property company to de-listing from the stock exchange - while wiping out shareholders – said that it now DOES intend to retain ownership of IVG Institutional Funds, which manage about €11bn of European office, retail and logistics property across numerous separate funds. (IVG itself has €3.5bn of assets under management across Germany). This is in contrast to earlier statements by the

company, which had said earlier it was looking for a buyer for the funds group.

Another about-turn by IVG is the halting of its ongoing efforts to sell its colossal flagship "*The Squaire*" property at Frankfurt Airport, which houses tenants **KPMG**, **Deutsche Lufthansa** and two separate **Hilton Hotels**. IVG stopped the sale after bids from international investors fell short of its valuation of €700m.

A number of bidders, including China's second largest insurer **Ping An**, the **Qatari sovereign fund**, developer **Tishman Speyer**,and private equity groups **Blackstone** and **BlackRock**, were invited to revise initial offers, but these too were rejected. IVG most recently had The Squaire valued in its books at €807m, but analysts consider this now to be closer to €700m

Instead, in somewhat of a surprise move, IVG has arranged a new €470m five-year loan from **Bank of America Merrill Lynch** to cover holding on to the 80%-let property, which apparently still provides a well-above-average yield for IVG. According to CEO **Ralf Jung**, in a statement, "The offers we received did not match our valuation of this property. At the same time, the refinancing obtained makes it commercially attractive for us to keep THE SQUAIRE in our portfolio. It shows a commercial viability well above total portfolio's average".

The construction costs with enormous overruns of more than €1bn played no small part in IVG's downfall, and led the group to being taken over by its bond creditors in debt-for-equity deals. IVG's finance director **Fabian John** added, "The refinancing terms ensure that, with its current letting levels, The Squaire will deliver an earnings contribution in the double-digit millions."

He said that the firm's liability restructuring is now almost complete, following this loan and two further loan agreements made with Deutsche Bank last October for €1.5bn, of which a €680m tranche was secured in a CMBS transaction.

Germany/Listed companies

AIM-listed Summit Germany raises €120m in share placing

Summit Germany, the AIM-listed and Guernsey-headquartered specialist for German commercial real estate, has raised €120 million by issuing 171.4 million shares at 70 euro cents each in an oversubscribed placing with existing and new institutional investors.

The German commercial real estate company said it will use the money to finance property acquisitions, joint ventures and co-investments as it moves towards its target of building an internally-managed portfolio worth more than €1 billion.

"The company is currently exploring a range of attractive acquisition opportunities and will seek to complete a number of them using the proceeds of the placing," it said.

"Demand for the properties of the company and its subsidiaries continue to be strong and are increasing with the increase in rental income and occupancy. The board is confident that the company is well positioned to benefit from the market trends by executing on new acquisition opportunities; by continuing to enhance the rental income from its properties and by realising value from its substantial portfolio," it added.

The company also said in a statement that it has signed a binding term sheet with a German bank for the financing of nine of the 11 properties the company bought back in April 2014.

The company said the deal is for a €33 million, seven-year facility, at an interest rate of 2.1% a year and an amortisation rate of 3% a year. It said the loan will bear "customary covenants". Of the total loan, €2.5 million is subject to the extension of some leases.

Summit regained full control of the portfolio of mainly office buildings last April when it bought a loan facility on the 11 properties for about €45.5 million. The properties covered by the refinancing have a lettable area of 58,000 square metres, have multiple tenants, an occupancy rate of 91% and an annual rent income of €5.6 million. It said it expects to complete the refinancing by the end of February.

Germany/Financing

Study calls for more support for traditional German RE financiers

We carry a number of articles in this issue about engagements from either new or existing debt providers in real estate financing, moving into to areas of lending that would typically have been provided by the traditional banks and focused real estate financiers (see articles on **Caerus**, **BVK** and **VGV**).

A new study just released by the **Institut der deutschen Wirtschaft (IW)** in Cologne in conjunction with the **Verband deutscher Pfandbriefbanken (vdp)**, the association of German Pfandbrief-issuing banks, carries a stark warning about the likely long-term effects of financial market regulation on the traditional sources of finance.

In particular, it highlights how the stringent demands of **Basel III** and **Solvency II** will see banks – particularly those refinancing via Pfandbriefe - being forced out of the property financing role, in favour of insurance companies, debt funds and pension pools.

According to **Professor Michael Hüther**, director of the IW, there is a political will to favour alternative providers of finance over the banks, by deliberately absolving insurers from the need to publish liquidity figures and by imposing lower equity capital requirements on debt funds than on banks, for example.

Jens Tolckmitt, CEO of the vdp, points out that the banks are effectively being forced to refocus on short-term lending by the new leverage ratios and liquidity measures LCR and NSFR demanded by Basel

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III. Likewise, Solvency II decrees that insurance companies have lower incentives to invest in long-term Pfandbriefe, since it would tie up more of their equity capital – with its accompanying negative consequences for bank refinancing and thus banks ability to provide loans.

Hüther raises the question in his study as to whether the alternative finance providers have boththe will and the ability to underwrite long-term lending. "First of all they have to build up the necessary know-how so they can make accurate assessments of the likely rate of delinquency of such long-term loans", he says. Another factor hindering debt funds is that their investors are normally oriented to the medium-term (5-7 years), rather than the long term (10 years plus). Solvency II even provides incentives for insurers to plump for shorter loan terms, since they need to underpin the loans with less equity capital.

Longer-term financing is the norm in Germany, particularly in private residential mortgage financing, with more than 70% of all new loans since 2000 being issued for a period of five years or more. Variable interest rate loans account for only 15% of new mortgages, compared to a eurozone average of more than 45%. Hüther argues that disadvantaging the banks in favour of more short-term oriented lenders would harm the country's ability to plan for the longer term and would remove a key stabilising element keeping German prices in check.

Tolckmitt of the vdp sees the Leverage Ratio (the relationship between core capital and total balance sheet, which is not allowed to fall below 3% for any financial institution) as the proviso likely to cause the most problems, particularly when it comes fully into effect in 2017. "This will raise the cost of loans significantly", he says.

Like Tolckmitt at the vdp, Hüther of the IW is firmly against any shift in long-term financing to the newer financial intermediaries who are less regulated, established and experienced, and he believes it would lead to unwelcome market distortions.

His proposal is to introduce the Leverage Ratio as a benchmark figure and have the authorities monitor it carefully for the next while. At the same time the authorities should lower the Liquidity Ratio NSFR from 100% to 95% to give the banks a bit more more wiggle room, and be less fixated purely on the numbers but take each individual bank's situation into account.

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Germany/Financing

Climate for financing in Germany hits record high

The **FAP-Barometer**, now well-established as a German index for measuring the real estate financing climate, showed it highest-ever reading for the first quarter of 2015, indicating that the environment for financing commercial property has never been as good.

The FAP reading, managed by **Flatow Advisory Partners** in Berlin, takes quarterly soundings from providers of real estate finance as to how they view the attractiveness of financing different market segments. The data collection is carried out by real estate research group **BulwienGesa**.

The reading for Q1 is +2.87, up from 2.33 in the last quarter. Financing conditions are seen as having improved by 53% of those surveyed, while 47% view the market as unchanged – with no respondent believing that conditions have disimproved. About half of respondents noted falling liquidity costs.

According to founder **Curth-C. Flatow** (*picture, right*) "The positive mood among financing institutions stems from the new business they are writing. Nearly 60% report increasing levels of new business, the highest level since end-2012. We could even be about to see another record year in German commercial real estate.

The average sums lent by 51% of respondents are between €10m and €50m. Loans of between €50m and €100m have risen by 7.5%, while loans of above €100m are up by 1.1%. Noteworthy is perhaps a shift to the financing of non-core assets, due to stiff competition in the core sector, as well as the demand for financing assets in C- and D-locations. Niche segments and operator-driven assets such as hotels and student accommodation are also attracting more attention here.

With financing of existing assets being made available at LTVs of 30% and 100%, the average across all lending and asset categories is 71%. Not such good news for finance providers is that margins are currently between 65 and 525 basis points, with the average being 158 bps, down from last quarter's average of 176 bps.

Project developments are seeing LTC values of between 45% and 90%, with the average being 72%. Margins are up to 300bps, with the average being 201bps, down from last quarter's 224bps. This indicates a fall in margins over the last 12 months of more than 22%, while for project developments they have fallen by more than 10%.

The study and accompanying graphics can be downloaded at: **http://www.fap-finance.com/de/barometer/**

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Germany/Study

German urban housing estates need €90bn investment - study

German housing estates, an important pillar of urban residential supply, are suffering an enormous investment backlog, and will need some €90bn for modernisation through 2030, according to a new and comprehensive study published by the **German Institute of Urban Affairs (Difu)** in Berlin.

Large estates with over 500 rental units make up some 10% of total housing stock or 4m apartments, and are home to 8 million people throughout the country, Difu found in its new study. It places the investment backlog in modernisation and new construction at €56bn through 2030, plus an additional €33bn for social and technical infrastructure in the surrounding areas. The main challenges are the conversion of space to become barrier-free and elderly-friendly as the population ages, and to find cost-efficient solutions for energy-friendly refurbishment.

Housing estates form an important pillar of urban social infrastructure as they offer affordable living space, Difu said. To counter the poor reputation of some neighbourhoods, these modernisation plans need to provide attractive everyday living spaces, mixed-use functions and a better integration into the cityscape.

Against the backdrop of a general housing shortage in the large conurbations, more municipal, investor and planning attention should be given to the role played by these estates. The study was commissioned by the **German Building and Construction Industry Association HDB**, the **German Building Materials Association BBS**, the **German Federal Association for Housing and Real Estate Companies GdW** and the **Housing Estate Centre of Excellency (Kompetenzzentrum Großsiedlungen)**.

Germany/Study

German investment and leasing markets drifting further apart

One of the notable features of the German real estate market through 2014 was widening gap between the investment markets and office leasing markets in Germany's biggest cities. While the large brokers were cracking open the champagne bottles to celebrate a record year for investment transactions, their colleagues responsible for leasing were experiencing their weakest year for five years.

In the Big 6 cities of Berlin, Hamburg, Munich, Frank-

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.

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furt, Düsseldorf and Cologne a total of 2.7m of new office leases were signed, 4.3% less than in 2013 and well below the 10-year average of 2.9 sqm. The figures are even starker when Hamburg and Berlin are excluded, as both those cities had an INCREASE of 12%, but this could not compensate for the -5% in Munich to the -31% in Düsseldorf.

At the same time (with the exception of Düsseldorf) all the main broker groups are at pains to point out the overall fall in the availability of office space in the bigger cities, such that the actual vacancy rates again fell – a trend likely to be continued in 2015, as more than half of the new-built office space coming on stream is already pre-let.

The winners in the current market are those locations on the edge of the cities' classical Central Business Districts, where increasingly cost-conscious tenants are clustering.

Brokers **Colliers** and **Savills** are predicting for 2015 that the current drift between investment and leasing activity will continue. After moderate rental growth in 2014, office rents are expected to stabilise as potential tenants hold off on major leasing decisions in anticipation of falling rents. With less new office property coming on the market, however, a floor exists which will provide good support, say the brokers.

Both brokers however anticipate investment volumes of again, €35m to €40m, with the wall of money looking for suitable assets likely to drive yields in cities like Munich down to 2007 levels. Investors will be drawn into taking on more risk, and finance providers will also be drawn further into non-core financing. As a rule, investors' yield expectations rise on average by 1.4% when they invest outside the tried and trusted A-locations, which they are increasingly being forced to do.

Germany/Debt Financing

CAERUS secures new mandates for €350m debt finance

CAERUS Debt Investments AG, the Düsseldorf-based consultancy specialising in real estate debt, gained two major new mandates at the end of the last quarter from German institutional investors. CAERUS will advise both clients on the investment of a total of €350m in senior collateralised mortgage loans with

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high loan-to-value ratios, so-called whole loans.

The Düsseldorf-based CAERUS, headed up by **Michael Morgenroth**, a former chairman of INREV and a board member of insurer **Gothaer Asset Management AG**, has now gained mandates of €420m since CAERUS's founding two years ago. It has already placed €188m in three investments, securing the loans on both individual properties and portfolios.

CAERUS's CIO **Dr. Patrick Züchner** commented, "For some time we have been noting considerably increasing demand for senior secured real estate loans, from a single source, for locations away from the top cities and use types outside the mainstream. This demand is not being adequately satisfied by the traditional market players. Individual clients advised by CAERUS have access to financing solutions for complex financing situations, for example in the area of larger portfolios."

At €200m, one of the two new mandates won by CAERUS is from the Dortmund-headquartered **Volkswohl Bund**, a traditional mutually-held German insurer that's been in business for nearly 100 years. Volkswohl Bund's policy holders are private households and commercial 'Mittelstand' companies, and the relatively low-key insurer offers its policies via an extensive network of insurance brokers and independent financial salesmen.

Volkswohl Bund board member and Head of Investment **Axel-Rainer Hoffmann** told REFIRE that the attractions of debt investment for his company were the low risk involved, the more attractive yield available, and that it is senior secured debt.

Although Volkswohl Bund has about 7% of its assets invested in real estate, and it offers mortgages to its policyholders and third parties, investing in debt is a new investment category for the group. With debt investments, he is not looking for either adventure or indeed, capital appreciation, he said, and certainly not at this point in the real estate cycle. As a fixed income investment, debt finance is an attractive option, he said.

Michael Morgenroth of CAERUS added, "Widening our invest-

Guest Column:
Jürgen Scheins, Managing Director of VALTEQ Gesellschaft mbH

Strategic outsourcing of facility management services

www.valteq.de

For a number of years, outsourcing of increasingly complex service packages has been a trend in the field of facility management. A market study titled, "The future of FM services in Germany in 2020" already showed in 2011 that many industry experts were declaring themselves in favour of the full-package placement of facility services as an alternative to the traditionally prevailing individual package contracts. However, the contracting of FM services in outsourcing or operator models is a process that can result in very differing degrees of economic success. Decisive factors are often organisation-related operative barriers and, in particular, the thorough preparation of the process, which should include a concept for the definition of services, as well as for control mechanisms, or contract and payment models. Generally speaking, it is to be decided whether contracts are to be placed individually, or as a full package, in which the demands placed on the configuration of service level agreements, functional performance programmes and the contractual definition of payment models are higher again.

For example, a major insurance concern tendered out comprehensive operator responsibility for its concern headquarters and placed the contract as part of an innovative outsourcing process. In this regard, the overall facility management of the self-used properties was contracted on the basis of strategic business principles:

- Comprehensive bundling of responsibilities and competencies by transferring the "operator responsibility" to the service partner
- Anchoring of "life-cycle orientation" through the agreement of a long-term service relationship, and of "performance orientation" through functional performance agreements
- "Output specification" coupled with a sophisticated quality assurance system.

In addition, a so-called "floating GMP" approach was selected. Until a defined payment baseline is reached, the true costs of performing the works are paid in addition to a preset profit margin. Once the baseline amount has been passed, the client bears at least part of the service provider's additional expenditure – within the bounds of a so-called "floating corridor". Beyond this, there is no further risk sharing on the part of the client; in other words, the client benefits from the service partner's Guaranteed Maximum Price. Accordingly, the client receives a rebate in the event that the baseline amount is not reached.

The significant improvements in performance quality and cost efficiency speak very much in favour of grappling with detailed concepts of this kind. Empirical evidence shows that most companies in the industry have so far only scraped the surface of the potentially feasible solutions. According to VALTEQ's experience with such projects, more intelligent concepts therefore offer qualified asset managers a broad scope for further significant improvements in the economic success of their management services.

ment solutions to include whole loans can provide investors with access to attractive yields. As part of our investors' portfolios, these make a noticeable contribution to achieving their internal target returns."

Germany/Hotels

German hotel investment at record €3bn, but demand set to fall

It was long looking clear that 2014 was shaping up to be a record year for investment in the German hotel sector, but when the final figures came in, they were still a cause for surprise. According to property advisers **JLL**, the transaction volume of €3bn exceeded the boom years of 2006 and 2007 (both around €2.3bn) by nearly a third (30%), and well above the 10-year average of €1.2bn.

In the last quarter of 2014 alone, hotel deals of nearly €1bn were transacted. The primary driver behind the surge in investment were international investors and other internationals who had not previously been involved in the sector.

The solid German economic climate, low interest rates, the willingness of banks to finance, as well as the low euro helped to drive more investors into real assets, the brokers say. Yields of 50 to 100 basis points above comparable investment in offices meant that fund investors as well as insurers and pension funds were often adding hotels into portfolio buys to raise overall returns. (Figures from **CBRE** suggest the peak hotel yields fell over the last twelve months by 50 basis points to 5.25%.)

JLL says another strong year lies ahead in 2015, although a survey it took in November raised warning flags about a notable shift in sentiment ahead. "In 2015 we expect another good year for the hotel investment market, though not necessarily a repeat of record year 2014," said JLL's Head of Hotels & Hospitality Group Germany, **Ursula Kriegl**.

JLL recorded 70 transactions across the market, 15% more than in 2013. Off those, 57 were single deals – up by 70% on the previous year to €1.8bn. "In 2014, potential buyers were provided with a lot of large single assets," said Kriegl. A dozen transactions exceeded €50m, against only three in 2013. Helping to boost the figures was the average transaction volume for single assets, which rose to €31m from €21m.

Trade in luxury hotels certainly lent the market wings, tripling in value to €965m. Among the largest deals were US REIT **Host Hotels & Resorts** buying 90% of the *Grandhotel Esplanade Berlin* for €81m from **Blackstone**, the sale of the *Atlantic Hotel* in Hamburg, and **Deutsche Asset & Wealth Management** acquiring the *Jumeirah Hotel* in Frankfurt as part of the €800m *Palais Quartiers* from **Rabobank**. Portfolio

transaction volumes more than doubled to €1.2bn in 11 deals with 124 hotels and two mixed-use transactions. The largest was French hotel operator **Accor**, buying 67 hotels from **Moor Park** for €450m.

The most active buyers were institutional investors, high net worth individuals, hotel operators and private equity firms. The share of domestic buyers fell to one third from 58% in 2013. French and UK investors were responsible for €625m in volume, US investors for €116m.

JLL surveyed 600 hotel experts in November about their forward views. In contrast to a similar survey six months before, the number of optimists had fallen from 77% to 58% - noticeably more so than for Europe at large, and at odds with stated global perspectives.

Frankfurt was seen as particularly vulnerable, along with Berlin and Hamburg, along with Düsseldorf which is particularly prone to volatility given the 2-3 year cycle of some of its biggest trade fairs. Munich was seen as the most favourable market.

The investors surveyed showed clearly that their intentions are shifting, from buying existing hotels to project developments, buying refurbished properties, or converting existing properties into hotels. Ursula Kriegl of JLL believes that this is being driven by the low yields currently achievable and the difficulties, particularly in Munich, of buying existing properties.

Germany/Acquisitions

UK's Capital & Regional departs Germany to focus on UK

The UK's specialist retail property company **Capital & Regional** sold its 50% stake in its German retail joint venture with **Ares Management** to clients and funds managed by fellow UK investor **Rockspring**, in a deal which puts an equity value of €105m on the joint venture.

The deal represents the last major step in Capital & Regional's stated strategy of refocusing its business onto its portfolio of dominant UK shopping centres, and dovetails with the company's conversion to REIT status on December 31st 2014.

The joint venture with Ares Management consisted of 23 properties with 100 retail units across five separate portfolios and mainly anchored by national grocery and DIY stores, which Rockspring will allocate to its **German Retail Box Fund.** The sale to Rockspring put an equity value of €52.5m on Capital & Regional's share, but will generate about €43m in cash after transaction costs and the keeping of a small minority stake in the ongoing German portfolios for the next five years.

Rockspring CEO **Robert Gilchrist** commented: "The deal is illustrative of the retail acquisition strategy we have been implementing in Germany for our institutional clients over the past 10 years, and we will be progressing a range of opportunities to generate a solid distribution return whilst applying asset management expertise to extract value over time."

Capital & Regional will now focus exclusively on its UK interests, after what CEO **Hugh Scott-Barrett** said had been a transformational year for the group. : "Having restructured the company's debt, undertaken a number of non-core divestments, acquired full ownership of the **Mall Fund** and received shareholder approval for a REIT conversion on 31 December, the proposed disposal of our German joint venture represents the last major step in repositioning the company's focus on its core portfolio of dominant UK community shopping centres."

Separately, Rockspring bought a 16-hectare site with permission for a fully-serviced logistics development right beside the new **Berlin airport**, which is still under construction after several controversial delays. The €13.5m *VERDION AIRPARK* deal was done in partnership with logistics developer **Verdion**, with Rockspring providing the full equity funding for the proposed 93,000 sqm scheme.

The development will move forward in a number of phases comprising logistics warehousing units ranging from 5,000 sqm to 40,000 sqm being delivered from this year onwards, and is expected to have an end-value of more than €85m. Verdion had previously developed the adjacent 46,000 sqm *Air Link Park,* where tenants include **Parxel**, **Dachser Spedition**, and **Unitax**.

According to Rockspring's Berlin-based partner and head of Germany, **Stuart Reid**, "This underlines our commitment to Berlin and our belief in the growing importance of strategic logistic sites in Germany, which benefit not only from strong regional access, but which are also within easy reach of the city and airport. With Berlin's projected growth and Berlin Brandenburg Airport expected to become one of Europe's busiest airport hubs on opening, we consider this site to be one of the best in the region."

Europe/Research

More capital heading to real estate – and more risk appetite

Investment in real estate is headed for a further rise in 2015, reflecting market stabilisation, according to the Global Investment Intentions Survey from non-listed property industry associations **INREV**, **ANREV** and **PREA**. Institutions intend to raise allocations to global real estate to a median 11.3% this year from 10.8% currently, meaning that a minimum €42.5bn is being targeted at real estate this year.

Figures from the latest INREV Investment Intentions Survey shows real estate is set to remain a 'hot ticket' in 2015, with the investment target well up from €35bn in 2014. Investors from Asia- Pacific are driving this increase as they expect allocations to rise to 11% from 9.8%. Likewise, North America and European investors will increase allocations in their regions to 9.1% from 8.6%, and to 12.6% from 12.3% respectively.

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 this some 45.1% or €19.2bn of the anticipated total allocation is pointed toward Europe, with Germany, UK and France still ranked as the top three investment destinations for all investors. Italy is now attracting attention, jumping three places to become the eighth preferred target destination this year. A big loser is Turkey, however, which has dropped out of the list of top-15 target destinations.

The INREV survey found an increasing focus on risk – with 41.4% of investors surveyed indicating value-added is their preferred investment strategy, now on a par with core, for which a further 41.4% of investors express a preference. While office remains the preferred asset type, alternative sectors are gaining in popularity. Just over 20% of respondents highlighted assets in hospitality, student housing, healthcare and parking as well as real estate debt as desirable investment targets.

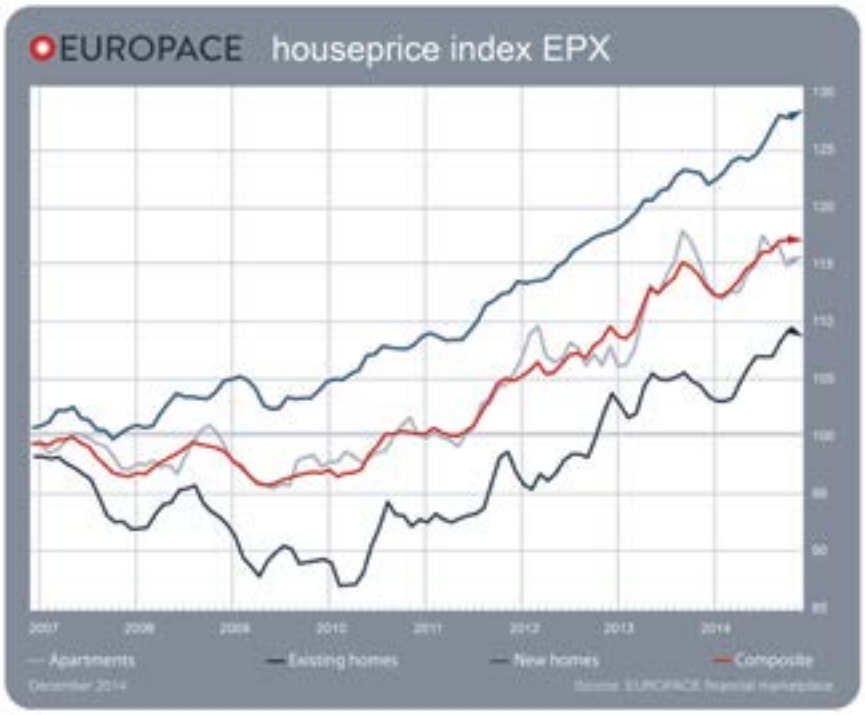
As in previous years, investors display a preference for investing in domestic markets. In Asia-Pacific 67.7% say they will invest in their own region, against 77.5% of Europeans and 68.5% of North American institutions. "However, there are encouraging signs that some investors are moving further afield. Investors from Asia-Pacific, for example, demonstrate a desire for geographic diversification."

INREV cited an increase of around 20% of Asian investors planning to invest outside their region – with more than half of them targeting Europe and North America. Within Europe, again, the key markets Asian investors are targeting are the UK, France and Germany

INREV has been carrying out its survey in Europe since 2007 but last year teamed up with ANREV and PREA – its counterparts in Asia and the US, respectively – to provide a more global perspective.

Henri Vuong, INREV's director of research, said: "This year's survey is broadly consistent with the predicted and actual investment trends we've seen over the past couple of years. It's a case of investors chasing dependable returns through real estate in an otherwise unexciting investment landscape."

"But we can't ignore the cyclical nature of real estate – what the survey shows us could also be reflective of a market enjoying a period of calm before the storm."



Germany house price development

Germany/Acquisitions

Corestate Capital sells further repositioned portfolio for €83m

Switzerland-based **Corestate Capital**, which largely focuses on opportunistic residential real estate in Germany, continued its long series of disposals by selling a further 2,360 units – this time to a listed (unnamed) international institutional investor, for a price of €83m. This brings to over €1bn the revenue raised from sale by the company in the last two years.

The properties are located in the German states of North Rhine-Westphalia and Mecklenburg-Western Pomerania, and were acquired from a distressed seller in early 2010.

Typical for Corestate's "repositioning" approach, when it bought the properties they had a significant maintenance backlog, high vacancy levels and a poor rent roll. By restructuring the funding, committing heavy capital expenditures to redevelopment, and actively managing the assets, Corestate says it lowered the vacancy rate from 14 % to 7 % and cut the delinquency rate from 15 % to 5 %.

Thomas Landschreiber, Corestate's CIO, commented: "We focus on creating value in real estate as opposed to passive buy-and-hold strategies. Our asset management platform covers the entire spectrum of real-estate-related deliverables, which made it possible for us to stabilise this distressed portfolio within four years and to successfully reposition it on the market.

"Given the persistently upbeat senti-

ment on the German investment market, the comparatively moderate entry-level investment volumes, and the low rate of interest on the capital market, real estate investments in Germany remain an interesting proposition", he said.

Since its establishment in 2006 by ex-**Cerberus** staff under the leadership of **Ralph Winter**, Corestate has invested more than €3bn in Germany for international investors and family offices. Two years ago it opened a further office in Singapore to tap into Asian capital sources looking to invest in Europe, in addition to offices in Zug, Frankfurt and London. This week it announced that it planned a doubling of its investment in the eurozone this year following the removal of the peg between the Swiss franc and the euro, which has seen the value of the Swiss currency jump by 20%.

Germany/Listed Companies

Green light for Deutsche Annington takeover of Gagfah this quarter

Germany's **Cartel Office** last week gave the green light for the takeover by **Deutsche Annington** of fellow-listed **Gagfah**, removing a potential hurdle to the creation of the new giant residential housing company, with its more than 350,000 apartments.

Annington said last week that it now had the acceptances of 85.2% of the votes of Gagfah shareholders, including shares tied in to convertible bond issues, to go ahead with the takeover. The minimum quotient had been set at 50%, or 57% of the bond-related share, a margin which has now been comfortably met. Annington has offered €122.52 in cash for every 14 Gagfah shares, as well as five new shares in the enlarged Deutsche Annington. Gagfah stock is currently trading at just under €20.00.

According to Annington's CEO **Rolf Buch**, "We are very happy about the unfailingly positive acceptance of our undertaking to combine Deutsche Annington and Gagfah to form a leading German residential company with around 350,000 units." Remaining Gagfah shareholders will be able to tender their shares in an additional acceptance period ending on 9th February. Formal closing of the deal is expected this quarter.

The new company, whose likely new name and headquarters location have yet to be decided upon, will see Rolf Buch becoming CEO and Gagfah's CEO **Thomas Zinnöcker** becoming his deputy CEO. The combined group will have assets worth €21bn.

Germany/Debt Funds

DeAWM launches €500m debt fund after record year

Deutsche Asset & Wealth Management (DeAWM), the alternative investment management arm of Deutsche Bank (previously known as **RREEF**), has closed its first senior commercial real estate debt fund, raising €500m.

The investment manager said it will structure the vehicle as a German *Spezialfonds*, and will write loans against German real estate – both in the commercial and residential sectors. The fund will invest in facilities that have loan-to-value ratios of up to 60% and are secured against office, retail, residential and logistics assets across Germany, while loan maturity would range between three and 10 years.

The group did not reveal any details on who the investors are, other than saying it used its Alternative Asset Management arm in the UK to raise the capital. However, insurers and pension funds have been backing similar debt funds in this cycle, with iii-investments of Munich being an early real estate debt fund to structure as a *Spezialfonds* on behalf of a German pension fund in 2012 when it was awarded a mandate to launch a €200m debt vehicle.

"The capital raise demonstrates the increasing demand for real estate loans as an alternative to corporate and government bonds," said **Andrea Vanni**, head of European real estate debt investments for DeAWM. "The fund close also represents a further milestone for the expansion of our real estate debt business."DeAWM has €1.27tr of assets under management globally, with €37.1bn invested in core, value-add and opportunistic real estate, real estate securities and property debt.

A recent statement by Deutsche Bank itself on the dealings of its DeAWM subsidiary said that DeAWM bought and sold €3.6bn of property for its German real estate investment funds in 2014, a rise of 65% to a record volume. Most of the transactions involved buildings in Germany. It bought buildings valued at about 2.4bn and sold about €1.2 billion euros of properties. The corresponding figure in 2013 was €2.2bn, unchanged from 2012.

The 2014 deals included the acquisition of Frankfurt's *Palais Quartier* mall, office and hotel complex, valued at about 800 million euros, which was Germany's biggest single-property sale of 2014. It also bought the *Rondo One* office building in Warsaw from **BlackRock** for its institutional clients.

DeAWM also carried out numerous deals for its open- and closed-ended funds, popular with thousands of private savers. These included buying five properties for €528m and selling four for €585m in its two open-ended real estate funds **Grundbesitz europa** and **Grundbesitz Global**. Its latest open-ended fund, **Grundbesitz Fokus Deutschland** is currently evaluating several potential investments, it said. The group also sold one property out of its closed-end fund business for €173m in 2014 and bought residential property worth €25m.

According to **Georg Allendorf**, (*pictured, right*) the genial, bow-tied co-head of European real estate at DeAWM, "2014 was a record year for us with extraordinary market opportunities. Institutional investors in particular need appropriate real estate investment opportunities and favour German special funds for that purpose."

Just recently DeAWM also took advantage of strong Asian interest in London to sell the *Tower Place* office property to Chinese insurer **Ping An** for €427m, bagging a 15% premium on the property's assessed value of €370m in September last year. The building was sold from the Grundbesitz Europa fund, where it had been the single largest asset; it had been bought in 2003 for about €320m at the time. The 35,000 sqm building near the Tower of London, designed by **Norman Foster** and built by **Tishman Speyer**, is fully occupied with consulting group **Marsh & McLennan** as the principal tenant.

Germany/Retail real estate

UK REIT Redefine boosts German retail holdings in €157m deal

Redefine International, the London Stock Exchange-listed REIT, completed an €57.4 million acquisition in mid-January of a portfolio of 56 German retail properties in a 50/50 joint venture with Johannesburg-listed **Redefine Properties**, its biggest (30%) shareholder.

The portfolio is valued at €156.8m and will be acquired together with existing bank debt of €100m, which the joint venture intends to refinance immediately after the deal is closed. The deal reflects a net initial yield of 7.5%, although Redefine says that, subject to refinancing, it is expected to produce an initial yield on equity of more than 11.0%. The deal will boost Redefine International's portfolio of assets in Germany to about €478m.

The acquisition is in keeping with Redefine International's stated strategy of focusing more on income yielding assets in the retail, commercial and hotel sectors in the UK and Germany to grow income returns to shareholders. Germany now represents 35% of Redefine International's total core portfolio by value, while the company recently exited the

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Swiss market by selling its retail portfolio there, let out to **COOP**, Switzerland's second-largest retailer.

The portfolio's 56 properties total over 128.000 sqm of lettable area, made up of stand-alone supermarkets, grocer-anchored retail parks and cash-and-carry stores. The properties are well-located within their respective micro markets, with 85% of the total annual rental income located in western Germany and Berlin and the remainder in eastern Germany.

The net price paid includes the acquisition costs and net working capital and will be funded equally by Redefine International and Redefine Properties from existing cash resources. As part of the deal, the joint venture will assume the existing bank debt facilities totalling €100 million.

Mike Watters, CEO of Redefine International, said the deal in one of the company's core markets in conjunction with its major shareholder is a considerable achievement in a highly competitive market. "The portfolio is well let, has been well managed, and offers considerable scope for asset management activity. The transaction is expected to be earnings accretive in this financial year," Watters said.

Redefine's other assets in Germany include: four office buildings let out to **VBG**, a workmen's compensation insurance system; three major shopping centres in Berlin, Hamburg and Ingoldstadt; and a range of strip malls, supermarkets and DIY stores, numbering **Edeka**, **Aldi**, **Lidl**, **OBI** and others among their key tenants.

Germany/Financing

German pension funds stepping up RE investment

German pension funds **Bayerische Versorgungskammer (BVK)** and **Nordrheinische Ärzteversorgung (NAEV)** have teamed up in a joint venture to purchase a newly built mixed-used property in Warsaw.

The UK-based **Invesco Real Estate**, part of US wealth management group **Invesco**, bought the 56,800sqm *Plac Unii* building for €226m on behalf of the institutions, both of which are separate account clients. The sellers were Belgium-based **Liebrecht & wooD**, a developer focused on eastern Europe, and Polish listed **BBI**.

This is the first time the BVK pension fund has entered into a joint venture with NAEV and a BVK spokesman said that the cooperation was currently limited to the Warsaw one deal - "but further joint ventures are not excluded". He said that the joint venture was entered into on this occasion "because of the size of the BVK's investment in this submarket and for this object" in order to allow for "risk diversification".

The property will become part of the portfolios of the two Versorgungswerke via the investment platforms set up by **BNP Paribas REIM** for the €60bn BVK and Universal-Investment for the €11bn NAEV, respectively.

The class-A property, located on the edge of Warsaw's central business district and only completed at the end of 2013, consists of three parts, with up to 21 storeys and 41,300sqm of office space, as well as 15,500sqm of retail space in total. The main office tenants are **ING** and energy services company **Dalkia**, and the retail space is let to a mix of clothing stores (including **H&M**), restaurants, cafés, a fitness studio and a supermarket.

Last summer, BNP Paribas REIM was part of a consortium alongside BVK to finance the development of the Mall of Berlin.

Meanwhile, the **VGV Verwaltungsgesellschaft für Versorgungswerke**, a pension fund for Berlin doctors and pharmacists, is pressing ahead with its first investment as part of the €500m mandate it granted **CBRE Global Investors** last year to invest on its behalf.

CBRE is now close to completing its first deal for VGV, the purchase of an office property in Birmingham, UK. The property, *Brindley Place* in central Birmingham, is let to the bank **RBS**, and is currently owned by investment company Tritax.

Early last year, VGV, through **Union Investment's Institutional Property** arm, bought *60 Holborn Viaduct* in central London for around £250m in a joint venture with **Hines**, with **Mercer Investment Consulting** advising VGV. The building is let to **Amazon** as its UK headquarters.

CBRE also has a €500m mandate to invest on behalf of pension fund BVK in global real estate markets. BVK awarded CBRE the mandate in 2013 ""in a bid to diversify its exposure to the asset class, targeting property types across geographies, capital structures and risk profiles".

Germany/Private Equity

Parking operator APCOA restructures, lowers debt by €440m

The previously troubled Stuttgart-headquartered **APCOA Parking**, the largest European operator of parking garages, has completed a major financial restructuring after nearly two years of complex negotiations, which should put it back on a strong financial footing.

Struggling in the last few years under the weight of its debt, the group has now undergone a "consensual financial structuring" which sees it slashing its debt burden by €440m permanently, and securing €80m of additional financing to support a much-needed capex program, along with extending existing loans by up to six years. The main creditors were Norway's **DNB Bank**, **Bank of Ireland** and Japan's **Mizuho Bank**

The group is now majority-owned by US and UK-based private investment firm **Centerbridge**, which has taken control through debt-equity swaps and agreements creditors, and with previous main sponsor French private equity firm **Eurazeo**. The French

group originally bought APCOA from Bahrain-based **Investcorp** for €885m in 2007, but itself nearly drowned under the weight of the debt it took on to finance the acquisition. In August last year **Deutsche Bank** also provided a loan of €90m.

APCOA has an annual turnover of €678m, with a staff of 4,700 managing 1.4m parking spaces at 7,400 locations in 12 European countries, including managing parking facilities at 30 European airports. Centerbridge, with offices in New York and London, has more than €25bn of assets under management.

Germany/Funds

Internos targeting German retail, care homes, in €750m drive

Internos, the €3.9bn European investment manager, plans to invest about €750m into real estate across Europe this year. A good chunk, put at about €400m, is being targeted at German retail property including shopping centres and neighbourhood malls (*"Fachmarktzentren"*), as well as into nursing homes and office properties.

Having completed €330m of acquisitions across five funds in 2014, Internos says it is looking to take advantage of specific opportunities in the European real estate market.

In the hotel sector, Internos is targeting a further €225m of investments for its **Hotel Fund 1** and its Hotel value-add mandate, which will bring hotel assets to €700m and add to the twelve hotels acquired since 2012.

In the German care homes sector, it has raised €80m of equity for its **Internos Care Invest Fund 1** and is currently in negotiation on €50m of assets. Also in Germany, Internos will be looking to make new buys on behalf of **SH-Immo,** a fund management mandate with a German Pensionskasse, which acquired two office assets in Cologne. It will invest a further €100m in German retail parks for **Internos Novapierre Allemagne**, its joint venture with French partner **Paref Gestion**.

Meanwhile, Internos has sold the remaining assets in the German Retail Partnership (GRP), a 55-asset German

...from page 24

retail portfolio, to a fund belonging to New York-based **Marathon Asset Management**. The sale was constructed in the form of a share deal, and marks the liquidation of the fund which was launched in 2007 as a closed-ended Luxembourg 'fonds commun de placement'. The fund had raised equity commitments from several institutional investor groups including co-investment by the **GPT Group**.

The retail assets are a combination of neighbourhood shopping centres, retail parks and standalone supermarkets geographically spread across Germany, with the majority in Bavaria, Rhineland Palatinate and Hesse. The properties are well-let and anchored by strong national retail chains such as **REWE**, **Netto**, **Norma**, **Edeka** and **Penny**.

Last year Internos raised debt financing of more than €200m at rates typically below 2%, which boosted returns in its newer funds, as well as refinancing or extending a further €500m.

Earlier this month Internos bought ten German retail properties for €38.3m on behalf of its SCPI Novapierre Allemagne, its French partner. Internos will be the asset manager for the 25,000 sqm portfolio, which are located in Bavaria, Baden-Wurttemberg and North Rhine-Westphalia. The French-managed fund has raised €50m but overall is targeting €200m, and will invest in smaller German shopping malls with 4-6 units, anchored by prominent retailers.

Europe/Acquisitions

Swedish group EQT Partners kicks off in real estate

Swedish investment advisory firm **EQT** is making its first foray into European real estate, having previously given the sector a wide berth. The firm has hired the two founders of UK property group Wainbridge to spearhead its strategy, which will see it investing in opportunistic and value-added real estate in the main European markets, including Germany.

EQT has raised €22bn for private equity investments since it was established in 1994 by Swedish family **Wallenberg's** vehicle **Investor AB,** bank **SEB** and the US-based **AEA Investors**. The group has since attracted investment funds from a wide variety of insurance companies, pension funds, sovereign wealth funds, funds-of-funds and family offices, and operates across the world with a wide network of partners and independent 'Industrial Advisors' with strong local industrial and geographic knowledge.

Edouard Fernandez and **Rob Rackind** of **Wainbridge** are setting up the European platform and will become partners in EQT, the firm said. "There are new real estate opportunities opening up across Europe," Racking said. "From the EQT platform, we can add a fresh approach when investigating business possibilities."

Lennart Blecher, EQT deputy managing partner and head of infrastructure, said: "The real estate segment has long been dominated by North American private equity firms. There is a market opportunity for a pan-European player, applying opportunistic and value-add strategies."

EQT said it has also recruited **Fredrik Elwing** as a director. Elwing had been managing director in **Greenhill & Co**'s Real Estate Capital Advisory group until July last year.

Germany/Banking

Bundesbank's Dombret calms fears of rising property prices

While the **European Central Bank** was announcing plans to open the financial spigots to combat the threat of European deflation, across town in Frankfurt at the **Bundesbank** German financial regulators said they are studying tools that can be used to fight potential real-estate bubbles – in a pointed statement that the liquidity measures by the European Central Bank can only increase the risk of escalating asset prices.

Germany's financial stability committee plans in coming months to recommend that the government create the legal framework for putting such tools to use, Bundesbank board member **Andreas Dombret** (*left*) said in a recent speech in Berlin.

"Even if the risks on the property market seem slight at the moment, we still have to prepare for all eventualities," he said. "The world has become a bit more dangerous for real-estate investors."

The ECB said on January 22nd that it will buy €60 billion of bonds every month through September 2016 in a drive to put more cash into circulation and revive euro-area inflation. The measure was announced against opposition led by German officials in the Governing Council, who have long taken an anti-inflationary stand against the majority opinion of the Council members.

German house prices rose 5.1% in 2014, for the sharpest increase since 1993, according to researcher **BulwienGesa**. Domestic and international buyers, including private individuals and investment firms, are piling into German real estate as a way to earn higher returns amid record-low interest rates in fixed-income markets.

Consumers and banks should prepare for potential increases in interest rates, Dombret said. "Mortgage contracts should only be signed if borrowers can still pay them off when interest rates are higher," he said.

The Swiss National Bank's recent decision to remove its currency cap shows that property markets can become vul-

nerable if borrowers take out mortgages in foreign currencies, as has been the case in several eastern European markets, notably Poland. However, only about €2 billion of Germany's approximately €1 trillion in mortgages are in Swiss francs, meaning that there's no cause for concern, Dombret said.

Dombret repeated the Bundesbank's assessment that there is no German property bubble, although home prices in cities such as Berlin, Hamburg and Frankfurt were overvalued by more than 20% as recently as 2013, by the Bundesbank's own measure. None of the conditions of a bubble are present, he said. Price increases have already started to slow down, credit growth remains moderate and most banks have maintained strict lending standards, he said.

However, regulators will take a closer look at data that were presented in the Bundesbank's annual financial stability review in November, suggesting some banks in large cities are offering mortgages covering more than the property's appraised value, he cautioned.

Germany/Research

German prices touch 20-year high in 2014 – more expected

German property prices across all categories rose 4% overall last year, the steepest gain since 2005 and touching a 20-year high, says Berlin-based research firm **BulwienGesa**. The price growth is expected to continue this year, although residential housing is expected to slow, say the researchers in their latest report.

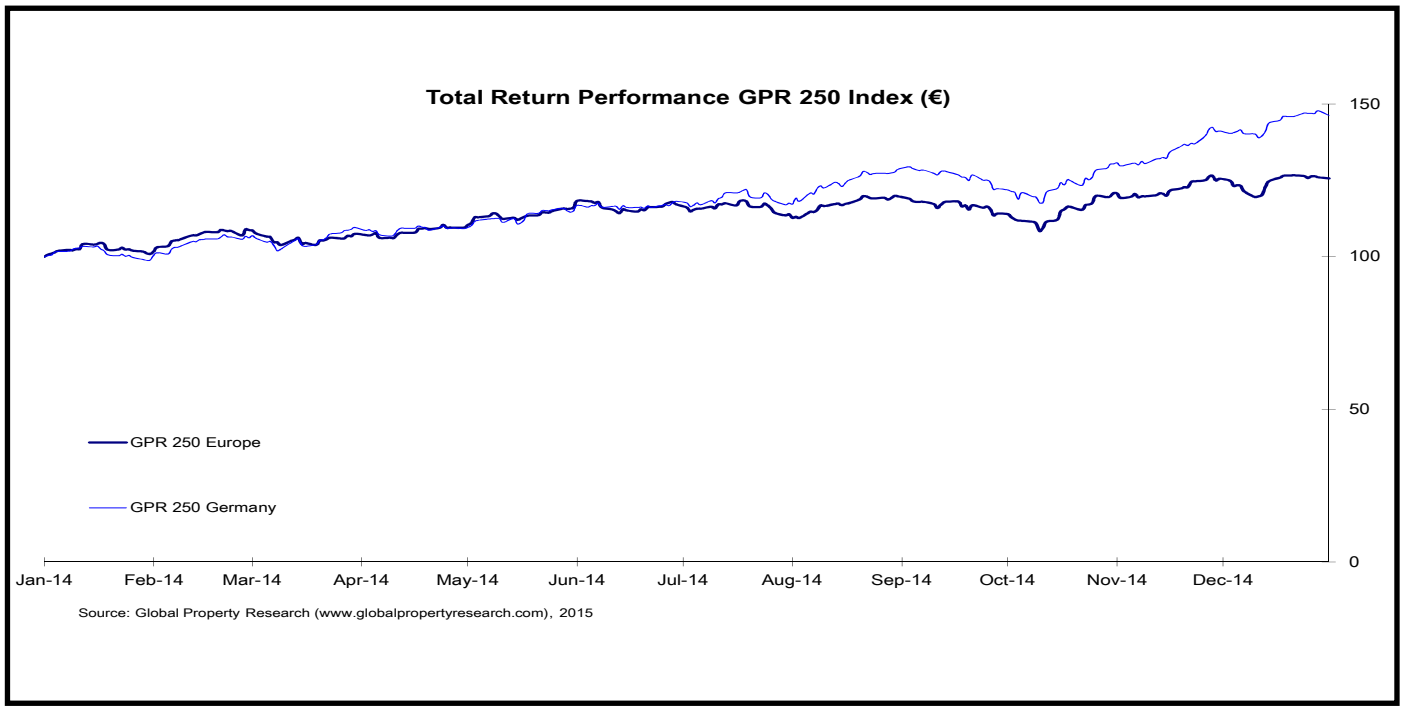
Last year, residential property in the large cities drove growth, gaining 5.1% on nationwide average. Prices for semi-detached housing rose by 6.4%, for new apartments by 5.4% and for single family home plots even by 7.4% as they become scarce. Rents for new-build properties rose by 3.2% and by 3% for existing homes over the period, in the A cities even by 3.4% and 3.8%.

BulwienGesa's property index is has been based upon 50 western German cities since 1975 and a total of 125 cities across all of Germany since 1990, using proprietary data and a range of third-party local studies, complemented by broker analysis and on-the-spot surveys.

For the coming year, more can be expected, due to low interest rates, a healthy economy with low unemployment, and few adequate alternatives, say the researchers. According to BulwienGesa director **Andreas Schulten**, "Yield levels across all asset classes are now significantly below their 2007 lows. German properties have never been as expensive as they are today compared to their European peers."

Nonetheless he does not see current political moves as likely to reverse the trend. "Urban development will have to face problems that are not to be countered by a rental cap," he says. "Less expensive sites, fast building laws and fewer political and legal requirements – these are what we need for affordable new housing."

In commercial property, prices rose 2%, with prime retail locations leading growth at 2.4%. Commercial plots gained 2.1%, office properties in central locations rose 2% with supply tight and



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

Charts courtesy of GPR Global Property Research

both occupier and refurbishment activity starting to pick up again. In A-cities, prime retail gained 3.3% and prime office 2.9%, while growth in C and D barely matched the inflation rate.

A similar annual study, commissioned by **Deutsche Bank** and carried out by the **Real Estate Institute of the University of Regensburg (IREBS)**, draws broadly the same conclusions. While seeing little evidence of a a national bubble developing, they do warn of tendencies to overheating in regional sub-markets.

The IREBS study highlights the issue of demographic development in Germany and the level of inheritance of property. For the years up to 2020, property valued at about €100bn is handed on from one generation to the next, of which about 60% is residential property. The researchers say that the issue of the aging population is becoming a major issue for the German real estate market, given the enormous backlog of refurbishment piling up. Of currently 8 million pure pensioner households in Germany, more than half are living in apartments that are more than forty years old, with only about 5% of these in any way adapted to 'elderly-friendly' living. At least €40 billion is needed urgently to adapt these properties for use. For those in need of more hands-on care, the market needs at least 750,000 new apartments, say the researchers.

Germany/Residential

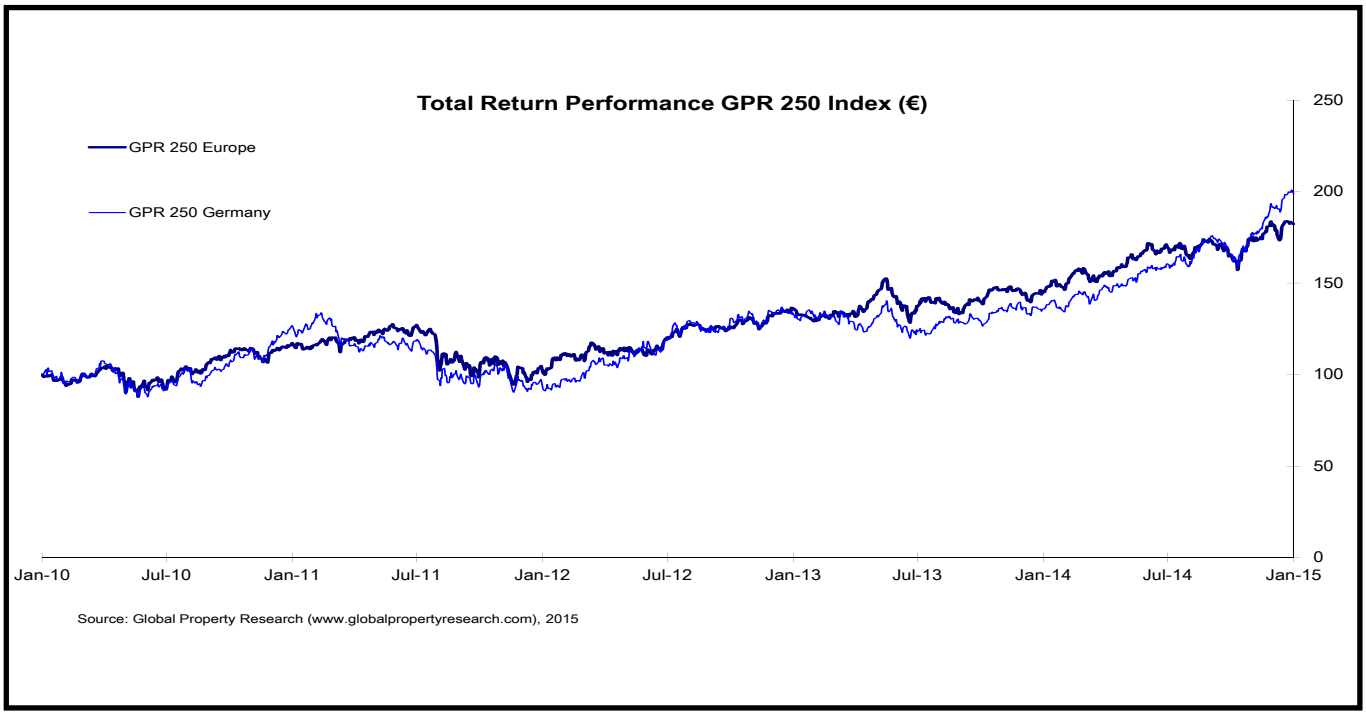
Soaring Adler Real Estate buys further 6,750 units

Publicly-listed German residential investor **Adler Real Estate** boosted its holdings by buying a portfolio of 6,750 housing units, bringing its total property holdings now to over 32,000 units. The properties are in Wilhemshaven in Lower Saxony, while the deal represents the majority interest in the housing association **Jade GmbH**. The portfolio is valued above €200m.

According to Jade, the portfolio comprises specifically 6,641 residential and 31 commercial units as well as 74 student apartments. They are described as well-maintained, with almost no deferred maintenenace or capex backlog and located in good parts of Wilhelmshaven, Germany's largest naval port. The properties were mainly built in the 1930s and 1940s and generate rental income of about €20.5m. The occupancy rate is 93%.

Adler said the portfolio had good upside value with further upward rent potential and positive local economic outlook, underpinned by the construction of a new deep sea water port in Wilhelmshaven.

Adler's stock has soared 1000 % over the last three years as the company, which has its roots in the old **Frankurter Adlerwerke** manufacturing business, has become an active investor and trader in real estate. Last year it streamlined its hotch-potch of recently-acquired properties, and raised €70.5m by selling assets, raising €28.3m in extra cash and



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

booking a profit of €4.9m. It also sold 56 building sites in Munich and Berlin, a 10,000 sqm site in Offenbach, and selling a housing project in Texas in the USA. It also bought housing portfolios which saw its holdings leap from 7,800 to about 25,000 units.

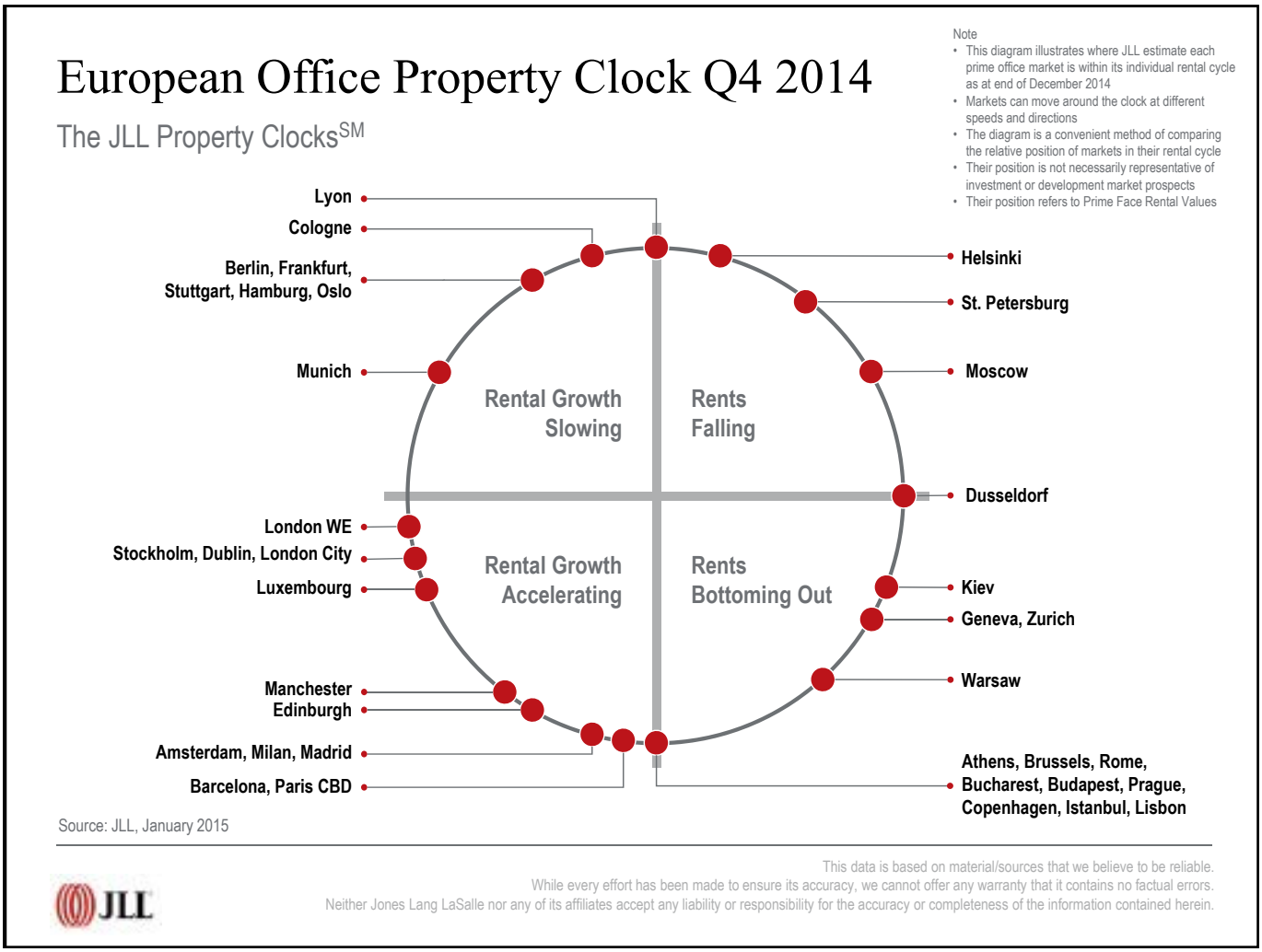
Investors have been liking the Adler story, buying up the company's bonds. Adler recently increased the volume of a five-year bond issue from April 2014 from €100m to €130m in a private placement to institutional investors. The bond was placed at an issue price of 102% and is paying a 6% coupon. Otto Seydler bank managed the placement as global bookrunner.

"We have advanced our realignment towards becoming a major residential real estate company. This began roughly two and a half years ago, and since then all acquisitions and disposals have gone according to plan," commented Adler's CEO **Axel Harloff**. "For 2015 we are targeting strong and profitable growth."

Germany/Residential
Skjerven Group sells €60m of Berlin apartments

Skjerven Group, a specialist investor in Berlin residential, sold €60m worth of apartments in the city last year, partly through individual sales to tenants, investors and owner-occupiers through its own Part-B privatisation subsidiary, but also to institutional investors. The group headed by the colourful Einar Skjerven, is both an investor and asset manager, co-investing along with clients.

The company provides asset management, financing and fund management services to international high net worth individuals, and has long had a powerful internet presence for attracting clients., as well as an interesting newsletter with its own market commentary. The group now plans to parlay its extensive Berlin experience into a move to offering commercial real estate within the city for professional investors



Guest Column: George Salden

The German Property Market: Correct Valuation is Essential for a Good Return - Part Two

In my previous column I focused on established valuation techniques. There I came to the conclusion that the three "classic" techniques – the sales comparison technique, the asset value technique and gross rental technique – had only limited suitability when applied to real estate investments. Why? Because all three only give insufficient answers to the most important questions:

1. What is the property currently worth?
2. What will the property be worth at the end of the investment period?
3. How can I raise the initial value to the final value?

One method that was not taken into account by legislators in the ImmoWertV (Immobilienwertermittlungsverordnung = German Ordinance on the Valuation of Property/Real Estate) is the residual contribution valuation technique. This technique is applied to property that will be subject to real estate development. The residual contribution valuation technique ascertains the value of real estate based upon the difference between the value of notional development in the context of a project and the investment costs. In order to reach the contribution that would constitute this value, the value of the real estate at the end of the project is determined. The value of this notional property can then be ascertained with the help of the comparative price technique or the gross rental technique. However, investment costs must be deducted from the anticipated sales price. In this regard, the various costs accrue in various stages of project development: in the planning stage it is primarily acquisition costs as well as experts' fees that accumulate. The construction costs and the ancillary construction costs accrue during the implementation stage, at the time of actual building, while it is in the disposal stage that both vacancy and recycling and disposal costs first arise. This is important, because unaccrued interest must be deducted from each individual cost.

A major problem of the residual contribution valuation technique is that one does not have the ability to predict future developments. On a professional level, it is virtually impossible to predict the planning and implementation costs of a major real estate project as can be seen time and again from such public projects as the Berlin-Brandenburg Airport or the Elbe Philharmonic in Hamburg. However, the methodology underlying the residual contribution valuation technique is of great importance for arriving at a detailed projection, because the residual contribution is ascertained from two values: the construction costs and the expected sale value. These two amounts are not only much higher than the residual contribution itself, but furthermore are almost identical. If accumulated costs increase or there is a reduction in the expected sales price, then the residual contribution can be erased or even pass into the negative.

It is for this reason that in academic circles the residual contribution valuation technique is in part made subject to the criticism that one can arrive at a residual contribution in the amount desired. It is indeed true that the highly subjective nature of investment costs allows them to be easily manipulated. Moreover, in order to ascertain the residual contribution, a second technique is always necessary, one that allows one to arrive at the expected sales price. However, because both the gross rental technique and the sales comparison technique are subject to methodological limitations, these limitations are then imported into the residual contribution valuation technique through the predicted sales price.

Another technique is the discounted cash flow method – in short the DCF method – which has its origins in the evaluation of companies. Strictly speaking, it is incorrect to speak of the DCF method, because an evaluation using discount rates belongs to the same type of procedures as the gross rental technique. In the language of experts in the real estate sector, which is being adhered to here, the concept DCF method is used for a special variant of the gross rental technique.

There is a discussion going on among experts as to whether or not to incorporate the DCF method into the ImmoWertV. There are two reasons for this: first, the DCF method is very close to the gross rental technique in terms of methodology and the latter has already been incorporated into the ImmoWertV. Second, the DCF method has proven itself successful in management consulting. However, at this point the DCF method has not yet been incorporated into the ImmoWertV, because it has not been sufficiently standardised. While use of the DCF method has not been prohibited by German courts, it

is nonetheless possible that its use could skew the value of real estate and thereby render an expert opinion vulnerable. This is because the DCF method has not proven itself in ascertaining a commercial price, i.e. a market value, but rather treats real estate as an investment asset and ascertains its investment value.

The methodological core of the DCF method is, as the name already suggests, cash flows, i.e. the periodic future inflows that are generated by an investment during a certain period of time. In the context of real estate evaluation such cash flows are treated as payment surpluses generated from rental income above non-recoverable costs. These cash flows are subject to a review period of between five and fifteen years and are discounted accordingly based on the measurement date. An amount is then added to this cash value that represents the residual value of the property after the review period. Up to this point the mathematical approach of the DCF method still resembles that of the multi-period gross rental evaluation technique. In contrast to the gross rental technique the DCF method also expressly takes into account factors such as inflation, maintenance expenses or financing costs.

Another crucial difference in the application can be observed in discounting. For while the gross rental technique seeks to obtain an objective discount in conformity with the market on the basis of property interest rates, the DCF method uses a subjective target rate, i.e. a discount rate at which the investor wishes to see his capital bear interest. This target interest rate, in contrast to the property interest rate, is subjective, thereby reflecting the investor's expected return as well as the risks of the investment. It is composed of a risk-free interest rate, to which a predicted risk is added. The amount of the base interest rate and the risk premium lie in the discretion of the investor who determines these independently of individual capital availability. In the context of an investment analysis this is not only unproblematic but also desirable. However, this interest rate is not suited for the determination of market value.

The limitations of the DCF method are due on the one hand to its methodological design and on the other hand to the problem of the predictability of economic development. The latter has a two-fold significance in the DCF method because it enters into the calculations at two different points. On the one hand, a review period of up to 15 years is established for the exact prediction of cash flows. However, even here inaccuracies enter into the calculations. This is because it is hardly possible to provide a detailed description of rental income over such a period of time. Moreover, general economic developments - and above all, the development of the regional location - can no longer be accurately predicted for such a time frame. Changes in the infrastructure can influence the level of rent or the economic power of the tenants can drastically change - to name only a couple of examples. The DFC method does not have any systematic instruments with which to monitor the marketplace and to create a forecast of its development. Although the suitability of the DCF method may appear reasonable for investment analysis, the lack of any systematic underpinnings makes it impossible for this method to provide accurate results for determination of market value.

At the end of this analysis of different methods for the valuation of real estate, the difference between the valuation procedures based on statutory norms, i.e. the classic three methods under the ImmoWertV and the new valuation methods based on international norms, becomes clear. Both the discounted cash flow method as well as the residual contribution valuation technique have a conception that focuses on the investor. It is the expected returns of the individual investor that have a highly subjective influence on the value of the property. However, it is these basic premises that limit the procedure because they thereby impose limitations on viewing the reality of the real estate market.

Furthermore, the process is not unjustly accused of having a static understanding of the market. The complex dynamics of the real estate market cannot be grasped by a market adjustment factor because the movement of the market as so far described cannot be broken down into individual cities, districts, and streets of houses.

Is property evaluation therefore a problem that really has no satisfactory solution? No, because the real estate itself can - as an asset and part of a market - specify a range of investment opportunities that can be identified - if one looks at the details, as we shall see in the next column.

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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