REFIRE
Real Estate Finance Intelligence Report Europe

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Inside REFIRE

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

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

The areas we focus on are:

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

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Convertible bonds find new favour as refinancing option for German AGs

We report elsewhere in this issue on a number of bond issues from German real estate companies which highlight the increasing role that bonds, and in particular convertible bonds, are playing as a rational alternative source of financing for listed companies. The trend to convertible bonds has been spreading throughout Europe, with transaction volume over the first six months DOUBLING over last year's volume to about €1.5bn. Around 60% of all new European convertible bonds are now issued by the property sector.

So it was timely for REFIRE to sit down recently with a small group of active bond market participants to learn more about why the market for convertible bonds is growing, and in whose hands these bonds are ultimately landing.

Leading French issuer **Société Générale** told us that by the end of May this year, 35 convertible bonds were issued across all sectors in Europe, with a value totalling €9.2bn. Last year saw a total of 20 issues for a record €24bn in capital raised for the whole year.

One of the leading speakers at the gathering was **Ralf Darpe**, Société Générale's head of equity capital markets and co-head of corporate finance for German-speaking Europe. "This year, convertible bonds of property companies continue to play a major role, because, in view of current low interest rates, they represent an attractive financing tool", he said. Listed property companies are issuing bonds not only to diversify their financing, but also to strengthen their investor base.

"Property companies in particular benefit from these attractive conditions, due to the fact that low financing costs with long maturity and without collateralization are of special importance", he said. On average, in recent months investors have granted listed property companies coupons ranging between 0.5% to 2.0% and looked for conversion premiums ranging between 30.0% and 35.0% above the reference price – with an average term of 5 to 7 years.

Deutsche Bank buys remaining Corpus Sireo residential

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The advantages of convertible bonds, argued the issuers in the group, lie in the mixture of shares and loans. Investors not only acquire a fixed-rate debenture but also the option of swapping the bonds for shares.

Because conversion prices are clearly above the market price at the time of issue, a rise in share prices means investors profit in addition to annual interest payments. But even if the share price develops positively and the market price of the convertible bond increases, the issuer is able to secure financing at attractive interest rates. According to Société Générale, a quarter of all issuers are now using convertible bonds as a refinancing option. In Darpe's view, about a quarter of issuers view their convertible bonds purely as a financing option. About 8% issue the bonds to finance acquisition or takeovers.

"Four of the six biggest-ever convertible bonds issued by listed German property companies were placed in the last 6 months, for a total of €1.1bn. The biggest of these was Gagfah's at €375m."

Also sharing his experience was **Gerald Klinck**, chief financial officer at publicly-listed housing group **Gagfah**. In May Gagfah issued a five-year convertible bond of €375m. The fixed-rate coupon was 1.5% p.a. and the initial convertible premium was 30% above the reference price of €11.92 (the share is currently trading at €13.20).

"For us the convertible bond offers an excellent opportunity to optimize our borrowing costs in the current financing environment," said Klinck. "As a result of the successful emission, we were able to refinance a portfolio unsecured at a favourable interest rate. The low interest payments had a positive effect on our income. Further, these unsecured assets gave us additional financial latitude, such as investing in the existing portfolio or in future acquisitions."

We also heard from the management of Austrian company **Convertinvest**, which is an independent asset management company specializing in convertible bonds, and a pioneer in the field of absolute return with convertible bonds. The company is taking the popularity of convertible bonds as an opportunity to issue a global property convertible bond fund, called **Convertinvest Global Convertible Properties.** The fund has a volatility of 5.0% and an expected return of 5.0-7.0%, and invests purely in others' convertible bonds.

Even before launching the fund, said CEO **Gerhard Kratochwil**, institutionals such as insurances, family offices and foundations invested more than €30m in the fund. Issuer ratings on the fund are performed by rating agency **FERI EuroRating**.

According to **Wolfgang Kubatzki,** board member at FERI EuroRating Services who addressed the meeting, "Convertible bonds are complex. When investing in this type of vehicle we recommend investing in professionally and actively-managed funds. As a rating agency we integrate the entire technical know-how of the investment process related to convertible bond funds, so that at the end an attractive product is created."

As with other bonds, the FERI rating includes a detailed determination of site and user type in each individual company's portfolio, based on a quantitative company analysis. FERI says it also analyses the individual properties underpinning the bonds, "so that ultimately the evaluations are based on the attractiveness of the property portfolios", said Kubatzki.

Underlining the current popularity of the bond trend, capital markets researcher **Barkow Consulting** separately notes that four of the six biggest-ever convertible bonds issued by listed German property companies were placed in the last six months, with a total of €1.1bn. The biggest of these was the €375m Gagfah convertible, which is likewise the biggest since the outset of the financial crisis. Only erstwhile market leader **IVG Immobilien AG** has ever issued a bigger bond – a €400m bond in 2007 just before the crash. Meanwhile, all of the larger German listed property company's have issued convertible bonds, with the exception of the biggest company, **Deutsche Annington.**

DEALS ROUNDUP

Germany/Acquisitions

Deutsche Bank buys remaining Corpus Sireo residential

Deutsche Bank subsidiary **Deutsche Asset & Wealth Management** (formerly **RREEF**) showed that it still sees upside value in the German residential real estate sector when it bought the **Merkur** residential portfolio from asset manager **Corpus Sireo**. The portfolio represents the last remaining residential holdings owned by Corpus Sireo. It will now join DAWM's institutional funds division.

The portfolio, held by **Corpus Sireo Investment Residential GmbH**, consists of 3,604 residential units and154 commercial units totalling 260,000 sqm. Following the sale, Corpus Sireo will continue to exclusively asset-manage the 123-building residential portfolio for the next ten years, initially.

The sale price was not disclosed, but we reported recently here in REFIRE that we thought the division was valued at about €300m, and generated annual rental income of more than €20m. This sales price would be based on housing portfolios of equivalent quality normally expecting to fetch a multiple of 15-16 times annual rent, while the market for such portfolios has still been holding up firmly in Germany recently.

Most of the apartments are situated in Berlin, with additional locations in Nuremberg, Braunschweig, Hanover, and Leipzig. The vacancy rate is around 3.2%. The properties dating from 1857 to 2005 were acquired by Corpus successively through 2008, since when the group has largely been operating as a pure real estate service provider and reducing its own owned physical assets.

Corpus Sireo's now-prime business is the property servicing business, known as **Project Venus**, and this segment of the business is up for sale, with a decision on the new owner likely by the end of July.

Corpus Sireo, which is owned by shareholders the **Sparkassen** (savings banks) of **Cologne-Bonn**, **Düsseldorf** and **Frankfurt**, handles real estate interests in Germany for clients including **Deutsche Telekom**, **Deutsche Bank**, and private equity groups **Cerberus** and **Brookfield**, and partners new institutional investors coming into Germany through either its Luxembourg investment management platform or through its international client management

EDITORIAL

Schäuble, the Bundesbank, and deflating bubble fears

The recent move by the European Central Bank to push interest rates to record lows elicited howls of protest from a phalanx of hardened German financial veterans, from Bundesbank board members to Berlin finance minister Wolfgang Schäuble. All view the ECB's policy as a mission of madness that will only foster future asset bubbles and do little to encourage a genuine overhaul of entrenched bad habits.

Former ECB board member Jürgen Stark accused the current regime under Mario Draghi of operating a policy of targeting specific countries at the expense of the eurozone as a whole, and of micro-managing individual markets to resuscitate the flow of credit, none of which address the structural problems prevailing in the – mainly peripheral and broke – eurozone countries. In particular, by charging banks to leave their money with the ECB overnight, the Central Bank's hope is that they will think better of it, and lend to businesses and individuals instead.

Not for the first time we find ourselves asking – do you have to work in a central bank to really believe this tosh? We think it's more likely that banks will hold on to more of their overnight money in cash, and just pass the extra costs on to their customers. Take unnecessary risks? Not likely. Hold tight, rebuild capital, watch stocks rise and see property prices take off again, helping you out of that nasty bad debt exposure you've been nursing for the last few years. Yes, that's the way to do it.

Naturally Draghi's move, along with a new €400bn long-term refinancing fund and the prospect of further quantitative easing, sent the stock markets into ecstasy, and saw the DAX breaching the 10,000-point mark for the first time.

The problem in prudent Germany is that, for a nation of savers, even the most risk-averse can barely be persuaded by posters in their bank's window of contented nuclear families feigning enthusiasm at the prospect of earning 1.4% annually on their nest-egg. It's no wonder they're turning to the property websites to consider buying, after years of being contented tenants.

The steady rise in German residential property prices over the past four years has many economists worried. Even veteran finance minister Schäuble said last week he shared the concerns of Bundesbank president Jens Weidemann, who sees the dangers of a property bubble developing in Germany, and whose economists think property in the larger cities could be up to 25% overvalued. Germany's second rank of large and mid-sized cities is now also squarely in the firing line, with noticeable price leaps as the wall of money comes to town. Schäuble said "the current situation is dangerous - there is too much liquidity and interest rates are too low."

Nonetheless, rates are likely to stay low for the next 2-3 years. High employment and steady immigration are providing a new floor for rents in the larger cities, and it's hard to see what could cause a collapse in the overall price level of residential property in Germany's big cities. Buyers are taking the view –not unreasonably – that housing demand still outstrips supply, and despite more building activity, this is not about to change in the short term.

In Frankfurt, prices for newly-built apartments in the vast new city quarter Europaviertel have risen by 30% in the past two years. Thousands of young professionals are moving into these apartments, as buyers, and paying only modestly more than they were paying before as tenants – once they've stumped up their 20% deposit, of course. Their successors as tenants in the old apartment are almost certainly paying up to 30% more, if the landlord can get away with it.

The Bundesbank view is that, of the 125 cities it monitors closely, "most are 10-20% overvalued measured against long-term demographic and economic factors of influence, while in the largest cities we estimate an over-valuation of 25% on average."

It's the Bundesbank's job, of course, to see the spectre of inflation hiding under every bed, and to warn, early and loud, of anything that could lead to instability. It is true that prices have risen rapidly - a recent report of a sale in Munich at a factor of 44 times annual rent does indeed send shivers down the spine - but buyers in Munich have always been prone to outbreaks of irrationality, without the market being in danger of collapse.

The Bundesbank also knows, better than anybody else, how much credit is circulating in the economy, since they largely authorise it. Property lending this year has risen by 1%. Hardly the stuff of a real lending bubble. The evidence is that borrowers are shelling out more in deposits, perhaps 23% instead of 20%, and managing their monthly burden through lower loan-to-value ratios and higher capital repayments, while locking in super-low interest rates for ten years and longer.

In our view, though, the most compelling argument against fears of a property bubble in Germany is the entrenched nature of the (by and large) smoothly-functioning rental market, which is what still affects the majority of German individuals in their daily lives. Despite the fears investors may have about the impending introduction of the Mietpreisbremse, or rental cap, the bulk of Germany goes about its business safe in the knowledge that it has the mutual protection of a rental agreement which protects both parties. The rental market works.

As we report in this issue, a number of studies show that every third tenant in Germany could afford to buy a house. A single family house costs, on average, five years of a household's net salary. It depends, of course, on where you live – it makes sense to buy in the east, less so in Baden-Württemberg, where the prices are already sky-high. Low interest rates are now distorting the figure somewhat, but for many, renting continues to make abundant economic sense.

Germany's low rate of property ownership still puzzles many outsiders, for whom property is a bulwark against inflation and a stable form of saving for one's old age – perfect, in fact, for the risk-averse, inflation-fearing Germans. In fact, the balance between ownership and a healthy rental market may well be the guarantor of price stability. Should it surprise that countries with the highest rates of ownership, property lending, and transactional volume – Spain, Ireland, and the USA, for example – are not for nothing the most prone to inflating their own property bubbles?

Charles Kingston, Editor

team in Frankfurt. It maintains 10 offices throughout Germany, with 560 staff.

Among those thought to be interested in bidding for the company are property advisory groups **JLL**, **CBRE** and asset manager **CR Investment Management**, given the industry-wide trend for brokers and advisory groups to vertically integrate along the whole chain of value-added services.

Germany/Acquisitions

France's FdR expands, Icade departs from German market

It was a tale of executing diametrically opposite German strategies for two leading French property companies over the past few weeks, as one leading French REIT took a decisive step to boost its residential holdings in the country and the other made an equally decisive step to exit the German market altogether, to refocus on its home market.

French REIT/SIIC **Foncière des Régions (FdR)** signed a purchase agreement for around €240m via its German housing subsidiary **Immeo** to buy a portfolio of 3,400 residential units in Berlin and in Dresden, along with 100 commercial units, totalling 201,000 sqm.. The price equates to about €1,200 per sqm, while rental income on the portfolio is about €15m annually, representing an immediate gross yield of 6.3%.

The seller was a long-standing Danish investor, and the deal was brokered by **Dr. Lübke & Kelber**, which had been the asset manager on the portfolio since 2006. The deal is expected to go through by late-July, and is being financed both by bank debt and through an Immeo capital increase.

The Immeo acquisition comes on top of the purchase of about 4,000 apartments last autumn, likewise in Berlin and Dresden, for €351m. FdR has been an active investor in German residential since 2005, and prior to this latest transaction has built up a portfolio of more than

40,000 housing units in Germany, mainly in Rhine-Ruhr, Berlin and Dresden.

According to FdR, "With this transaction, Foncière des Régions confirms its strategy to strengthen its positioning on the German residential sector…A promising market in terms of residential property, Germany has value creation potential which is reflected in the regular increase of rents at constant scope and capital gains in the long term."

Ulrich Jacke, (*pictured, right*) managing partner at Dr. Lübke & Kelber, which has been intimately associated with the portfolio after managing it for the last eight years, also commented on the sale: "We don't see our job as just the passive administration of real estate stock while the years go by. For us, asset management means to preserve and increase the value of the properties…It is also important to keep an eye out for the right time to sell."

Meanwhile **Icade**, the French REIT (SIIC) controlled by French state-owned financial institution **Caisse des Dépôts**, said last week that it had sold nearly its entire €160m German asset portfolio in a bid to refocus its business back onto the commercial sector in the Greater Paris region.

In a press statement, Icade said its German portfolio at end-December comprised three office properties in Munich, Hamburg and Frankfurt, and three development plots in Berlin and Dusseldorf – valued at about €160m. At the beginning of June, Icade sold and transferred the Munich asset (59,154 sqm in Dachauer Strasse in M-Allach) to a group of international investors (although not named by Icade, REFIRE believes the buyer to be London-based private equity group **Maple Knoll Capital**, with financing of €90m from the increasingly-active **HSH Nordbank**), and the two plots of Berlin (7,335 sq.m.) to a Berlin developer.

Maple Knoll is a London-based private equity investor focusing on value-add and opportunistic real estate. It is headed up by **Phillip Burns**, a recent former CEO at **Corestate Capital** and before that, at **Terra Firma Capital Partners**.

The other 19,524 sq.m. plot in Dusseldorf and the 9,475 sq.m. building in Hamburg are currently merely awaiting the notary's signature on their sale. The total value of these disposals is in line with book value, Icade said.

These sales will leave Icade owning only the property in Frankfurt, which consists of a complex of two office buildings and a plot of land for development (in the Goldsteinstrasse in Niederrad). This last commercial lot is subject to an exclusivity agreement with a local developer which Icade hopes to realise before year end. "Complete withdrawal from Germany will allow Icade to lower the share of non-strategic assets in its overall portfolio from 5.5% on 31 December 2013 to 3.7%," it said.

Icade had originally entered the German market in 2006 by buying a portfolio of partly-empty office buildings and 13 development plots from **Daimler-Chrysler** for about €313m. The group is a major player around Greater Paris and active in regional development. For 2013, it posted an EPRA earnings from property investment of €214m, and at year-end owned EPRA triple net asset value of €5.7bn, or €77.3 per share.

Germany/Retail real estate

Pramerica, Swedish pension fund form Joint Venture for German retail

Pramerica Real Estate Investors, an arm of US insurer **Prudential Financial**, and the **Third Swedish National Pension Fund AP3** have formed a joint venture to invest in German retail, and have wasted little time in already buying its first portfolio and agreeing to buy a second, in two deals worth €265m.

A first portfolio was secured in April and an agreement signed on a second grocery-anchored portfolio from funds managed by Boston-based private equity firm **Taurus Investment**, which remains a minority partner in both transactions, said Pramerica in a statement. Combined, this gives the portfolio over 200,000 sqm of gross lettable area in 83 assets across Germany, with large clusters around Wiesbaden, Frankfurt and Munich in the states of Hesse and Bavaria. Key tenants include food retailers **REWE**, **Aldi**, **Lidl**, **Netto**, **Norma** and **Tegut**.

According to **Sebastiano Ferrante**, head of Pramerica Germany, "The German market offers good prospects for retailers amid low unemployment, low household debt and rising wages. Grocery-anchored retail properties continue to fill a critical need, despite the growth of online sales, leading some retailers to expand, and providing our investors with attractive opportunities."

Klas Akerback, AP3's senior portfolio manager: "We see a potential for attractive risk-adjusted returns in established German regional grocery-anchored retail as tenants are strong companies, and existing sites will benefit because stricter planning rules make new construction difficult".

AP3 is one of five so-called buffer funds within the Swedish national pension system, managing a diversified global portfolio of equities, fixed income and alternative investments valued at SEK258.5bn (€28.5bn) at the end of 2013.

The Boston-headquartered real estate private equity firm Taurus Investment Holdings will remain a minority partner in both of the transactions. **Lorenz Reibling**, the German-born founder and managing partner at Taurus, also commented on the deal: "We have found a strong and experienced partner that en-

ables us to continue **Taurus Euro Retail Funds I and II**, and we share Pramerica and AP3's positive outlook on the German retail estate sector."

As recently as April this year, Pramerica teamed up with leading Dutch pension fund manager **APG**, which backed a new €265m lending venture targeting high-yielding debt in the Netherlands and Belgium. Pramerica Real Estate Investors had end-of-year figures in 2013 of US$55.8bn in gross assets under management.

Germany/Non-performing Loans

Latest CRE disposals sees Commerzbank ahead of sales schedule

Germany's second-largest lender **Commerzbank** has clearly resolved to let nothing stand in the way of further sales of its performing and non-performing commercial property loan portfolios, in advance of the looming stress tests coming up for the eurozone's largest banks in the autumn.

The Frankfurt-headquartered Commerzbank's 'bad bank' has just shed a further €5bn in property loans in Spain, Portugal and Japan in two large transactions, which it said would further reduce its total non-performing loans by nearly a third, and its overall commercial property lending portfolio by 16%.

The **"Project Octopus"** sale included Commerzbank's total commercial property lending book in Spain with a nominal value of €4.1bn, including non-performing loans of €1.1bn, along with the non-performing loan book in Portugal with a nominal value of €300m. The package, with a nominal value of €4.4bn, was sold to **JP Morgan** and **Lone Star**, for a price variably estimated at between €3.5bn (Spanish newspaper *Expansion*) and up to €3.9bn (*Reuters*). The Portuguese performing loans are not included in the sale.

According to **Sascha Klaus**, Commerzbank's board member for non-core assets, "In Spain we were able to take full advantage of the excellent market opportunity, thereby reducing significantly the earnings impact through an auction process." The Spanish, Portuguese and Japanese transactions would cut the bank's risk-weighted assets by €3.2bn and improve its core capital. Nearly all the portfolio loans the bank had classified as "high risk cluster" had now been sold off, he added.

In the second transaction, the bank sold its subsidiary **Commerz Japan Real Estate Finance Corporation** including all its Japanese loans valued at €700m to Asia-focused **PAG Funds' Secured Capital REP V** fund and its **Special Situations Fund**. The loans are categorised as 'higher risk', while a report in German newspaper *Handelsblatt* estimated the discount on the sale at about 5%. These were Commerzbank's last remaining commercial property loans outside Europe. After a recent sale of its UK loans – also to Lone Star - it still holds its loan book in France, Italy and Germany.

The bank says it is now ahead of its own schedule in reducing overall assets in its bad bank, cutting the portfolio by 29% at the end of the first quarter from the same time last year to €102bn. The bank plans to cut non-core assets to €75bn by 2016 from a previous goal of €90bn. At the end of March, Commerzbank's core tier one equity ratio – a crucial regulatory measure of strength – stood at 9 per cent, which is still relatively weak compared with other European lenders.

Germany/Listed Companies

Shareholders happy as Fortress exits Gagfah for last €740m

It's been all good news for residential housing group **Gagfah** shareholders in recent years, who are sitting on a six-bagger since the dark days of early 2009. Things were given a fillip last year with the arrival of CEO **Thomas Zinnöcker** (*pictured, below*) from Berlin housing company **GSW Immobilien**, and the group's successful moves to restructure its financing has also been well received. However, the recent complete departure of US private equity investor **Fortress** from the shareholder roster seems to have caused the most cheer, as uncertainty about future large sales is now removed.

Earlier this month Fortress sold off its remaining 27.6% stake in the Essen-based listed company Gagfah for €740m in a share placing to a wide range of investors handled by **Deutsche Bank**. The 60m shares were placed at €12.34 each (the current share price is about €13.15), giving Gagfah a €2.8bn market cap, with all shares now in free float.

The placing is the largest ever block deal in the German real estate sector, and the fourth-largest real estate equity capital markets transaction in German history, with only the **Deutsche Wohnen/GSW Immobilien** merger and the Gagfah and **LEG** IPOs being larger.

Fortress bought the firm in 2004 for €3.5bn from German state pension fund **BfA (Bundesversicherungsanstalt für Angestellte**, now known as **Deutsche Rentenversicherung Bund**). After a number of acquisitions Gagfah listed on the stock market in 2006. After turbulent years including class action lawsuits and a generous dividend policy largely favouring its majority shareholder Fortress, the group shifted its strategy to get a grip on its financing and overcome the negative image partly caused by underinvestment in capex on its housing stock. Gagfah has 145,000 apartments across Germany.

Fortress started its exit last year, and over the past twelve months has placed

...see page 10

shares worth €1.4bn. It sold off a 10% package at €8.85 in July 2013 and another 7% for €10.15 last December. According to a Gagfah spokesman, Fortress's exit is "the last logical step after a long engagement. Gagfah is now standing on its own two feet with a clear strategy based on the housing economy."

Europe/Hotels

Internos buys further German assets for hotel fund

Real estate fund manager **Internos** has bought the *Maritim* hotel in Dresden and the *Mercure City* hotel in Berlin in two separate transactions worth €75m for its **Internos Hotel Real Estate Fund I**. The sellers were **AXA Investment Managers** and **ActivumSG** respectively.

The latest purchases take the number of hotels acquired by the fund to 11 since its first closing in mid 2012. Both hotels are operated under long term leases with Maritim and Accor, highlighting the long-term trend towards branded hotels in clearly-defined categories.

Internos said the fund is now at €340m, and that it is still looking for new investments. The fund is expected to have a size of €450m once fully invested.

"We are pleased to continue to deploy the fund's capital with this momentum while also delivering and exceeding the fund's required returns," said J**ochen Schäfer-Suren**, partner and head of Internos' Hotel and Leisure division. The vehicle is forecast to generate income returns in excess of 7.5% dividend per annum for the coming years. Added Schäfer-Suren, "We are now well diversified in Europe and have covered the key markets in Germany. Jointly with the capital from our Value Add fund, we have additional investment capacity of up to €250m for which we are pursuing secure income and value-add opportunities."

Since its foundation in 2008, Internos has been expanding rapidly across Europe with offices in London, Frankfurt, Amsterdam, Paris, Lisbon, Luxembourg, Madrid and Milan reaching €4.1 bn of assets under management. In a recent discussion with REFIRE, head of Germany **Paul Muno** said the goal was to reach €5bn of assets under management by end-2015.

The European hotel sector has emerged as one of the top performing property sectors last year offering returns of 6.6% versus returns of 5.9% for the wider market, according to the **IPD Pan Europe Annual Hotels Index**.

Hotels outperformed all property types in 2013 except industrial. Of the 12 countries measured, the UK saw the strongest performance in 2013 with a total return of 11.2%, more than double the 2012 figure of 5.2%. The UK was followed by Austria at 6.4%.

A recent report by hotel consultancy **HVS** focused on the rise of branded and affiliated hotels across Europe, with franchisors increasingly looking to partner up with independent firms to manage hotels. With two-thirds of European hotels still unbranded, the consultants see a lot of opportunity for growth in the branded sector.

Another experienced investor in hotels, co-operative fund manager **Union Investment**, has just published its second *Investment Barometer* of hotel executives conducted with trade magazine **HospitalityInside**. The survey concludes that rate-of-return considerations are currently driving the investments in hotels, more than diversification and safety concerns.

For 52% of those surveyed, the "rate of return" was the most important investment criteria, with only 10% naming "security" as their reason for investment. 39% claimed "diversification" as the most important reason to invest right now.

"In the current environment of low interest rates, pension funds and insurance companies are looking for respective levers for the rate of return, and looking for opportunities to diversify their real estate portfolios further. Among the operator properties, hotel investments have become an equal option for many institutions alongside residential investment," says **Andreas Loecher**, head of investment management-hotel at Union Investment Real Estate GmbH.

Currently, budget hotels and serviced apartments seem to be connected to especially good perspectives concerning the rate of return. The initial survey had pinpointed serviced apartments as having the largest potential to develop into an investment product.

Union Investment has been actively supporting German budget hotel chain **Motel One** as it expands at home and abroad. It most recently bought the chain's first Belgian hotel in Brussels, a 490-room hotel near to the Royal Palace, having secured the asset at the project stage in 2011 through option rights for its open-ended real estate fund **UniInstitutional European Real Estate**.

Union now owns five German Motel One properties in its open funds in addition to the Brussels hotel. Overall, its hotel portfolio comprises 37 properties and projects with 23 different operators. It also secured the first Motel One in Amsterdam at the project stage, which is scheduled for completion by mid-2015. The property will be added to the **UniImmo: Europa** portfolio.

The hotel sector in German in particular is going through somewhat of a purple patch. According to industry information provide **Tophotelprojects**, there are currently 309 new German hotels being completed - not much fewer than the 350 which opened in total over the past five years. One in four of all new hotel rooms is in Berlin, where 24 new hotels are coming on stream. Hamburg has 25, and Munich 19. Among the fastest-growing groups are **B&B**, Motel One and **IBIS**.

The Tophotelprojects data show that B&B opened 39 new hotels in Germany in the last five years, and has a further 12 in development. Motel One opened 29 new hotels, with a further 9 in the pipeline, while IBIS (part of French **Accor Group**) opened 20 hotels, and is developing 17 further hotels across the country.

Germany/Listed Companies

Adler completes takeover of Berlin's Estavis

The Hamburg-headquartered listed housing firm **Adler Real Estate** completed the takeover of Berlin property investor **Estavis** earlier this month, when it secured 92.7% of acceptances for the exchange offer for Estavis's €23m share capital.

Adler had offered 14 new shares for 25 Estavis shares, corresponding to a value of €2.19 per share. "We are pleased that our exchange offer has been accepted by such a large majority and with the entry in the commercial register now all conditions for closing of our offer have been met," said Adler CEO **Axel Harloff**.

From minnow status barely a year ago, Adler Real Estate has soared over the past year to become one of the most active and aggressive residential investors on the German market. The company, which has its roots in the old Frankfurt **Adlerwerke** automotive and engineering firm, made the commitment over a year ago to transform itself into a specialist residential investor, and has been hungrily on the acquisition trail ever since.

Its most recent acquisition – and its largest to date - was a share deal which saw it buying 7,721 residential units, along with 490 commercial units, from Switzerland-based **Corestate Capital**, bringing its German residential holdings up to about 18,000 units. The 540,000 sqm portfolio is spread out across most of Germany, but with a strong weighting towards North Rhine-Westphalia, Saxony and Saxony-Anhalt.

Estavis was created in 2012 out of a residential portfolio of Hamburg's **TAG Immobilien**, holds €146m of assets under management. Its subsidiary Accentro focuses on the privatisation of residential housing for Estavis itself and third party holdings. US private equity fund **Mezzanine IX Investors**, controlled by Atlanta-based **John D. Heikenfeld**, owns

47.9% of Adler equity, with Swiss family office **Wecken** holding 10.18%.

In a recent statement, Adler's CEO Harloff said, "We are growing very successfully on all levels - revenue, assets and earnings - and we also have the resources which are required for continuing the expansion of Adler rapidly and consistently".

This is certainly true – consolidated revenue in the first quarter rose twelvefold to €12.8m (up from €1.08m) as the full rental income on the portfolios bought in 2013 – plus the 2,400 WBG housing association units in Helmstedt, near Braunschweig and Wolfsburg, bought in the quarter - came through to the bottom line. The total of all operating income rose to €37.66m from last year's €1.72m. Adler's balance sheet total reached €540.9m at the end of the quarter, up from €460.9m at the end of December, while equity rose from €86.9m at end of year to €115.3m after the first quarter.

All of this helped make the placement of a further €50m bond at the end of March even more palatable to investors, and gives Adler further firepower to propel itself towards its goal of 25,000 units by year-end

Germany/Research

Peak 'already reached' in Total Returns, but good prospects thru 2018 – study

A new research study by real estate market research group **BulwienGesa** offers a fairly bullish prognosis for the outlook for German real estate investment over the next four years, but forecasts a halving of total returns over the period, to 6%, which will by then be effectively only the cash flow return on assets.

While many markets would love to have this problem, Germany generated Total Returns last year of 12.6% (up from 12% the previous year), which the researchers see as falling to half that, or 6%, by 2018 across all sectors. Assets tipped to do very well are residential properties in mid-sized cities such as Bamberg.

Last year, among the different asset classes, residential outperformed with a total return of 16.7%, which will fall to around 14.5% in 2014. Retail came to 10.6%, logistics to 10.1%, while office performance already slowed to 10.2% from 10.9%, with a further decline to 8.5% forecast for the full year 2014.

Last year's Total Return was the highest since BulwienGesa launched its **GPI German Property Index** in 1995 – and is likely to have represented the peak, with this year's Total Returns forecast to fall to 10.3%. The GPI Index is based on publicly available market data and BulwienGesa's own proprietary research from 127 regional markets in Germany, and covers office, retail, residential (new and second-hand) and industrial, particularly logistics, properties. It is made up of Capital Growth Return and Cash Flow Return ("Gesamtrendite, Wertveränderungsrendite und Mietertragsrendite").

According to **Martin Steinger**, BulwienGesa's chief economist, "In view of the excellent position which Germany has earned for itself economically over the years, the institutional real estate market here in Germany has actually been behaving very reasonably. Of course, in a €50bn market there are always some exceptions and excesses, but they are negligible. The real estate industry will be one of the winners in the coming years, with fears of a bubble unjustified." The market is benefiting from low interest rates, increasing employment and a stable economy. Investors are realistically betting on stable cash flows rather than speculating on capital appreciation, he added.

Logistics assets, which offer the best cash flow yield, are likely to be the best performers in 2018, based on this prognosis, and should top the list with 7.7% four years from now. In residential, the top performers are likely to be many of those whom the boom has so far passed by, such as Bamberg, Ingolstadt and Leipzig, where BulwienGesa expects a strong increase in construction. In the office sector, Koblenz, Potsdam and Regensburg are tipped, while Gera, Fulda and Erfurt – all at the centre of Germany between east and west – are seen as the best for logistics. Retail returns are still likely to be top in the big cities, headed by Berlin.

Germany/Financing

Grand City, TAG Immobilien- top up financing with fresh bond issues

Two German listed companies tapped the bond markets successfully again over the past few weeks, as financing via bonds continues to find favour. **TAG Immobilien** and **Grand City Properties**, both hungry to acquire further residential property portfolios, were the latest to raise fresh funding on the bond markets.

The fast-growing Grand City Properties, which specialises in buying and upgrading undervalued housing in German's larger cities, has increased a €150m secured convertible bond by €125m to finance new acquisitions, and said it is in the final stages of negotiations on several portfolios worth €250m.

The Luxembourg-registered company said it raised its series-C convertible bond by €125m nominally, fixing the emission price at 111.25% of nominal value plus cumulative interest, for €140m in proceeds, which will be used to finance acquisitions. In April, the firm increased its seven-year 6.25% bond tap issue for the second time due to strong investor demand. It boosted total issuance by €50m to €350m after raising the original €200m issue by €100m.

The company's share price has doubled since its listing last year, during which time the group also doubled its residential holdings to 26,000. It says it has a further €300m of immediate investments in its pipeline.

Meanwhile the Hamburg-based TAG Immobilien, fresh from disposing of its remaining commercial property holdings to concentrate on being a full-time residential specialist, also issued a corporate bond in the amount of €125 million through a private placement with institutional investors, managed by **Close Brothers Seydler Bank** as sole bookrunner.. The bond matures on 25 June 2020, pays a coupon of 3.75%, and is traded in the Open Market of the **Frankfurt Stock Exchange**. The proceeds from the bond will primarily be used "to finance TAG's continued growth", said the company. TAG has now issued a total of €435m in bonds

At the end of the first quarter TAG held 70,000 housing units valued at €3.6bn, including a freshly-acquired portfolio of 7,000 units in eastern Germany

Europe/Funds

AEW targeting€700m for "manage-to-core" fund

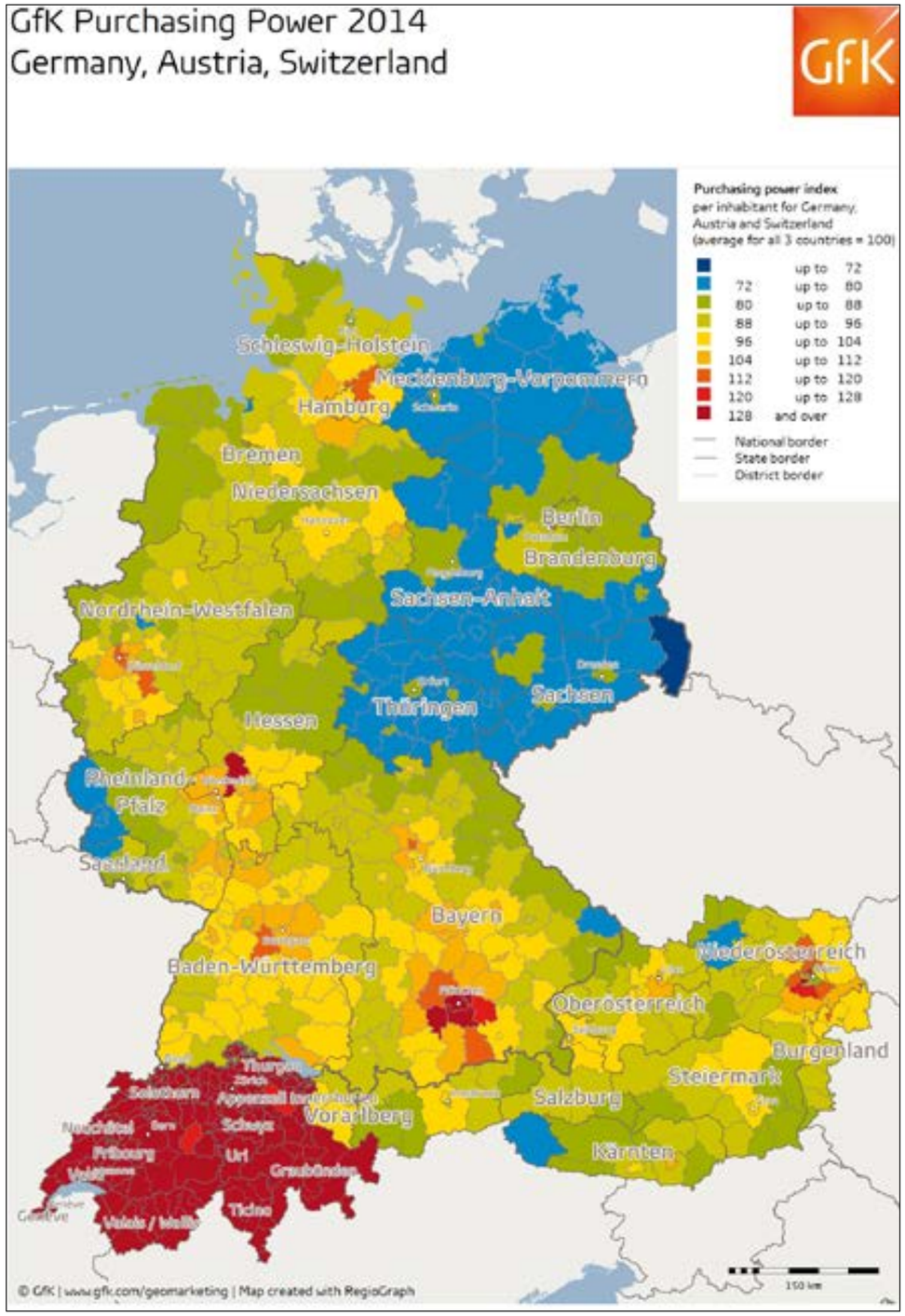
Pan-European real estate manager **AEW Europe** has brought German and Austrian institutional investors into the first close of its latest European real estate fund, a so-called "Manage-to-Core" fund.

Six investors have committed €101m to the **AEW Europe Value Investors Fund**, which will focus on core-plus and value-add office investments. AEW said the fund, which is targeting a total investment capacity of €700m, expects to have two further closings this year. The fund will focus on office markets in Germany, France and the UK.

"Current market pricing provides the opportunity to acquire office assets at discounted values and at an attractive point in the cycle. The fund will benefit from the capabilities of our European platform of local and experienced teams specialising in value add investments," said head of private equity funds Russell Jewell.

Carsten Czarnetzki, fund manager for Europe Value Investors, said the fund would invest in office assets that can be managed or repositioned into core assets. "The fund's strategy is to take advantage of the strong demand for stabilised core assets, targeting the most liquid European markets," Czarnetzki said.

AEW Europe has launched a number of private equity real estate funds since 2001 and currently manages more than €18bn in Europe in a number of funds



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and separate accounts. AEW Europe is part of the French **Natixis** group and has more than €18bn of assets under management, with nine offices and over 270 staff.

The group recently bought a new logistics asset in a multi-modal logistics park in Bremen's harbour, scheduled for completion in December this year and fully-let to a top logistics provider on a 10-year lease. AEW said the new asset would further its plans of growing its **Logistis** platform in northern Europe, and said it plans further investment in Germany of up to €500m over the next two years.

"We are currently targeting further German acquisitions already identified by our local teams. We will continue to build a high quality portfolio that provides a relatively high stable income return to our investors as part of the next phase of expanding the Logistis brand in northern Europe," said fund manager **Rémy Vertupier**. Logistis has a significant acquisition pipeline in Germany, Benelux and France, AEW says.

Germany/Study

German investors favour Vienna over high-priced London

Austria's capital Vienna replaced London as the favourite investment destination of German commercial real estate investors in the first five months of this year, according to research group **Real Capital Analytics**, which tracks capital flows.

Overall, German investors placed €3.9bn in international real estate markets over the period to end-May, while Vienna took the top spot as a result of five transactions with a combined value of €437m, RCA found in a new report. It was followed by Amsterdam and Warsaw. London, first placed last year, came in 10th in the city ranking.

"German institutions, particularly open-ended funds, are balking at the high pricing from the intense competition for a dwindling supply of grade A properties for sale in central London," said Real Capital Analytics' managing director for EMEA **Simon Mallinson** (*right*). "Instead they are looking at prime locations elsewhere in Europe and further afield for investment opportunities. Recent transactions by German investors show that European cities offer yields that are about 200bp above what is available for equivalent assets in central London."

Meanwhile, from the other direction, international investors into Germany spent €7bn on properties since the start of the year. US investors were the most active buyers, led by **Blackstone** with the acquisition of the **WestLB** building in Düsseldorf and a logistics portfolio from **Foncière de Régions**. The largest portfolio deal was the UK's **Kildare Partners** buying the €1bn **Mars** office and hotel portfolio of distressed assets from **Deutsche Bank**. The largest international single asset sale was **Unibail-Rodamco**'s purchase of a 50% interest in the *CentrO Oberhausen* shopping mall, which is valued at around €1bn.

International capital targeting German housing seems to be abating, though, said RCA. Some €434m deals were registered in the sector, following €3.79bn last year.

Total German transaction volume fell 9% in the first five months to €13.9bn, as investors seek opportunities elsewhere, said RCA. They are turning to smaller or less expensive assets in Germany's seven largest cities, Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich and Stuttgart, or to the best assets in the smaller B-cities.

"Keen pricing for safe haven, defensive real estate assets is persuading more investors to move up the risk curve," said Mallinson. "Looking at Germany solely in terms of overall transaction volumes by value tells us only part of the story, whereas the number of smaller transactions is on the increase." The key point, he said, was that the German commercial property market is returning to a healthier state after the recession and financial crisis.

Germany/Study

German real estate tops list of investor priorities - KPMG

Global investors have ranked Germany as their top real estate investment destination for the next 12 months, according to the latest **KPMG Real Estate Invest Survey 2014**. The UK came in in third place, with the USA in fifth.

The international consulting group asked institutional investors about their investment plans for the coming year. 81% responded that they intended raising their allocation to real estate, while 71% said that the country with the best opportunities was Germany, followed by 45% voting for Spain in 2nd place. The UK was third with 42%, followed by France with 29%, just ahead of the USA.

With the survey methodology having changed since 2013, direct comparisons are not possible, although last year London topped the list. This year cities were replaced with countries in the survey questionnaire.

Among asset categories, 81% of investors named their favoured category as office, 65% for retail, 26% for residential, and a similar amount of 26% for industrial and logistics properties over the next twelve months. Not surprisingly given the higher prices and lower yield perspectives, prime and core properties had lost ground versus last year, with investors leaning towards more speculative strategies.

Germany/Legislation

Rental cap 'Mietpreisbremse' will make residential less attractive for insurers - survey

The coming *Mietpreisbremse*, or rental cap, is likely to make investment in German residential a much less attractive proposition for insurance companies, although real estate as an asset class remains highly rated, according the annual trend barometer published by consultant **EY** (formerly **Ernst and Young**). So far, however, it has not stopped insurers increasing their allocation to the sector, who are reconciled to an overall level of yield lower than in previous years.

EY surveyed 30 insurance companies for its 2013 study – a representative cross-section, it says. If last year 74% said they would be buying residential, this year the number is 59%. According to EY partner **Dietmar Fischer**, this is likely to have to do with the Mietpreisbremse, where in another part of the survey all but 18% said they expected the measure to have a negative effect on the attractiveness of the sector.

Real estate as a whole is actually gaining in importance for insurers, as they struggle to match their assets with their long-term liabilities. The surveyed insurers held an average of €2.5bn in real estate, with the proportion to total assets being 7.3% at the beginning of 2014, up from 7.0% in 2013, and 6.3% in 2011. Directly-held property rose this year by 0.5%, while indirectly-held property fell – very probably in sync with the out-of-favour open-ended funds.

The insurers are now striving to raise their property quota to 7.7%, plan average new investments of €264m and mean sales of €177m. Yield expectations have also fallen; expected yield on directly-held assets is 4.4%, as against 5.2% two years ago. On indirect investments, expectations have fallen from 5.8% in 2012 to 5.0% now.

Retail remains the favourite asset category, with 81% of respondents expressing a preference for the sector. This year only 63% plan investment in offices, down sharply from 78% last year. 48% plan investments in logistics, while the big winners are elderly and care homes, where the number of insurers planning to invest has shot up from 4% to 15% over the last year.

Not surprisingly 'core' properties are targeted by 92% of respondents, with interest in other risk categories actually falling – in the case of opportunistic, from 18% to a mere 4%. But 96% of respondents said that B-cities would see much higher demand for top assets given the shortage of properties available in the biggest cities.

Other interesting results: More than half the respondents (57%) said they planned to get more involved in debt finance. Only 21% expressed any interest in investing in listed property companies, and no more than 11% said they would be interested in paying a premium for any form of sustainability certification. Investing in the US has become less popular, with only a third expressing interest in investing there. On the issue of whether there is a property bubble in Germany, opinions were divided. 36% said there is, 43% said there isn't, and 21% didn't know.

Meanwhile, the word from Berlin is that the legislation surrounding the impending introduction of the Mietpreisbremse is causing more and more divisions among the coalition partners charged with bringing the new measure into law.

The justice minister in Berlin, **Heiko Maas** from the **SPD** party, is facing a barrage of criticism from even those federal states ruled by his party brethren, who see the legislation as it stands as far from enforceable. A key sticking point seems to be the inclusion of the five-year limitation on the measure, seen even by politicians of the left as important in order to ensure that sufficient forward planning for new construction takes place to meet demand, independent of short-term market bottlenecks.

Coalition partners in **Angela Merkel**'s party the **CDU** are pressing the SPD to ensure clarity on three key issues: first, the measure must be limited to a period of five years; second, the individual *Länder* must furnish proof of a serious housing shortage in the specific areas and neighbourhoods which will be designated as subject to the new law; and thirdly, the draft legislation must detail specifically how a 'rent table' in the affected areas is to be calculated for the purposes of establishing a 'fair rent'. The **Green Party** is also contributing to a further muddying of the waters, by accusing the CDU of deliberately holding up negotiations on the measure and by increasing their demands for a more draconian law, including extending the period of validity to a full ten years.

Doubtless the fine print will be sorted out in due course, but it's now clear that the Mietpreisbremse will NOT, as originally thought, be coming into effect this year – but in summer 2015 at the earliest.

Guest Column:
Dr. Gabriele Lüft, Managing Director of VALTEQ

Environmental Desktop Studies - A Model for Germany?

www.valteq.de

Let's begin with the name, "Environmental Desktop Study". The impartial reader is no doubt asking: What's that then? My answer: An environmental risk analysis, drawn up at a desk, without ever having seen the actual property in question. It sounds fairly simple; but it isn't – it's quite the opposite. Environmental Desktop Studies hail from the English-speaking world, where consultants can identify any existing environmental risks, relatively exhaustively and accurately, without ever leaving their desk. This works fine in the UK and USA, where there are databases in which environmentally-relevant data, such as accidents, former fuel stores, existing chemical plants etc. are precisely recorded in a radius of up to 500 m. These databases are managed by public authorities and distributed by specialised providers, such as, for example, Landmark Information Group or EnviroFACTS. The consultants then gather the risk-relevant information by searching the database and, following analysis of the same, produce an evaluation of the environmental risk. Job done.

But let's now look at Germany and, for that matter, the rest of Europe. Whenever an English or American customer asks me about Environmental Desktop Studies, I usually tell him he would be better off throwing his money out the window – at least then, we'd be able to watch it fly. Here, it's simply not possible to weigh up the environmental risks for a property on the basis of publicly accessible information alone. There are several reasons for this. First of all, the authority receiving the inquiry may only disclose information to those who have a "legitimate interest", i.e. the owner or his authorised representatives. Even then, the so-called 'registers of inherited contamination' kept by the authorities are not systematically or, more importantly, consistently structured. Nomenclature and logging mechanisms vary from one place to the next. Added to this, properties listed as suspected contamination sites are not necessarily contaminated. And vice versa: Just because it is not listed as a suspected contamination site, does not mean the property is contamination-free. For example, we analysed a property for a customer, which had been listed as a suspected contamination site. The reason for this was that it previously belonged to Siemens or, in other words, to an industrial concern. However, our research revealed that Siemens had only ever used the site as an office location, with no production or storage facilities whatsoever. As a result, the property was removed from the register of suspected contamination sites.

So, what does it take to produce a valid analysis? At VALTEQ, we always recommend that the time is taken to look at the property properly. In other words, that information regarding the current use and clues regarding the historical use of the location and environs are gathered on site, and then analysed and evaluated. What's needed therefore are experienced experts with a full understanding of the material; not just some lonely man at his desk. In the long run, this approach saves a lot of time and money in Germany.

Germany/Research

Wüest sees strong German second half on fundamentals

The latest half-yearly report from valuation and market consultants **Wüest & Partner Deutschland** provides a buoyant outlook for transaction volumes in German commercial real estate through the end of the year. The key drivers are the increasing willingness of corporates to invest, the demand for luxury labels in top retail locations, and the surge in online sales boosting the logistics sector.

The consultants' latest German market outlook "Investmentmarkt Deutschland" point to the office sector as remaining the favoured asset category. According to Wüest's managing director **Sven Graven**, (*pictured, right*), "For the second half of the year, we expect significantly more construction activity, which in turn will lead to higher space turnover." Last year, the biggest increase in leasing volumes was in the retail sector, up 54% on 2012, mainly driven by demand from luxury labels which were trying to position themselves early at sought-after locations and to ride the wave from the uptick in the economy.

The rise in online activity is helping to drive both retail and logistics, as retailers experiment with new in-store concepts to attract and keep customers in their stores through sophisticated design, while more and different types of logistics properties are in demand to provide more immediate and/or timely customer deliveries.

In the office sector, in particular, a further study crossing our desk here at REFIRE points to further growth indicators, with good prospects foretold for Berlin, Hamburg and Munich.

The **German Society of Property Research gif** and the **Center for Real Estate Studies CRES** of the Steinbeis private university in Berlin forecast in their latest half-yearly report that office rents in Hamburg, Berlin and Munich will show the best performance nationwide of the big cities, with increases of 0.9% to 2.2% over the coming two years.

The report, established in collaboration with the Mannheim-based **ZEW (Zentrum für Europäische Wirtschaftsforschung)**, was based on a survey of 15 professional researchers and their quantitative models, as in the previous four years.

The report showed that prime yields have almost reached their lows, however, with only Berlin, Hamburg and Frankfurt having potential for further compression, of around 20bp. Yet the experts predict that prime initial yield across the largest five cities will hold stable at below 5%, and most see this holding below 4.5% in Munich. "The prognoses underestimated last year's market dynamics," said **Dr. Jaroslaw Morawski**, one of the researchers surveyed. .

The Düsseldorf and Frankfurt office segments in particular exceeded the expectations of most of those surveyed, who now predict both cities to stagnate until 2015. They view other big cities as set for slight falls in vacancies and a small rise in prime rents.

Germany/Indices

Financing index DIFI rises, margins tightening

Sentiment on the German market for commercial real estate financing, as reflected by the quarterly **DIFI index**, improved again in the second quarter, as Germany's currently favourable economic climate led to a further rise in optimism in the period.

The DIFI (Deutsche Immobilienfinanzierungsindex) is an index managed through quarterly readings by property advisor **JLL** and the **ZEW Zentrum für Europäische Wirtschaftsförderung** in Mannheim, covering the financing climate in different real estate categories. For the second quarter it rose to 24.9 points, a gain of 1.9 points on the first quarter. Across all asset categories the composite component of the index rose to 39.3 points, a rise of 5.1 points year-on-year.

The latest index reading shows that increasing competition among finance providers for core assets is leading to a noticeable tightening of margins, while most respondents expect margins across all asset categories to shrink further. Typical margins for 'core' financing of office, retail and logistics properties at the moment are put at 100-150 bps, while margins on residential property are estimated at 50-100 bps. The equivalent figure across all categories of 'value-add' is 150-200 bps.

Typical market LTVs for 'core' asset financing in the office and retail segments were seen as 60-65% in June 2013, and are now 65-70%

from page 18

Germany/Residential

LBS sees plenty of further potential for German home ownership

There is still plenty of potential for much higher rates of home ownership in Germany – traditionally the country with the lowest rate in Europe, bar Switzerland – and it could well be headed to a rate of more than 50% from its current 43%, according to the **LBS Landesbausparkasse**, Germany's largest building society.

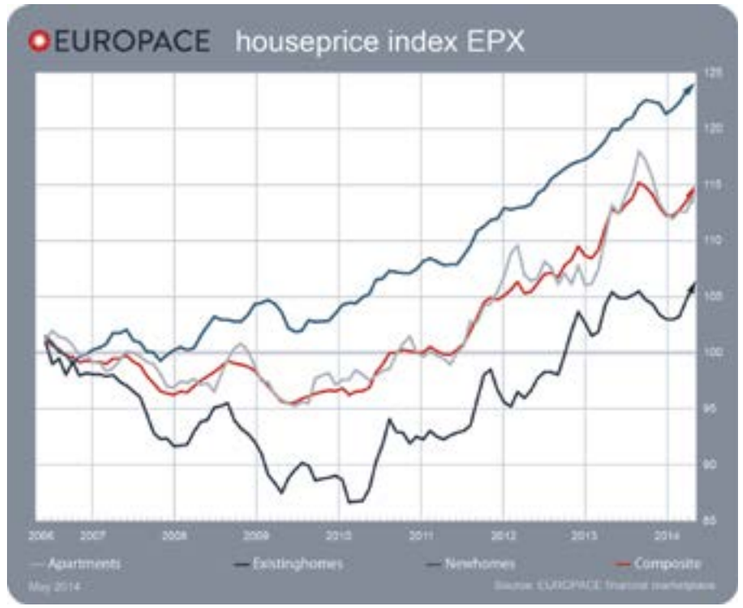
The latest study by the LBS and market research group **empirica** shows that, theoretically, in ten of Germany's 16 federal states three out of four households could afford to buy a dwelling, while in thirteen of the 16 states a rate of owner-occupiership of 50% or more would be possible.

In all the eastern states, as well as in Bremen, Lower-Saxony, Saarland, Rhineland-Palatinate and Schleswig-Holstein, the study concludes that three-quarters of households would be able to finance an average home. The least amount of people who could do this are in Berlin, but even there the amount who could become owners could at least double to 30%.

Empirica used data from the **Federal Statistics Office** relating to income and combined it with price data for second-hand single-family homes, coming to the conclusion that these rates of ownership could be reached in the respective federal states (*Länder*), if:

- Equity required was equal to a year's income
- Financing costs were 6% per year (for interest and capital repayment)
- Repayments did not exceed 35% of net household income

The LBS study shows that the situation is different in the prosperous southern states of Bavaria and Baden-Württemberg, where prices are already high and there is less potential for the growth in home ownership. In Baden-Württemberg, for example, the rate is already 53% and therefore only 7% below its 'potential', whereas in Bavaria recent price rises may have actually pushed the 'actual' above the 'potential'. Nonetheless, long term the overall rate nationally is headed upwards, concludes LBS, underpinned by new construction activity – up almost 46% compared to 2010 – and which was absorbed almost exclusively by new owner-occupiers.



Germany house price development

Europe/Indices

German real estate industry "transparent", but must try harder - JLL

The latest edition of property broker **JLL's Global Real Estate Transparency Index** sees Germany in 12th position among 102 countries surveyed – the same position as in the last survey two years ago. This must surely be a big improvement on where Germany was, say, 10 years ago, but Germany's ranking two years ago was actually downgraded from the top tier of ten markets (*"very transparent"*) after the researchers' evaluation criteria were amended.

While the positive news is that the German **IPD-Index** is now being given an upgraded weighting for benchmark purposes, Germany's relatively poor overall ranking is largely due to what the researchers describe as a deficit in the transparency of Germany's stockmarket-listed property companies compared to their international peers. Points were earned, however, for improved valuation methodologies and access to market data, although criticism was voiced about market data outside Germany's Top 7 cities. Also singled out for praise was an improved level of available information about building and planning regulations, including better availability of relevant information online.

According to **Helge Scheunemann**, JLL's head of research in Germany, "On an international basis, the transparency offered by Germany's listed property companies is still lagging the relevant standards. Even **INREV's** Index for non-listed funds is not given sufficient respenct in Germany. Also, the complexity of Germany's tax code and the availability of concrete data relating to property lending or actual purchase prices lead to a moderate rating, at best."

As to methodology, the criteria in the 2014 Transparency survey are largely unchanged from the measuring criteria of two years ago. The Index is based on 115 separate criteria Germany finds itself back in the second tier of countries ("*transparent*"), along with countries such as Switzerland, Sweden and Singapore, but behind countries such as the Netherlands, France and Ireland, which earn the top rank of "very transparent"). Top of the list for transparency, according to the JLL rankings, is the UK, followed by the USA.

Among the top European improvers are Romania, Serbia, Hungary and Kazakhstan. In particular, the researchers note, the EU accession talks in Romania and the enforcement of new EU legislation is helping to alleviate corruption and improve the judicial system.

Germany/Banking

Lively interest among buyers in upcoming WestImmo sale

Interest in buying **Westimmo**, the Mainz-based property-lending subsidiary of **WestLB**, is running at a higher level than originally anticipated, with about a dozen financial investors and banks currently granted access to the bank's data room. That's about twice as many as had originally expressed interest, before the due diligence and bidding process began officially in May.

The bidders now have until the end of the summer to submit their closed and binding offers, with a deal expected before the end of the year.

WestImmo was put on the selling block by its erstwhile parent under the terms of the WestLB restructuring imposed on the landesbank by the EU in return for government subsidies granted to bail out the bank during the financial crisis. **JP Morgan Chase** has been mandated to handle the sale.

The Mainz-based WestImmo has €9.7 billion in property loans, including €7.7bn in commercial property and €2bn in residential. Although not allowed to write

UPCOMING EVENTS AND CONFERENCES

EVENTS/ CONFERENCES July 2014

July 3rd, Thursday
ULI Urban Leader Summit 2014, Main-Tower, Frankfurt
The annual gathering of ULI Germany and CEE countries , always well-attended by the German real estate industry. This year featuring the ULI Building Healthy Places Initiative, with keynote speeches from Prof. Andrea Boltho of University of Oxford, Guy Perry of IN-VI INvestment Vision AG, and Frankfurt Mayor Peter Feldmann
more at: germany.uli.org

July 3rd, Thursday
"Anleihen als Finanzierungsalternative für Immobilienunternehmen", Frankfurt
Organised by BOND Magazine and Der Immobilienbrief, the first workshop of its kind, "Bonds as a financing alternative for real estate companies" is targeting chairmen and CEOs of mid-sized companies considering issuing bonds to finance their growth.
More: www.www.bond-conference.com

July 10th-11th, Thursday-Friday
IPD/SPR RealWorld Conference, St. Johns College, Cambridge, UK
Now in its 10th anniversary year, the conference brings investors, fund managers, and property consultants together to provide modern research and market insight. new prospects for the industry, in line with development to multi-asset-class portfolio.
More at www.immobilien-forum.com

July 17th-18th, Thursday-Friday
16th IIR Immobilienstandort München 2014, The Charles Hotel, Munich
The annual gathering organised by IIR to do with all things Munich, a dialogue for project developers, investors and city authorities, focusing on residential, commercial, retail and hotels. New innovative ideas for a city suffering from a shortage of space.
More at www.http://www.iir.de

new business, most of the WestImmo loans ARE performing, and the bank actually posted a 2013 net profit of €50m, which should help shore up its marital prospects.

'Bad bank' EAA's shareholder equity is likely to be of the order of €575m after stripping out certain loan portfolios, not eligible for Pfandbrief-refinancing, when the sale is consummated. The bank, which primarily refinances itself by the issue of Pfandbriefe, still has 290 employees.

Back in April, **Matthias Wargers**, EAA's CEO said that the workout bank was "currently in negotiations on the sale with several interested parties." Among those known to have been interested in WestImmo last year were **PIMCO** and **ING Bank**, while WestImmo's near neighbour **Aareal Bank** dropped out and instead bought **Corealcredit Bank** in Frankfurt from turnaround specialist **Lone Star** for €340m. Among the latest list of likely suitors is also thought to be **Starwood Capital**, which manages the world's largest mortgage REIT in the US.

Back in 2011 a deal for the sale was in advanced stages with New York-based **Apollo Global Management** before falling through. EAA said at the time its preference was for a long-term owner for WestImmo, who was itself able to fund the acquisition through long-term financing and would continue to run WestImmo as a German Pfandbrief-issuing bank.

Europe/Acquisitions

GVA shareholders give resounding approval to Bilfinger takeover

The Mannheim-based German construction group **Bilfinger's** takeover of UK real estate group **GVA Grimley Holdings** has now been given the all-clear after 99% of GVA's 300 shareholders accepted its purchase offer within the set deadline.

The deal will give **Bilfinger Real Estate** greater access to the UK market, but critically, will also provide Bilfinger with a platform to provide cross-border support for its numerous international clients.

Bilfinger, with €8.5bn in annual revenues, was known to be on the lookout for a UK brokerage partner to accompany its rapidly-growing real estate business. GVA had been going through a financial restructuring and had brought in consultants **Canaccord Genuity** in 2012 to review its strategic options – a move which attracted the attention of Bilfinger. According to Bilfinger Real Estate CEO **Aydin Karaduman**, "This deal is part of a strategic plan to develop a leading international real estate consultancy and management offer with representation in every major commercial centre in the world."

The deal will see GVA combine with Bilfinger's real estate advisory, which generates annual turnover of €160m and employs some 1,500 real estate professionals. This output volume is expected to double as a result of the merger. The property business sits within the larger **Bilfinger Building and Facility** division employing 22,000 and turning over around €2.3bn a year.

In the year to end-April 2013 GVA reported turnover of Stg£147.3m, a 5% increase on the previous 12 months, and made pre-tax profits of £7.8m. It said it has 12 offices around the UK and has 1,300 staff, of which 700 are fee-earners, on its books. GVA offers consulting services such as project management, valuation, planning and transactional services, and its clients include occupiers, developers and public sector clients such as local authorities and government departments.

At the end of 2013, Bilfinger had already acquired facility services provider **Europa Support Services**, a company specialized in technical and infrastructural services. That acquisition boosted the annual volume of its facility services

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CORPUS SIREO

ASSET MANAGEMENT COMMERCIAL

EXPERT VIEW: UPWARD TREND ON THE GERMAN COMMERCIAL REAL ESTATE MARKET

Guest column by:

Ingo Hartlief,
Chief Operating Officer,
CORPUS SIREO Holding GmbH & Co. KG,
Cologne

The year 2014 has made a very good start, and economic performance in Germany is encouraging. There is also a corresponding increase in investor interest in German commercial real estate. These investors are targeting strengthening demand for office space and rising rents. The following assumptions of Corpus Sireo - the leading German provider of investment and asset management services with a wide network of branches - are supporting the optimistic assessment of the German market for commercial real estate.

Assumption 1: Economic growth in Germany is resulting in increasing demand for office space

Despite ongoing uncertainty, also as a result of the Ukraine crisis, the leading indicators are pointing to further economic recovery. German economic growth is forecast to come in at 1.9%, the unemployment rate will fall further to 5.2% (ILO) and the employment rate will probably rise to 78.2% in 2014. These assumptions mean that demand is likely to increase for office premises. On the rental markets, we expect to see a reduction in vacancy rates and rent increases; it is foreseeable that this will be followed by price increa-

Assumption 2: Financing of commercial real estate is becoming cheaper

We are observing increasing competition and declining bank margins despite the trend towards higher interest rates. LTVs have risen to approx. 70%, and credit availability is good. Core properties continue to be the focal point of financing activities; this area is characterised by fierce competition between lenders. The margins for average commercial properties will fall to approximately 150bp despite slightly higher interest rates. Overall, financing for commercial real estate in Germany will become cheaper.

Assumption 3: Rising demand for office premises with a positive impact on rental markets

Demand for office premises will continue to rise as a result of economic growth; the rental markets are responding with a reduction in vacancy levels and rent increases. The currently moderate volume of completions is also having a positive impact on rental markets. Turnover with office premises was high during the past three years, and this trend will continue in 2014. The process progress particularly in top-20 cities. In consequence, there is likely to be a further increase in rent levels, and the discrepancy between prime rents and average rents is likely to decline.

Assumption 4: Ongoing investment pressure is driving transaction volumes and is reducing risk aversion

Strong demand from within Germany and abroad is resulting in higher trading volumes, prices and 'side-stepping' movements of investors. There is a strong inflow of funds from abroad, and we are observing increasing levels of activity particularly with regard to private equity and funds. Investors continue to focus on 'core' products; product availability is correspondingly low, and acquisition yields are falling. At the same time, there is strong investment pressure and yield expectations have risen. In consequence, we are already observing certain side-stepping movements in subprime locations, regional markets as well as properties with optimisation potential.

Conclusion and outlook: Investors focusing on German subprime locations

Core properties at attractive locations outside the German 'Big 7' are investments offering stable values and good yields prospects. This is also demonstrated by the annual study "GERMANY 21 – Regionaler Büromarktindex", in which Corpus Sireo compares the German top-7 cities (Frankfurt, Hamburg, Munich, Cologne, Berlin, Düsseldorf, Stuttgart) with 14 regional cities (Aachen, Bonn, Bremen, Dortmund, Dresden, Essen, Hanover, Karlsruhe, Leipzig, Mainz, Mannheim, Münster, Nuremberg, Wiesbaden). A striking aspect is that the office market in the 14 regional cities mostly achieve a more stable performance than the traditional German prime locations. Overall, since the beginning of 2008, rents in the regional office locations have performed better in the centres of the cities than in the other municipal districts. New premises built since 1995 in the city centre have produced a particularly positive performance. Properties which were built before 1945 are also very popular. Rents for these properties have performed very well at the subprime locations, and are leading the index. The focus on German subprime locations is becoming more and more important for investors. And there are various reasons why this is the case: The vacancy rate is low, prime rents are stable and long-term rental agreements have been concluded with local companies. At the prime locations, prices are frequently driven by fierce competition between investors – this is (still) not the case in the subprime locations, and investors in such locations are less 'driven' by the market. This means that there are good prospects for investors. ih

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activities in the UK and Ireland €35 million to over €200 million.

In a big internal intra-company move at the beginning of this year, Bilfinger Real Estate then subsequently took over from its parent company the infrastructure and transport asset management units of the Group's dissolved project investments division. The move raised the firm's managed assets by €7bn to €40bn.

That division, **Bilfinger RE Asset Management**, manages 35 transport and infrastructure projects with a combined valued of €7bn. The firm operates from London, the Rhine-Main region in Germany, Toronto and Melbourne. The takeover has added infrastructure to the types of use previously managed by Bilfinger Real Estate (office, shopping, commercial & logistics, residential and hotel).

"In our new division, we have gained a lot of know-how in financing, managing, and supporting complex infrastructure projects and public facilities," said Aydin Karaduman in a statement at the time. "In addition, it gives us important access to the real estate and financial markets in Australia and North America, which we are planning to expand further. The local branches will help us start dialogue with existing customers as well as potential new clients and market participants and convince them of our one-stop-shop offering."

With the obstacle of GVA shareholder approval now removed, the acquisition of GVA will give the Bilfinger Real Estate business a major leg-up on the international ladder. As Karaduman says, "Our goal is to become one of the leading international real estate service providers, with the ability to support the investment activities of our clients across borders and to manage their real estate portfolios anywhere in the world. With London as Europe's financial centre, the UK is among the three largest investment and property markets in the world. We want to – and have to – have a presence here to achieve our goal. In addition to giving us a strong, nationwide presence in the UK market, the strategic merger with GVA will provide us with critical access to international investors and allow us to take on international management and consulting mandates."

Germany/Retail

REDOS strikes out in new direction with new €500m JV

REDOS Real Estate, previously most widely known as a partner with **Morgan Stanley** in the investment bank's German retail investments, has now teamed up with fund manager **Union Investment** to create a new retail investment fund. The new *Spezialfonds*, **REDOS Einzelhandel Deutschland**, is targeting a volume of €500m in large scale German retail property.

The new fund has already raised €250m (including 50% leverage) from institutional investors with longer time frames, such as pension funds and insurance companies. It will by 'oversized' superstores and hypermarkets, as well as larger retail warehouses. Four properties worth €50m have already been bought (two **TOOM** home improvement stores, a **REAL** box warehouse and an **Adler** clothing store), with signatures on a further €70m 'imminent' (six stores with predominantly 'grocer' anchor tenants), according to REDOS. The fund is expected to run for 12-15 years, and is aiming at a 7% pre-tax dividend payout.

Oliver Herrmann, REDOS managing director, commented on how the fund aimed to benefit by focusing on the restrictive planning climate being favoured by many German municipalities, anxious to protect endangered downtown shopping districts. "The investments will concentrate on selected sites characterised by high purchasing power and centrality", he said. "Municipal governments rarely ever zone new sites for large-scale retail units - the licensing practice is highly restrictive." This, said Herrmann, makes existing properties "particularly interesting for institutional investors with a focus on core properties", due to the exclusion of potential competition.

Assets targeted will be large, predominantly grocery-anchored stores, with a unit value of between €5m and €20m and a lease life of between 7 and 20 years. Preferred locations are those with above-average buying power, a high centrality factor, and positive (i.e. growing) demographics. Assets with short remaining lease life and those with strong development potential will also be considered

REDOS has most recently worked with Morgan Stanley's **MSREF** funds, with a recent notable deal being the **Christie** retail portfolio from **M&G**. REDOS itself has a portfolio of 77 German retail properties valued at €1.1bn. According to Herrman, "If we're known, we're largely known as an opportunistic investor, after doing four deals with Morgan Stanley. But the second pillar of our business is now 'core'" – hence the new partnership with Union Investment.

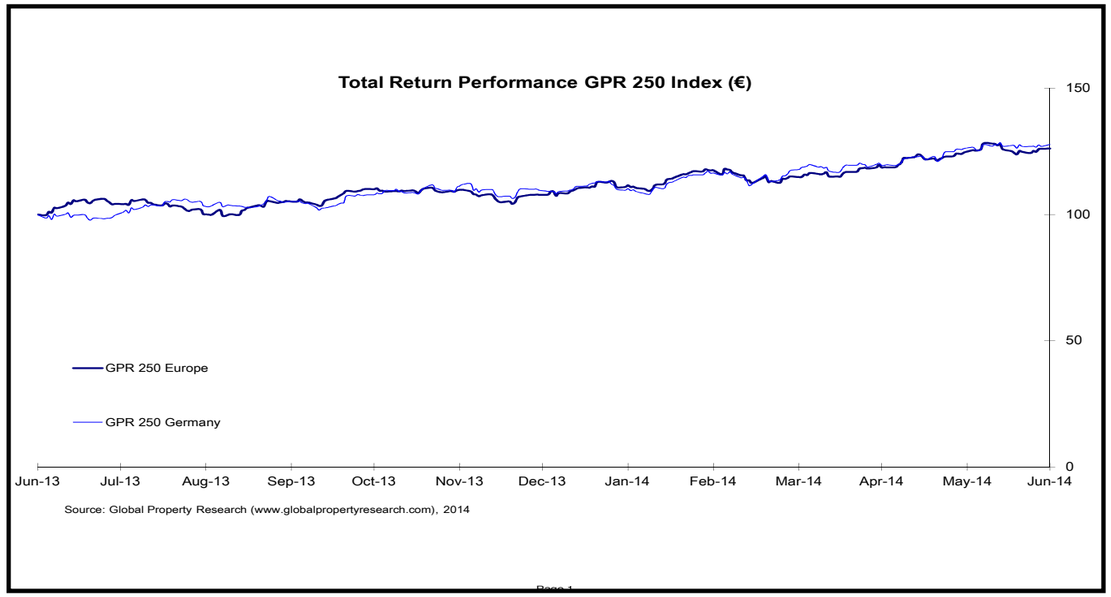
With its new partner Union Investment, REDOS will act as the fund manager and asset manager for the joint venture, while Union will provide fund administration through its **ServiceKAG** platform, and raise equity through its extensive distribution network, which includes the **Volksbanken** and **Raiffeisenbanken**, as well as pension funds. REDOS is also building up its own distribution network. The two partners said they will manage investor accounts jointly.

Europe/Non-listed Funds

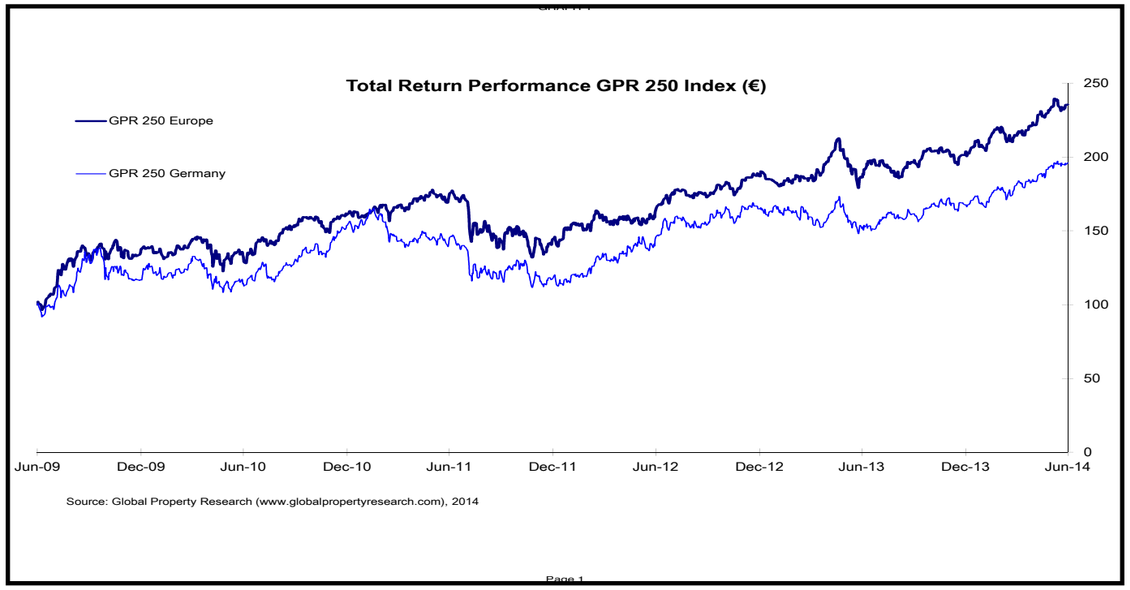
INREV sees debt funds raising €8.9bn, led by Europe

Alternative lenders raised a record €8.9bn of new capital for non-listed real estate debt funds in 2013, according to **INREV**, the **European Association for Investors in Non-listed Real Estate Vehicles.**

The European real estate association's *Capital Raising Survey* found that European investors were the most active,



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



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

Markets Report

Food Retail Properties in Germany - stable rentals and net returns

A useful study by eastern German specialist TLG IMMOBILIEN GmbH - **"Food Retail Properties in Germany 2014 - Market Trends and Investment Opportunities"** - compiled jointly with market research group BulwienGesa, has just been published. It concludes that,

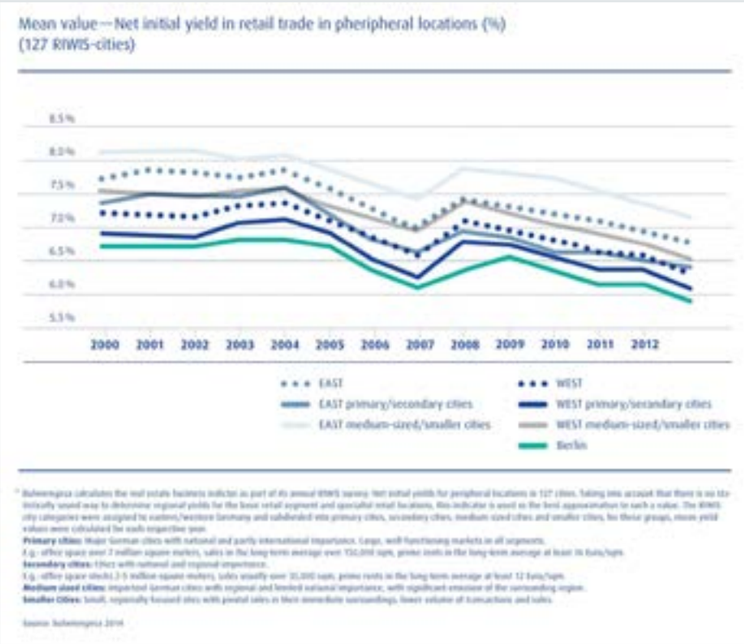
a) The sector provides higher and more stable yields than in other asset classes
b) Discount stores continue to dominate the retail landscape in eastern Germany, and
c) Online grocery shopping has yet to take hold, seeing only very modet demand

Investors have long found that, in Germany, food retail properties - such as food discount stores and supermarkets - are an attractive and sustainable asset class. With an average yield of 6% to 7%, investments in food retail properties have earned significantly higher and more stable returns than other real estate asset classes.
The attractiveness of food retail properties can be attributed partly to rising food expenditures in recent years and the expected future increase in expenditure per head, which also has the effect of counteracting potential population losses.
"In addition, restrictive German planning laws create a de facto safeguard and long-term leases for many existing food retail premises. This makes it difficult to create new locations outside the central supply areas," said Niclas Karoff, (*pictured,right*), managing director of TLG IMMOBILIEN GmbH in Berlin.

At the same time, investors are currently focusing more on regional growth hotspots in eastern German cities, such as Dresden, Erfurt and Rostock, as well as Potsdam and Jena. Food retail properties in these locations feature comparatively high returns of up to 7.2 %.

"Medium sized cities in eastern as well as western Germany frequently offer significantly higher returns than the metropolitan areas, at the same or a slightly higher risk," explains Karoff. However, the data is of limited value, since the number of completed transactions very often does not allow for definitve conclusions.

For example, the relatively strong decline in returns (see chart) in the eastern marginal locations - secondary cities, but also in the medium-sized and smaller cities - can be attributed to the fact that purchase transactions in eastern Germany have so far been predominantly limited to modern, newly-erected buildings with quality tenants, such as Rewe or Aldi, and long-term lease contracts.



"Accordingly, purchases prices have been high in recent times - and the net initial yield relatively low. In addition, most transactions completed within the respective city categories were concluded for locations with the best growth prospects in the East," says Ralf-Peter Koschny, CEO of BulwienGesa.

In the preface to the study, Professor Dr. Tobias Just, Director of the IREBS Real Estate Academy and Professor for Real Estate at the University of Regensburg, confirms the finding that food retail properties can offer interesting investment opportunities. "Risk-averse investors could do a lot worse than looking at food retailers. Although their rents often increase at a lower rate than in the central top locations, their dividend yields are often considerably higher, while offering manageable risks," he said.

"Especially in this asset class, there are comparably low competitive risks due to strict regulatory planning requirements and, also, the product ranges of local suppliers are dominated by everyday consumer goods. It is hard for consumers to do without such goods, even in the toughest times. The discount segment, in particular, is not overly susceptible to crises," Just added.

The TLG/BulwienGesa study confirms that food retailers in eastern Germany are still enjoying positive momentum, even though average rents for food suppliers both in the East and West of Germany have risen steadily since 2000.

In fact, in the eastern German food discount store segment, rents have increased by up by 7.4% to about €10.20 per sqm in the past five years, while rents in comparable markets in western Germany have actually fallen by 3.3% to around €11.60 per sqm. "This is quite remarkable, particularly since food discount stores are the most important type of operation in eastern Germany, with a 46% market share. In western Germany, on the other hand, supermarkets are much more prevalent than in the new federal states," says Koschny.

Little demand to date for online grocery shopping

The study "Food retail properties in Germany 2014" went beyond analysing current trends in the food retail segment. Experts from the sector were also interviewed about future challenges and private households were surveyed about the significance of online grocery shopping, among other things.

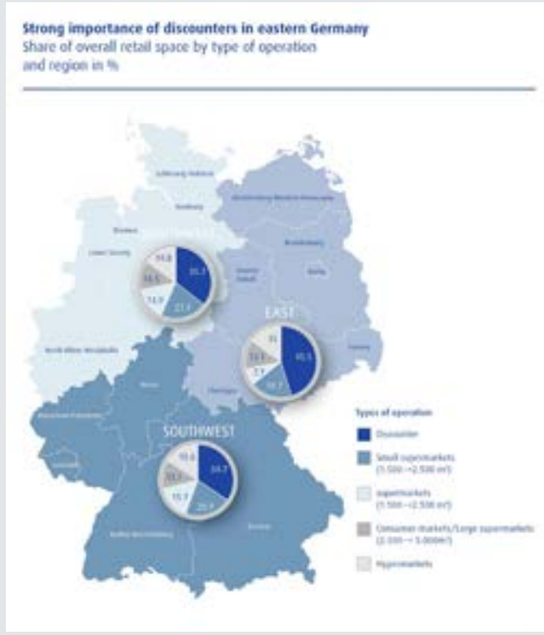
Expansion managers at food retailers plan in future to focus mainly on urban and suburban areas close to residential districts. "Greenfield" locations are no longer in demand. The experts also predict that the differences between discount stores and supermarkets will in time become much more blurred. This will further increase the competitive pressure among the retailers. This pressure, as well as the challenge posed by online retail trading, will have to be addressed with new concepts.

These new ideas will have to include more amenity value and service quality in the markets, modernisation of the chain store network and the expansion of digital marketing. While the non-food product range offered by food retailers has been available in non-food online shops for a long time, the food retail sector has so far been very slow to offer food products on the internet combined with a delivery service, or has not identified this channel as a target. Among other things, this is due to the related logistical challenges - particularly for perishable goods.

However, the major market players are currently working hard on developing new concepts for the integration of online trading in their sales structures, either in combination with delivery services or in the form of pick-up stations or drive-in concepts. This means new opportunities for smaller rural communities without their own local supply system. These could be operated in future, for example, through the nearest food store, which would then assume the function of a central ordering and pick-up station.

Cross-channel retail, i.e. the combination of stationary trade with e-commerce, is thus one of the mega-trends in the German retail landscape. However, not all food suppliers are convinced – particularly the big discount chains. For example, ALDI SÜD pointed out: "We offer our customers exclusively high-quality products with excellent value for money, and currently do not see a means to transfer this ambition to an online store."

This is also consistent with the household survey conducted by BulwienGesa. According to their findings, households are still reluctant to order their groceries online. Only 11% of the surveyed households had already shopped for food on the internet at least once. When asked about what would need to change to move them to purchase more food online in future, the overwhelming majority replied that they were not interested in this type of shopping.



investing almost three quarters of the total capital in debt strategies.

INREV said the results demonstrated the increasing importance of debt in the European real estate market. The UK alone was responsible for more than €2bn of new capital for debt, while €3.5bn was raised for joint ventures and club deals.

Non-listed funds attracted €18.1bn in 2013 – the most raised since 2007 and 77% higher than the average for 2008-12. A total €47.3bn was raised last year, INREV's survey of 147 fund managers found. However, European capital accounted for less than half (47.3%) of the total raised in 2013, with North American and Asian investors upping their market shares significantly, accounting for 35.7% and 16.6%, respectively.

INREV said appetite for opportunity and value-added products was behind the increase.

Casper Hesp, INREV's research and market information director, commented, "These results are further evidence of the global appetite to invest in the European market and the increasing appeal of non-listed real estate as an alternative to other asset classes. The fact that over 50% of new equity was allocated to opportunity and value added funds suggests that the wider economic recovery is giving investors the confidence to take on more risk and seek out new opportunities."

INREV found that 42.9% of new equity went to opportunity funds last year, compared with 8.4% in 2011.

Pension funds remain the biggest source of capital for non-listed funds (55.8%) and separate accounts (48.4%). Sovereign wealth funds (49.8%) were the largest source for joint ventures and club deals.

Germany/Retail Real Estate

GIG buys Aldi retail portfolio from Blackrock

US private equity investor **Blackrock** sold a portfolio of 70 retail assets leased to discount grocer **Aldi**, to the Munich-based retail investor **GIC Grundbesitz Immobilien** for a price estimated at around €140m. According to Blackrock, the assets, which are located in the southern and western parts of Germany, came from Blackrock's Europe Property Fund III.

That fund's predecessor, the **MGPA Europe Fund III**, had originally bought the portfolio with 140 properties for about €180m in 2010, and then held and managed the Aldi properties before being subsequently absorbed into Blackrock's Meridian portfolio after the sale of MGPA. Blackrock has been developing, repositioning and selling off the Meridian assets in stages.for a number of years.

REFIRE Report - Retail real estate in mid-sized German cities

GfK study on 2014 retail centrality in Germany

Mid-sized cities offer substantial retail trade potential, according to the GfK study "Retail Centrality 2014". To tap this potential, certain location and real-estate prerequisites must be met. An essential factor in establishing and maintaining an attractive retail landscape is the availability of good retail real estate.

In 2014, mid-sized cities such as Straubing, Passau and Weiden once again succeed in generating retail turnover more than twice the amount of the retail purchasing power available at those locations. With centrality ratings between 213.7 and 204.7, these Bavarian mid-sized cities lead the retail centrality rankings calculated by the GfK study, outpacing shopping metropolises such as Berlin, Munich and Hamburg. Fifteen mid-sized cities with populations from 20,000-100,000 rank in the top 20.

Top 10 districts in Germany	GfK Retail Centrality 2014 rank urban district (UD) / rural district (RD)	inhabitants	retail centrality*
1	Straubing UD	45,099	213.7
2	Passau UD	49,038	207.7
3	Weiden i.d.OPf. UD	41,684	204.7
4	Trier UD	106,544	201.8
5	Schweinfurt UD	52,098	201.7
6	Würzburg UD	124,577	186.5
7	Rosenheim UD	59,935	181.9
8	Hof UD	44,461	176.2
9	Memmingen UD	41,551	173.4
10	Zweibrücken UD	34,064	169.5

The study "GfK Retail Centrality 2014" provides a breakdown of retail potential for all of Germany's regions. Values over 100 indicate an inflow of purchasing power, while values under 100 indicate an outflow of purchasing power. A total of 157 districts have a centrality rating above 100, while 245 districts have a centrality rating below 100. This means that 60 percent of Germany's districts do not succeed in converting the local population's purchasing power into turnover or in drawing additional purchasing power from further afield.

There are various reasons that explain the sometimes surprising low or high retail centrality revealed by the study:

Successful large shopping centers and retail centers have a drawing power that extends far beyond their regional boundaries. For example, this effect can be observed in the tenth-ranked district of Zweibrücken, whose high centrality rating is due to its factory outlet center.

An additional factor is the regional significance of a specific town or city with respect to Germany's retail trade. Cites such as Straubing, Weiden and Passau serve as retail hotspots for the surrounding rural areas. All of these cities have large catchment areas that encompass a relatively high level of purchasing power. At the same time, the cities themselves have a relatively small number of inhabitants, which means that the inflow of purchasing power from the surrounding areas significantly exceeds the purchasing power of the cities' inhabitants.

By contrast, metropolises such as Berlin, Hamburg and Munich have a large number of inhabitants who predominantly shop within the city boundaries. While the retail trade in these cities draws many out-of-town shoppers, municipalities that serve as retail hotspots for surrounding rural areas draw proportionally even more shoppers.

Centrality rating of Germany's five most populated urban districts rank	Urban district	inhabitants	retail centrality*
1	Berlin UD	3,375,222	105.3
2	Hamburg UD	1,734,272	110.9
3	Munich UD	1,388,308	114.0
4	Cologne UD	1,024,373	122.5
5	Frankfurt am Main UD	687,775	105.9

"Centrality ratings measure the extent to which a given area can currently draw turnover beyond the locally available purchasing power," explains GfK retail expert **Manuel Jahn (***pictured, right)*. "The greater the product variety and turnover volume, the greater the drawing power. A good retail location functions as a magnet for the surrounding region. This makes it even harder for already weakened small and mid-sized cities to lure back consumers."

An important and often underestimated factor behind this situation is the increasing lack of sufficiently large and modern shop spaces with attractive surroundings. "Franchise chain retailers are also looking for good locations in small and mid-sized municipalities," says Jahn. "But even if there many unoccupied retail spaces, expansion endeavors often still fail due to the lack of suitable retail real estate with acceptable conditions. In this age of online trade, tenants are increasingly less tolerant of real estate with small spaces and unfavorable layouts. At these already flagging locations, prominent chains usually only accept pure turnover rent, for which investments and financing are hard to justify."

Jahn stresses that cities, owners and project developers must summon the vision and decisiveness to offer retailers favorable conditions for establishing a presence at a given location: "Even communities with currently low centrality ratings can be very attractive to chain retailers if they offer good potential. But if cities with weak centrality do nothing, a vicious cycle of declining customer frequency, turnover, consumers and drawing power can occur. It's crucial that project developers, retailers and municipalities think ahead at least 10 to 15 years so they can flexibly react to emerging developments, particularly in these times of expanding online trade and increasing consumer demands for convenience and an appealing shopping experience."

For many small and mid-sized cities, maintaining vitality depends upon proactively modernizing the existing real estate according to guidelines from the city, determined in cooperation with real estate owners and retailers. Studies from the UK – where the decline of small and mid-sized shopping cities has long been a theme – show that cities with historical architecture offer better conditions. But even the most appealing architecture will be of no use without a good retail offering.

For this reason, Jahn argues that it's vitally important that product offerings be aligned with both the size of the catchment area and the characteristics of consumers in the region. This imperative is meant for both municipalities and retailers interested in establishing a presence at a given location.

"Straubing is obviously doing many things well to earn the top spot in the centrality rankings: Compared to other small mid-sized cities, Straubing has an above-average city center offering of top-tier clothing, shoe and jewelry retailers; this offering is well chosen with respect to the city's socio-demographic characteristics and income situation. Thanks to sound urban planning policies, discount retailers are concentrated at a limited number of traffic-oriented locations that clearly target consumer demand in the extensive rural regions surrounding the city."

Definition of "mid-sized city"

According to Germany's **Federal Office for Building and Regional Planning (BBR)**, a mid-sized city is a city with between 20,000 and 100,000 inhabitants. Cities with between 20,000 and 50,000 inhabitants are characterized as small mid-sized cities. Assuming good catchment area conditions and potential, these small mid-sized cities are in some cases as attractive for retailers as large mid-sized cities with more than 50,000 inhabitants.

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