

PIE German Property Breakfast sees investors returning, bank credit rising, yields reverting

Property Investor Europe on 21 May brought together four experts to discuss the question: Can German real estate provide stable rental flows to bring long-term value, or has local demand compressed yields too far? Held in the offices of legal practice DLA Piper in

London, PIE's German Property Breakfast welcomed the following panellists (left to right): Christian Bischoff, Managing Director of ProLogis Northern Europe; Markus Beaumart, Real Estate Partner at DLA Piper who heads the German Real Estate group; PIE's Allan Saunderson; Alexander

von Cramm, Chief Financial Officer at Prime Office, Munich; and Andrew Groom, Head of Valuation Advisory Germany, Jones Lang LaSalle, Frankfurt. A fifth panellist, WestImmo Board Member Claus-Jürgen Cohausz, was unable to attend. The following is a resume of the experts' views.



Investment recovers; location plays larger role

Investment interest in German real estate is recovering and valuations should respond by taking yields back down to normal levels, although location and asset quality will play a larger role in the future, according to the PIE panel.

JLL's Groom sees an investment recovery in all centres, and expects a return in values to the long-term yield curve. Driving the value change is the occupier side, although Groom cautioned it is still unclear precisely where values are heading in the shorter term. His view of a coming flattening of the bounce throughout the coming year was broadly shared by panellists. "Our valuation tool VICTOR – taking in the top five German office locations and the data on all office stock which we've analysed since 2003/4 – corroborates this," he said

Prime Office lost no tenants and none had asked to reduce rents either. "Germany is more asset management driven," said von Cramm. "Here you look to

invest in the city. Plus there is a new focus on sustainability and green buildings, where new stock has to be certified LEED silver or gold standard minimally."

No one in 2009 was inclined to buy, remarked DLA Piper's Beaumart. Trends included higher demand for loans from local savings banks, while insurance firms, other institutions and open-ended funds moved to residential investments. ProLogis' Bischoff pointed to signs that exports are returning, a key driver for the country. With investments there are shortages of core products. But looking at what's driving the logistics market, the signs are it's getting better. ■ pie

Stable market attractive to institutional money

Institutional money moved back to London 12 months ago, then Paris, and the PIE panel consensus was Germany's federal structure will bring more widespread investment in the nation, with front-runners being Munich, Hamburg and maybe Frankfurt.

London is a global city attracting money from everywhere; Paris is on its coat-tails so global funds investing in Germany might opt for Munich and Hamburg, said Groom. The message? Prime assets need to be in prime locations, such as Berlin's Sony Center, bought last month by the Korean National Pension Fund, and Frankfurt's Opera Tower in which the same investor is also said to be interest. As yet, there is no overall capital influx, von Cramm commented. Demand is there; supply is not. Stability rules while banks are not going to sell nor force clients to sell. The key difference is there are few trophy buildings in Germany. "It's not that sexy for investors but it's stable and attractive," he said. Beaumart agreed, emphasising that particular investment situations had brought forward stability.

Cities want to see job creation, Bischoff said. There is a need to develop new assets and green developments. "You must be in up to 15 locations and if you can grow business, you get good returns. You must commit to a project and build immediately," he commented. ■ pie

Debt costs revert to 4.5%; banks taking more risk

The cost of real estate debt financing in Germany is reverting back to around 4.5%, with banks beginning to take on more risk. This is true also in Spain so that change is afoot, according to the PIE panel. Funds are being formed to lend into real estate deals but are offering borrowing rates higher than most banks.

Banks are loosening their purse strings, said Groom. Will we see LTV ratios not beyond 75%? "Never say never." What has been seen recently are the conservative, building-society-style Postbank and savings banks lending more against commercial real estate. Old-fashioned banking has a new lease of life even if foreign banks have mostly disappeared from German real estate, said von Cramm. But change is good; there is much competition, particularly for re-financing and new financing. Rates, margins and risks have all increased, with more to come in the future although there will be no return to the bubble years. Banks are taking risk onto balance sheets again.

For banks to win new business, it boils down to what's on the table, said Beaumart. If there are three to four bids, rates will be more competitive. Von Cramm said Deutsche Bank has invited Prime Office to bid for financing, albeit at a slightly higher cost of money - which he did not detail. But the invitation shows more willingness to lend. If you want to grow, you have to lend and take on risk, he said. Bischoff pointed out that banks are even lending credit for



The German Property Breakfast attracted an enthusiastic crowd of investment professionals, and Prime Office CFO Alexander von Cramm (top) was busy handling questions on a number of issues. Jones Lang LaSalle's Andrew Groom (above) said his group's VICTOR German office price indicator has begun to point higher, 18 months after hitting a low amid the global economic crisis.

new developments again, and ProLogis has taken advantage of this.

A comment arose regarding the Frankfurt building, asking with an investor looking to develop globally, whether an all-cash deal will be driving the pricing or will debt be involved. Key points were that investors should not read too much into the current interest of sovereign wealth funds, or the Asian fascination with brands, and the fascination with Berlin as an environment.

Bischoff noted construction costs are now 20-30% lower than 2008. Now is a good time to develop and construct - although von Cramm indicated the necessary funding for that is impossible to obtain. It's almost Catch 22. ■ pie

Property funds problems could hit demand

In the first week of May the federal government proposed a 10% across-the-board write down, and a two-year minimum holding period for investment in



Panellists ProLogis MD for Northern Europe Christian Bischoff and DLA Piper Real Estate Partner Markus Beaumart (centre) discuss topics. Bischoff said Germany is taking on greater importance as a logistics crossroads, while Beaumart is watching key legislation on the open-end funds sector. Former JLL Executive Robert Orr (above) provided useful perspective from the floor.

the €90bn open-ended fund segment. Can German property funds survive such reforms, the panel was asked? Did they think a 10% discount will become law? Most importantly, what could be the impact on demand?

Open-ended funds must tackle the absurdity of having investors wanting to redeem shares every day against the reality that fund managers cannot sell the assets daily, Beaumart said. Government initiatives are required to make changes to investment law. But he predicted problems for large financial institutions wanting to invest money for the short term. If open-ended funds are forced out, is there another group of investors to substitute – perhaps, sovereign funds?

Large German pension and institutional funds could step in to back everything up, the panel decided. These would be interested in returns and yields, and take a long-term view of the investment. Obtaining 5% from a German office building is a good yield; there just might be a silver lining to the withdrawal of open funds, if this occurs.

There have been huge drains from the German real estate funds as a result of the controversy, von Cramm said. The issue of valuation has been discussed behind closed doors once a year, now semi-annually or quarterly. Conversely, the advantage of being on stock markets is that stocks are publicly traded so that this complex liquidity issue does not arise. The prospect however of having €90bn assets in vehicles that become no longer viable is a serious prospect for the market.

Groom welcomed the prospect of quarterly or semi-annual valuations for funds but posed questions on what managers should tell investors and what exactly you are asking from them. Investments rely on debt, and there is enough business around to provide funding through banking systems. The key message? Germany is a good place to do business, even more so if the euro achieves parity with the dollar, which the panel did not exclude. It is a good time to consider

Germany. It might not be the most exciting market, but there is stability ahead. ■ pie

Green issues changing investment models

The new emphasis on sustainability will impact German real estate business models, and the PIE panel pointed out the seriousness of being green; within a decade, buildings without certification will not be viable. Conversely, sustainability standards will have a positive effect on a building's investment prospects.

The sustainability standards in favour today are US Green Building Council's LEED, UK's BREEAM and Germany's home-grown DGNB (Deutsche Gesellschaft für Nachhaltiges Bauen). But which standard should be pursued? Should DGNB be best in Germany? LEED has a head start, is unstoppable and players in the industry feel comfortable with it. Is the difference in the valuations down to clients, Groom asked? It's a question of the role the valuer plays; does he reflect what's happening or make it happen? Deutsche Bank's twin towers in Frankfurt were gutted and refitted to LEED standards, and now show 75% cost savings in energy and water. It makes sound financial sense.

The pressure for sustainability is a big motivational resource, Bischoff commented. However, owners cannot yet charge tenants more for green building lettings; but one can use purchasing power to get ahead of the competition and do more. Developers all build in sustainability when they build new, as it is more expensive to retro-fit. Beaumart said that as tenants of offices in Germany, green strategies are quite important. "In 10 years' time, if you don't comply you're out," he said. It's not a fad, it's a trend, said von Cramm. Criteria for new buildings are that they must be at least silver if not gold LEED-rated. Investors require this. ■ pie