

- European REITs • German non-performing loans (NPLs) • Institutional real estate portfolio investment • Mortgage securitisation, CMBS/RMBS
- French office property • Distressed debt • German real estate banking • Special mortgage servicing • US real estate funds in Europe •

## New Fortress German home fund covers Viterra

Fortress Investment Group announced that it has closed its latest German residential property fund of \$ 2bn in volume. The new Fortress Residential Investment Deutschland Fund has the potential to raise around \$ 10bn. This would cover a Viterra purchase. **PAGE 3**

## German AHBR mortgage bank now in play amid BHW takeover

The Frankfurt mortgage bank Allgemeine Hypothekbank Rheinboden (AHBR) is now 'in play' amid the current sale of major shareholder BHW group. **PAGE 4**

## JLL sees European shopping centre rents rising

European commercial property lease rates are likely to rise across all segments through to 2008, a new Jones Lang LaSalle (JLL) study says. **PAGE 4**

## GAGFAH apartment pool aims at stock market float

Before Viterra AG considered it, German apartment group GAGFAH, taken over last year by Fortress Investment, was also considering a stock market flotation within 12-24 months. **PAGE 6**

# Tax issues risk delaying start of G-REITs beyond January 2006

Two tax issues risk blocking progress on the introduction of German Real Estate Investment Trusts (G-REITs) and delaying legislation allowing their introduction beyond the originally-planned January 2006.

Property specialists had expected agreement as early as this month in the talks between the German states and the federal government to allow G-REIT-enabling legislation to begin passage through the Bundestag parliament before the summer recess.

However the issue of tax treatment for foreign investors in G-REITs, and also for domestic corporate treatment of booking capital gains - as they bring undervalued property assets into a REITs vehicle - have proven to be stumbling blocks.

The REIT vehicle is an idea that has galvanised Germany Inc. REITs, long a feature of the US property market and gradually being introduced in most other European countries, could finally bring life to the nation's long moribund property market. The sector is pressing for the G-REIT to take its place in the global markets for listed property vehicles alongside the J-REIT (Japan), the S-REIT (Singapore), and other variously-named entities. **PAGE 2**

## PFEUROPE

Welcome to this first edition of **Property Finance Europe**, a newsletter that grew out of an informal information service we at easetec in Frankfurt have provided to clients and business friends for some time. Through this, it quickly became clear that the need for English language information in this sector is large.

PFE aims at a fortnightly report and analysis on a number of themes: all those you can see above on the right of our fresh new title.

The probable authorisation of REITs in Germany, so-called G-REITs is also crucial. As well there are some important changes in German and European banking systems that you need to know about - everything to do with institutional real estate finance on the European continent, in other words!

Though our name refers to Europe, our initial focus will be Germany. We hope to rapidly supply more material on France, Italy, Spain and other major continental markets - and then, gradually, other jurisdictions from Europe 'old' and 'new'.

PFE will be published on the second and fourth Monday of every month, from the easetec offices in Frankfurt am Main. It is independent of investing or selling institutions, and issued free of charge to **BACK PAGE COL.1**



Frankfurt's Zeil shopping precinct is currently being remodelled.

# Hudson Advisors continues to seek staff in Germany after Lone Star buying spree

Lone Star Funds' tied special servicer Hudson Advisors remains on the lookout for staff in Germany order to reach the capacity it needs for the portfolios acquired so far. Hudson has around 130 staff at present, based in Frankfurt and Berlin. Current staff remain on full stretch with current projects.

By establishing themselves as the largest and most active operators in the non-performing loan/distressed debt and property segment, Lone Star and Hudson have galvanised the German real estate banking establishment over the last 30 months. Because of Lone Star's aggressive and, therefore, successful bidding, it has won more than €5bn in NPL or semi-performing real estate-backed portfolios, including the biggest yet - HRE's €3.6bn NPL pool last fall. making Hudson by far the most active Special Servicer in Germany. *PFE*

## German financial centre says G-REITs could become €127bn sector by 2010

The Financial Centre Germany Initiative said in a report that the market potential of German REITs (G-REITs) should be as much as €127bn by the year 2010. A healthy G-REIT sector would generate additional tax revenues of €8.2bn annually, excluding indirect fiscal benefits from a variety of welfare effects.

In a report handed to the federal government at the end of January, IFD (Initiative Finanzstandort Deutschland), grouping banks, stock exchange and state government representatives, pressed strongly for minimum regulation to ensure REITs attract foreign capital into the suffering German real estate sector.

It estimated that a REIT industry would bring additional indirect benefits, including a higher rate of return on real estate, better risk diversification for stock market investors, and the creation of specialist jobs. The impact of these elements alone promised further tax revenue benefits of €4.4bn by 2015.

Mobilising real estate holdings by German corporations alone could free up €60bn in liquid funds that conglomerates could reinvest in core businesses, IFD calculated. These hidden reserves were prevented from being realised by the current tax requirements on corporate property revaluations.

“Given the hidden reserves that have been building up over the years, a mobilisation of real estate assets on company level for the establishment of G-REITs will only be successful if fiscal incentives are provided,” the report said. “Otherwise the hurdle that has to be overcome for a contribution of real estate assets or conversion into a G-REIT is too high.”

The IFD report said it, “recommends increasing the real estate investment spectrum by introducing a new unregulated category of Limited Corporation, the G-REIT, which is taxed exclusively at the investor level and offers incentives for bringing property into these new legal entities.”

The IFD officially proposed to the government a number of specific criteria for a new legislative environment to allow establishment of a G-REIT: its main business should be the acquisition, construction, disposal, rent and lease of directly or indirectly-held real estate, and include the active management of the owned property.

A G-REIT should pay dividends equivalent to at least 90% of distributable profits in order to qualify.

A G-REIT should hold at least 75% of its assets invested in real estate and generate at least 75% of gross earnings from the rent, lease or sale of property.

To differentiate it from a real estate broker, a G-REIT should, within any five-year period, sell no more than 50% of its average property holdings under management.

A G-REIT should be required to be listed on the stock exchange to qualify for fiscal benefits; REIT status should be granted on the day of first quotation, IFD proposed.

A G-REIT should widely place at least 25% of its equity capital after listing but no further shareholder restrictions should be imposed. Minority shareholder interests should be adequately protected if G-REITs are subject to the Stock Corporation Law (Aktienrecht), the Securities Trading Law (Wertpapierhandelsgesetz, WpHG), and the Takeover Law (Wertpapiererwerbs- und Übernahmegesetz, WpÜG).

All real estate assets in a G-REIT should be valued at market prices, and the financial statement structured in accordance with the best practice of the European Real Estate Association (EPR).

A G-REIT should be allowed to allocate results from disposals for up to two years to its reserves; these will increase the distributable profit if it is not re-invested in property in this period. Any limited liability company (AG) that opted for G-REIT status should be exempt from corporation and trade tax after its initial listing, the IFD recommended.

As a basis principle, all dividends a G-REIT distributes should be subject to normal taxation at shareholder level. A withholding tax of 20% should be raised on distributions that are subject to taxation even for foreign shareholders. Double taxation treaties will, in some cases, have to be adjusted to the introduction of G-REITs.

But the IFD report cautioned: “The French experience has shown that the phase of fiscal reorganisation – as long as it favours foreign investments in national REITs – can trigger meaningful impulses.”

It said a G-REIT introduction would offer retail investors directly and through institutional investors (capital funds), an attractive and internationally successful alternative investment form to the open-end funds that currently exist. The globalisation and professionalism of the real estate markets mean Germany has the opportunity to establish a domestic REIT industry and compete with international financial centres.

*PFE comment: Tax is the main sticking point in all aspects here. France and the UK are grappling with the problem of how to avoid encouraging domestic real estate investors to move funds offshore and use foreign capital fund vehicles to invest in domestic property via REITs. Berlin is nervous of encouraging domestic institutional capital to invest in real estate from Switzerland, Luxembourg or The Netherlands. One major stumbling block is the fact that US investors are, as yet, untaxed at source in their German investments though the US taxes German investors in its property sector.* PFE

## German state of Hesse looks to G-REITs to withdraw from property holdings

Hesse State Premier Roland Koch, whom many see as a future chancellor candidate of the right-of-centre opposition Christian Democrats, is a leading protagonist of G-REITs and other liberalisation measures for the German financial markets.

With the main financial centre, Frankfurt located there and regulated by the state supervisory authority, Hesse is involved in negotiations with the federal government on REITs legislation, alongside Bavaria (CSU), Hamburg (CDU), North Rhine-Westphalia (SPD) and Rhineland-Palatinate (SPD).

Hesse Finance Minister Karheinz Weimar told the Immobilien Zeitung (IZ) newspaper G-REITs would bring a number of benefits to Germany. “I want to see international capital flowing into Germany,” he said. “Our country sees capital flowing abroad every day. REITs should serve to bring investment back.”

Chances were good to see G-REITs enacted into German legislation by January, he said last month. An agreement over the parameters was likely in the working group by late spring, and the two houses of the federal parliament, Bundestag and Bundesrat, should pass this into law without major obstacles.

This would show that Germany was open to innovation in capital markets. The slow establishment of the ABS market had given a negative example of how the nation can lose business to other centres if it cannot act more rapidly.

“The alternative to REIT introduction on 1 January 2006 would be never-ending discussion groups,” he told the IZ. “This

would imply the end of the concept of the German REIT since the capital market would, if this occurs, quite justifiably ignore us. Keep in mind the British REIT is supposed to come in autumn 2006! The international arena is watching very closely to see if we are capable in this country of solving the problem. This discussion is becoming the measuring stick for our ability to institute reforms of our banking centre and fiscal rules."

Hesse is strongly opposed to the tax-induced hesitations of the Red-Green Berlin government over financial centre reforms and G-REITs. Weimar said these were short sighted and well outweighed by the macro-economic benefits of providing an attractive vehicle for capital to flow into the long-depressed German property sector.

"Property portfolios are weighing like lead in many corporate balance sheets," Weimar said. "The activation of these capital reserves would give them the ability to make new investments."

The hardest obstacle to G-REITs is international taxation rules, and Germany could not risk losing tax income if domestic funds invest into the property sector from abroad, Weimar said. But G-REITs were a highly appropriate vehicle for liquidising state-owned property portfolios.

"I am strongly of the view that the State of Hesse should sell all the property it owns, with the exception of emotionally important buildings such as the state parliament, the state premier's office and its castles," he said. "The real estate we own are suitable for development over and above straight public sector use, for example construction development of the property lots or better use of the buildings themselves. They could be much better managed, and the REIT is a good vehicle to achieve this."

"At the moment I'm selling off state property at the current market price," Weimar said. "A REIT gives me the opportunity to participate, after I have sold it off via an equity participation, in any stock market increases in value... I want to be one of the first to execute this limited liability AG model in the Frankfurt financial centre – assuming we get the legislative framework right." PFE

## Eon says Viterra sale may be in IPO rather than to bidding institutions

Parts or all of the immense residential housing portfolio being put up for sale by Germany's Viterra AG, a subsidiary belonging to the Essen-based conglomerate Eon, may yet be floated on the stock market rather than sold to investors.

Deutsche Bank has been mandated to prepare a stock exchange listing for Viterra, the holding vehicle for 152,000 apartments, the Handelsblatt newspaper reported. Viterra's market value is estimated between €5.5bn and €6bn.

A company spokesman confirmed that it had not yet been decided which of the alternatives to take in selling Viterra into the market - whether to sell it to investors or to execute an international public offering (IPO) on the stock market. A decision is not likely before the summer.

Six investors, some in consortia, have participated in the bidding process so far. The closing date for bids to be lodged with Viterra advisor Morgan Stanley is May 9. Bidders include Fortress Investment Group, Cerberus Funds jointly with Goldman Sachs' Whitehall Funds, and Terra Firma working with a subsidiary of Citigroup.

Handelsblatt said Viterra/Eon is considering establishing a Real Estate Investment Trust (REIT) structure to take

advantage of a prospective change in legislation being considered by the federal government. However, the size of the portfolio could create problems with placement in an IPO.

Terra Firma is bidding for Viterra via its Deutsche Annington subsidiary, which already owns 80,000 apartments from prior purchases. Fortress has just successfully closed its Residential Investment Deutschland Fund, providing an easily sufficient €2bn in potential equity capital for the Viterra deal.

*PFE comment: Even if doubts have been raised over whether Berlin will agree to create a liberalised legislative environment for G-REITs (see front page item), sellers of large property portfolios in Germany would be ill-advised to ignore this. There are two very important valuation issues to consider: (i) the current proposal to the government committee considering REITs - , comprising federal and state representatives - is to tax corporations less than half the current corporate tax rate on their liquidation of hidden reserves in property sales, or around 20%. This is assuming these assets are liquidated at creation of a REIT or in immediate preparation for it. (ii) A G-REIT would certainly be a major form of 'exit' for the investor, were Eon to choose to sell to one of the bidders. A REIT structure offers an immense opportunity with relatively little risk – given current depressed residential property values: floating a part of a portfolio on the stock market would provide a capital market valuation for the underlying assets that is highly likely to be well above the present net asset or corporate book value. This should offer significant capital gains for the ultimate property owners at the time, and REIT-enabling legislation could be introduced with effect as early as January 2006.* PFE

## Fortress new German residential fund covers Viterra purchase price

Fortress Investment Group announced that it has closed its latest German residential property fund of \$ 2bn in volume. The new Fortress Residential Investment Deutschland Fund has the potential to raise around \$ 10bn in total, which would easily cover a purchase of the Essen-based Viterra AG, a residential apartment holding subsidiary of the E.ON conglomerate.

"We are convinced of the prospects in the German residential property market and want to plan a significant part in its further development," Robert Kauffman, co-founder of Fortress and head of its European activities, said in a press release.

The new Fortress fund was launched after the company acquired the GAGFAH portfolio in September 2004 (see elsewhere in PFE) from BfA. Steve Gruber, senior real estate investment officer for Fortress, led the roadshow for the Residential Investment Deutschland Fund in the US. Gruber gave a conference call presentation to the Oregon Investment Council in late March. PFE

## Hamburg to sell commercial portfolio

The German North Sea city state of Hamburg is contemplating sale of a portfolio of 245 city-owned properties, comprising office and other commercial buildings. HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsverwaltung mbH is lead-managing the project. PFE

## German AHBR mortgage bank now in play amid BHW buyout by Postbank

For a number of reasons the Frankfurt-based mortgage bank Allgemeine Hypothekbank Rheinboden (AHBR) is now very definitely 'in play'. The bank is currently 40% owned by the BHW group, a residential mortgage financier, itself more than 50% in ownership of the German trades' unions.

However union financial problems have obliged BHW to be put up for sale, and the group is almost certain to be taken over by Postbank AG, the privatised offshoot of the German post office.

AHBR, because of heavy past losses and continuing serious balance sheet problems, is not part of the deal. In 2004, it avoided showing a loss in the P&L only by selling more than €100m of securities from proprietary holdings into the market. It managed to show a small profit of €18m at the net level, just 2% up on 2003.

BGAG, the unions' holding company vehicle for the BHW investment, has had to pump over €1bn into the group since 2001. For 2004, BHW announced net profit of €103m, 1.7% up on 2003. Operating profit however was 26% higher at €943m, and earnings from usual activities rose by 15%. The BHW balance sheet expanded by 3% to €119bn.

BHW was successful last year as demand for residential property mortgages rose on the back of record low financing rates. It closed 38% more business at €158m compared to 2003, and this trend continued into the first two months of 2005.

AHBR first got into deep trouble after completely misjudging monetary developments in the aftermath of Sep. 11 2001 and setting its entire fixed income strategy around rising interest rates. S & P and Fitch both downgraded the bank in January even after it was made clear that AHBR's majority owners were prepared to chip in another €600m to help offset the balance sheet problems. Ex-Bundesbank President Ernst Welteke has been appointed as the trustee for the funds while AHBR is undergoing restructuring prior to sale.

AHBR Management Board Chairman Dirk Hoffmann has confirmed that the bank is moving into a due diligence phase prior to a private auction process for its sale. "There has been more interest in us than we had originally expected," Hoffmann said recently. He expects most interest to come from foreign institutions that want to gain access to the bank licence of AHBR or the credit portfolio – mainly performing and non-performing mortgages – or simply to gain access to the German market for this and other purposes. *PFE*

## Average German apartment prices fell 15% in last 10 years - Feri Immobilien

The price of a single family home in Germany failed to keep pace with inflation in the 10 years to the end of 2004 and apartment prices have dropped significantly, a new study by the Bad Homburg-based Feri Immobilien has shown.

The average home price across the 70 major German cities rose on average by just 2.2% overall in 10 years, roughly the nationwide rate of inflation in a single year, to € 306,600, Feri calculated. East Germany was by far the hardest hit. In Berlin, the average price fell 4.8% per annum throughout the same period, to € 284,000 today from € 479,000 in 1994.

Apartment values have however dropped far more dramatically, with prices in eastern Germany having nearly halved over the 10 years to 2004. Across the German average, apartment prices have dropped a nominal 15% to € 1,429 per square meter today. In the east, the fall has been around 45% to € 1,291 per sq.m.

Like DB Real Estate however, Feri sees present conditions as the base of the cycle. For the next 10-year period until 2013, it forecasts average value increases for residential property of at least 2.5% p.a. for the major German cities of Aachen, Bonn, Darmstadt, Düsseldorf, Frankfurt (3%), Heidelberg, Köln, Mainz, Mannheim, München (3%), Stuttgart and Wiesbaden (2,9%)

## Munich office vacancies seen roughly flat in 2005 - Bavarian Property Group

The Munich office market had a small increase in leasing volumes during 2004 and this should continue into 2005, according to the Bavarian Property Group (Bayerische Immobilien Gruppe). Its chairman, Dr. Udo Scheffel, said vacant office space in Munich would total around 1.9m sq.m. by the end of this year, only around 50,000 sq.m. more than at the end of December.

However, the leasing volumes should rise this year to around 500,000 sq.m., slightly above 2004 levels, Scheffel said. Of these, about 15% should be genuine new leasors and 85% would comprise changes in location by companies already located in the Bavarian capital city. "The Munich property market has found a floor," Scheffel said. "However we continue to think that Munich property will remain a renter's market." *PFE*

## Hines closes second Europe fund at €285m

The Houston-based Hines has now closed its second pan-European property fund, the Europe Value Added Fund, totalling paid-in capital of €285m. Hines advertised the fund as focusing on the asset class of 'value added', in other words property investments which offer capital revaluation potential

The fund will focus on office investments in France, Germany, Italy, Spain and the UK. Up to 40% is allowed to be invested in retail and residential property. *PFE*

## Mipim attracts record 17,641 attendees to Cannes, 74 national exhibitors

The Cannes international real estate trade fair Mipim (Marché international de référence des professionnels de l'immobilier) this year attracted a record 17,641 participants in its three days March 14-17, according to organisers Reed Midem. Participants came from 74 countries, with 4,660 registered as end-users or investors.

Some 6,235 firms took exhibition space, with the largest being the Paris Region, which booked over 1,000 square meters. This well outstripped the second largest exhibitor, the City of London which booked 750 sq.m. for itself and numerous

private sector partners. The third largest exhibitor, Limka, was a Turkish delegation mainly representing the city of Istanbul, while Rome and Frankfurt completed the list of the top five purchasers of Mipim exhibition space.

The United Kingdom, with 497 companies overall was also the numerically largest national group, followed by France, Italy and Germany before the Russian Federation. No fewer than 94 exhibitors came from Russia, while Asian exhibitors also showed strongly boosted presence, with an 11% rise over 2003 to 97 firms. Some 117 Middle East firms were represented. *PFE*

## Deutsche Bank Real Estate sees German, Dutch market falling further

DB Real Estate has concluded, in its latest report published at end-March, that the property market will deteriorate further in its homeland of Germany, and also in its northern neighbour, the Netherlands. Using data from 25 major cities, DB forecasts that the general macro-economic upswing in most European nations in 2005 and 2006 will however have a positive impact on property capital valuations.

Office space prices will reach their cyclical base this year almost everywhere in western Europe and then begin to recover. Rental and leasing rates in eastern Europe are however unlikely to climb significantly before 2007. Similarly, DBRE doesn't see any recovery in western European retail space valuations until that year. *PFE*

## HVB announces €2bn 2004 loss due heavy property provisions

The €2.5bn in special valuation provisions made by the Munich-based Hypovereinsbank Group (HVB) in 2004 against underperforming property assets dragged the bank into a net loss of around €2bn in that year, only slightly less than the €2.4bn shortfall of 2003. The pre-tax loss before provisions and extraordinary items amounted to €1.8bn, down from a shortfall of €2.15bn in 2003.

Real estate loans totalling €15.4bn remain on the HVB its balance sheet. The bank announced at the end of March that it would pass on the dividend for 2004, as for 2003. Operating profit of the bank in 2004 was €1.39bn, vs €1.43bn in 2003. The HVB Group balance sheet shrank in 2004 to €467bn, vs €480bn in 2003. *PFE*

## German residential property outperforms commercial since 1990

In the 15 years to the end of 2004, German residential property clearly outperformed commercial, according to the latest real estate index issued by BulwienGesa AG.

Home and apartment rental/sales values rose by 20% in that period, while the same calculation on commercial property showed a drop of 7%. However, the residential index was driven mainly by a rise in rents totalling 37%, much of it in local authority or public sector apartment dwellings. Capital

value increases have been much lower.

In the 30 years since 1975, Bulwien's German general real estate index rose most in the Rhineland city of Wiesbaden, the capital of the state of Hesse - by an average of 3.9% per annum. This outpaced values in the larger commercial centres Munich (3.5% p.a.) and nearby Frankfurt (3.3% p.a.), Bulwien showed. *PFE*

## Germans avoid home buying due lack of downpayment

Germans continue to avoid buying their homes because of financial uncertainty and excessively low savings, a survey conducted by the internet portal Immowelt has found.

In response to the question, "Why haven't you bought your home?", 57% of the 1,300 people surveyed said they did not have the downpayment to do it. Every fourth person cited concern over over-indebtedness and the risk of losing their livelihood in job loss.

A minority also cited concern over loss of mobility as an obstacle to home purchase, or the low or non-existent capital gain likely from an investment in housing - as well as the comparatively affordable rental levels in most German cities. *PFE*

## JLL sees European shopping centre rents rising strongest to 2008

European commercial property lease and rental rates are likely to rise across all segments through to 2008, a new Jones Lang LaSalle (JLL) study says. It sees the strongest gains in shopping centres (3.3% p.a.) and in 1A retail property locations (2.9%p.a.), though rises in Germany in both categories are unlikely to be more than 2% p.a.

JLL sees office rents rising on average across Europe by 2.7% p.a. through 2008. Germany is also expected to be much weaker in this segment, ranging between rental declines of 3.5% p.a. in Frankfurt to 0.8% in Hamburg. Rents for logistics properties are expected to rise by 2.3% p.a. on European average in the next four years, with Germany seeing very little of this development. *PFE*

## Mainz LRP presses into mortgage lending as core business

The Mainz-based Landesbank Rheinland-Pfalz (LRP) intends to continue to strongly develop real estate financing as a core business segment, its chairman Friedhelm Plogmann says.

In 2004 LRP, a 100% subsidiary of Landesbank Baden-Württemberg, boosted new property financing business by 50% to € 1.3bn. Property-backed assets on its balance sheet rose 12% to total € 4.3bn. LRP works actively with initiators of open and closed funds, developers, and leasing and housing companies. *PFE*

## CBRE sees a further strong year for EU cross-border property investment

The European Union attracted a record € 103.6bn in property investment in 2004, well surpassing the prior record in 2002 and outstripping 2003 by 26% in nominal terms and 2005 promises to be just as strong, new report by CB Richard Ellis shows.

The property company said the improvement in the global economy boosted global investor confidence generally last year, and capital allocations were increasingly aimed toward Europe. By 2H04, this economic growth had begun to filter through the occupier markets of the EU. Purchase demand from sitting tenants was boosted by record low financing rates, but rental growth too was evident in some core locations. Capital investment in property picked up speed over the year, with € 57.9bn transacted in 2H04, a 27% increase on the first six months of the year.

German open-ended funds saw considerable reductions in new money inflows but German institutions in general remained the most active cross-border investor. Other most active cross border investors came, unsurprisingly, from the US, Ireland and the Netherlands. However UK investors were also much more active cross-border than in previous years, predominantly buying in France.

The most popular destinations for investors also showed few surprises: The UK was the recipient of half of the total amount transacted in 2004, a third of which into central London.

During 1H04 the market was dominated by local investors, with cross-border acquisitions representing just 23% of the total capital invested overall. However, this turned around in 2H04 and cross-border investment totaled 31% for 2004 as a whole. Even so, this was significantly down on the 42% in 2003. In total, investors placed € 31.5bn outside their borders in the EU during 2004, CBRE showed, only slightly lower than the € 34.6bn in 2003.

CBRE expects 2005 to be another strong year for property investment across Europe, driven by the continuing low cost of borrowing, unprecedented demand for investment property, and the comparative absence of supply. Strong competition for prime buildings is forcing investment capital into lower-quality properties in secondary locations. While foreign investors previously focused on income yield, an increasing number of is now turning toward opportunities they see in the potential capital value increases. *PFE*

## German apartment holding GAGFAH aims at stock market listing

The GAGFAH German apartment holding company, taken over late last year by the US-based Fortress Investment Group, is aiming at a stock market flotation within 18-24 months, its Chief Executive Udo Bachmann said. GAGFAH intended to reshape into a German nationwide apartment trading company from its current status as a regional management company.

He told a press conference at the company's Essen headquarters: "We want to become the market leader in the field of apartment trading since we are convinced that a

GAGFAH stock, combining secure, high dividend yield, growth and comparatively low risk, can be an ideal investment product also for the private investment community." First objective is to raise the portfolio size toward 100,000 quite quickly but the short term strategy is to sell around 4,000 apartments annually from 2006 onward.

Gortress is believed to have paid around € 3.6bn to acquire GAGFAH from the German salaried employee insurance firm BfA (Bundesversicherungsanstalt für Angestellte). Containing some 80,000 units, mostly apartments built in the 1950 and '60s, average unit transaction price is estimated at around € 45,000.

Bachmann said the stock market listing was not intended to allow Fortress to exit from the investment, and concrete details would depend on the situation in the capital markets and the German real estate branch in general. The IPO was also not dependent on whether Germany introduces legislation to promote REITs from next January. Fortress has said it sees GAGFAH as a base for further exposure to the German residential property market.

In financial year 2004, GAGFAH said it showed net profit of € 58.7m, the second most successful year in its 85-year history after 2000. This compared to earnings of € 53.3m in 2003. With a return on total capital of 5.1%, GAGFAH achieved ROE of 8.5%, slightly up from 2003.

GAGFAH (Gemeinnützige Aktien-Gesellschaft für Angestellten-Heimstätten), founded in Berlin in 1918, is the largest portfolio of residential units out of 10 major acquisitions to date in Germany. Its properties are located in 150 different sites, and the company has 17 administrative centres for the portfolio. The GAGFAH business model encompasses purchasing apartments from the German public sector, modernising them and selling them either individually to their renters or to institutional capital investors. The New York-based Fortress has capital under management of around \$12bn, and offices in London, Rome, Frankfurt, Geneva and Toronto. *PFE*

## TIAA-CREF makes €493m investment in three Paris La Defense properties

The US pension and mutual fund group TIAA-CREF announced in early April that it has invested € 493m to buy a portfolio of property in the Paris region.

The properties comprise Triangle de l'Arche, a multi-leased 37,500 sq.m. office property in the La Defense office complex in the west of Paris city centre, Villabe, a 200,000 sq.m. logistics scheme located to the south of Paris, and Bruyeres-sur-Oise, a 120,000 sq.m. logistics development to the north of the French capital.

Standard Life Investments funded the development of all three properties and was advised by its local partner, Newport. Cushman and Wakefield Healey & Baker introduced the prospect to Invesco Real Estate, which then acted on behalf of TIAA-CREF in the transaction.

TIAA-CREF purchased the portfolio from Standard Life. The latest acquisition was a key addition to its existing \$1.35bn European real estate portfolio, focused primarily on the core UK and French markets. Standard Life Investments was assisted by Clifford Chance, Paris and TIAA-CREF was assisted by Linklaters, Paris. *PFE*

## HRE to boost foreign business, partly refocus on German market

Less than two years after being floated off from the Hypovereinsbank Group, Hypo Real Estate (HRE) is now ready to push further into international business but also cautiously expand new business in Germany, Chairman Georg Funke said.

Chief Financial Officer Markus Fell told the same press conference that HRE aimed to boost its pre-tax profit this year by 80% to between € 400-425m. For 2004, the bank reported net profit rose to € 271m, vs € 116m in 2003 though last year's result had been boosted by a positive tax effect.

Funke said the German commercial property market had reached the base of the cycle, and it was time to reengage in domestic business. Alongside classical commercial real estate lending, HRE would extend its activities in innovative capital market products, particularly credit risk conversion and structuring derivatives. It had created a new business area for this called Capital Markets 2005.

HRE's objective is to boost new foreign business by € 10bn this year, and around € 1bn in Germany. It has intentionally held back from the difficult domestic market since its flotation from HVB in October 2003. Its Stuttgart-based mortgage subsidiary Württembergische Hypothekenbank aimed, separately, at new business of € 2.5bn.

Since flotation, the HRE share has been a star performer on the German DAX, and clearly outperformed. For 2004 it will pay a dividend of 35 € cents per share, or 28% of its net profit before special tax impact. Funke said the bank aimed to increase this in the future to a 50% payout. The investment bank Sal Oppenheim raised its rating on the stock to 'outperformer', and its target for the price to € 36-38. It was last trading around € 32 *PFE*

## German True Sale securitisations to be boosted by law change in summer

True sale mortgage securitisations in Germany are likely to be strongly boosted by a change in law being contemplated by the government in July, a report by Mayer, Brown, Rowe and Maw (MBRM) says.

Parties to securitisations or other refinance transactions will, if the alteration becomes effective, no longer be required to acquire title to assets and collateral – mainly mortgages and land charges - via the costly process of registration in the land register. This had previously been necessary to protect the beneficiary in the event of the seller's insolvency. These additional costs on the transaction, notarial fees in particular, have however been a major impediment to the development of the true sale securitisation sector in Germany to date.

MBRM says that as of 1 July 2005 three registers are likely to be introduced into the German Banking Act: a refinance register (Refinanzierungsregister), a syndicate register (Konsortialregister), and a land charge and mortgage register (Grundpfandrechtsregister).

Use of these registers is aimed to allow insolvency-proof access by the Special Purpose Vehicle to the relevant assets of the originator without requiring a German law transfer of title.

The KfW Group, which chairs the True Sale Initiative

launched last year, has been lobbying hard to alter the legislative environment and foster easier asset transfer. The expected change, which looks highly likely to be enacted, has already raised considerable interest among domestic and foreign institutions that had previously seen true sale excessively hindered by transaction cost.

"The new legislation will will simplify the collateralization of German law mortgages a and land charges," MBRM says in the report. In particular, the introduction of the refinance registers would allow, "cost effective and easy collateralization of asset-backed securities and other refinance transactions" For more information see: [www.mayerbrown.com](http://www.mayerbrown.com) *PFE*

## Morgan Stanley sets up German real estate investment fund vehicles

Morgan Stanley has announced the foundation of Morgan Stanley Real Estate Investment GmbH, a property investment fund (KAG) regulated by the German financial supervision authority. This confirmed in corporate terms the strongly renewed desire to tap into the nearly € 260bn in capital invested in the nation's closed and open-end funds.

The BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) supervisor authorised the launch of a vehicle (Kapitalanlagegesellschaft, KAG), which is designed to manage investment capital in a variety of funds on behalf of German institutional and retail investors.

Morgan Stanley Real Estate Europe Managing Director John Carrafiell told a news conference at the MIPIM: "In terms of



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the investment liquidity in Europe, Germany has the biggest potential. The KAG is a key factor for gaining access to these core clients."

In particular, MS is anticipating the release of at least some of this fund capital if and when German authorises the establishment of REITs. "Institutional and private investors .. have invested around €260bn in real estate funds to date, an amount comparable to the market capitalisation of all REITs globally," Carrafiell.

"To date, in Germany, we have been active largely as advisors and by acquiring non-performing loans and residential real estate portfolios. Going forward we will pursue a broader strategy in which we continue to invest in the German real estate market and also offer private and institutional investors in Germany the opportunity to invest in global real estate."

MS is planning to launch two new products, a fund for institutional investors (Spezialfonds), and an open-end real estate mutual fund for private investors. The former will focus on the Asian-Pacific markets, while the latter will invest globally. MS is seeking distribution agreements with German financial institutions, insurance companies and fund distributors.

Carrafiell added: "Currently we are seeing a paradigm shift with the open-end real estate funds in Germany. While a couple of years ago many funds invested only or predominantly in Germany, today they increasingly make use of the enhanced investment possibilities abroad".

In 2004, Morgan Stanley Real Estate Funds partnered up with DIC Deutsche Immobilien Chancen to acquire a portfolio of 57 assets from Frankfurter Sparkasse. At the end of last year, together with Corpus Immobiliengruppe, it acquired a portfolio of 48,000 apartments from a subsidiary of the steel conglomerate ThyssenKrupp for a purchase price of some € 2.1bn. Morgan Stanley Real Estate Funds in December also closed the acquisition of a property portfolio from the Hypo Real Estate Group with a volume of approximately € 394m. *PFE*

## Aareal continues strong diversification into non-German property assets

The Wiesbaden-based Aareal Group is pressing strongly into non-German European property assets to reduce its heavy dependence on its home real estate market. Announcing a net loss of €124m for 2004, Aareal said the value of German property assets on its books fell by €1.5bn, to €13.9bn. It closed new German business of around €1bn in 2004, but a much higher €4.6bn of property-backed credit business outside its domestic market. Aareal's foreign real estate portfolio thus climbed by 10% in value to €12.6bn equivalent.

Aareal in spring was obliged by the German supervisory authority Bafin to triple its pre-announced loan loss provisions for 2004 to €410bn; for 2003 these had totalled €248bn. The bank expects however a "clearly positive net result" for the current financial year. *PFE*

## German banks sold € 35bn of loans in 2004

Around € 35bn in German bank loans changed ownership last year in portfolio sales, the largest component of them being non-performing, Merrill Lynch Managing Director Mark

Devonshire said. Only a small part of these trades were made public. In Europe as a whole, around € 100bn of bank credits were traded last year.

However so many investors were seeking to purchase German bank claims that it had clearly become a sellers' market, with the advantage all on the side of the domestic originating banks. "There is much more capital in the market chasing credit portfolios than there are sellers," Devonshire told a banking conference recently.

German banks were finally now attempting to clear past mistakes off balance sheets, and were prepared to sell NPLs with discounts of up to 50% of face value of outstanding balance. Investors, on the other hand, were able to recoup more than their investments via various exit strategies.

Dresdner Bank was one of the earliest German financial institutions to tackle NPL assets on its books. In late 2003 Dresdner, a subsidiary of the Allianz insurance group, placed its entire NPL portfolio of some € 36bn into a newly-created department named the Institutional Restructuring Unit (IRU). By the end of last year, the IRU had cut Dresdner NPLs to around € 10bn. Its objective is to finish the process of selling or unwinding by end-2005.

Much of the portfolio has been bought by Lone Star Funds. The fund has publicly announced that it intends to hire the IRU personnel for its own German business once the process is completed.

Lone Star is by far the largest and most active acquirer of NPL assets in the German market. It has built its Hudson Advisors at the Berlin and Frankfurt base over the last 30 months into the largest special servicer in Germany, and it is still seeking staff for it.

However, Citigroup, GMAC CM and Eurohypo launched a joint venture in December to unwind the NPLs on Eurohypo's books, and also to acquire and work out third party NPL portfolios. "This is an attractive business and we aim to grow our exposure to it," Eurohypo Managing Director for Germany, Joachim Koolmann, told the conference. Eurohypo is the largest mortgage bank in Germany. It was created in 2003 by merging the property financing institutions of Deutsche, Dresdner and Commerzbank.

The Munich based Hypovereinsbank (HVB) also still has around € 15bn of NPLs on its books to sell, and was at the receiving end of some criticism at the conference for dragging its feet on this. Lone Star Managing Director for Germany Bruno Scherrer said: "HVB should sell as much as possible as soon as possible of its NPLs. Its shareholders are still waiting for it to get rid of this stuff."

Much of the delay of the German banks in ridding balance sheets of NPL assets has been due to the very weak state of the domestic property market, i.e. little prospect of rising capital valuations to help exits. Deutsche, for instance, has placed more focus on unwinding corporate NPLs, and general restructuring. Using its experience from Air Canada, Deutsche is currently active in restructuring the high-tech firm Augusta, the film company Senator, the pharmacy chain Ihr Platz and the cinema chain Cinemaxx.

Ernst & Young's Andreas Diehm told the conference the corporate NPL business was likely to pick up in the near future. "Real estate NPL portfolios dominate the business at the moment but the trade with debt of individual companies is likely to pick up," he said. Bank exposure to the struggling retail chain Karstadt Quelle and the insolvent building company Walter Bau were currently being traded in the market. *PFE*

## ProLogis US logistics group seals 4th pan-European CMBS, worth €389m

The fourth commercial mortgage-backed securitisation (CMBS) of the pan-European property portfolio of ProLogis, was closed at a volume of € 389m, joint lead managers ABN AMRO and Banc of America Securities announced on 4 April.

Pan-European Industrial Properties Series IV S.A. has issued €389m floating rate notes secured against property in the UK, France, Germany, Italy, Spain and Holland. The funds were then advanced to ProLogis European Finance VII S.a.r.l. to repay existing debts incurred by various Group companies in acquiring and developing properties.

The Colorado-based ProLogis group is a provider of distribution facilities and services with more than 1,990 facilities in 72 markets throughout North America, Europe and Asia. *PFE*

## Deutsche and Lone Star in JV bid for Germany's Delmora "Bad Bank"

Deutsche Bank and the Dallas-based Lone Star Funds have joined forces to bid for Delmora Bank GmbH, a 'bad bank' holding vehicle into which the German Schmidtbank AG and Bankhaus Delbrück have transferred the entirety of their non-performing loan books totalling around € 2.2bn. Goldman Sachs, Lehman Brothers and GE Capital Corp. are also among the bidders for Delmora.

The sale is currently in due diligence, with the data room open, and the deal is expected to close in the next few weeks. Delmora opened the loan book in January and called for offers in February. A € 1.5bn bailout by Germany's largest banks saved Schmidtbank from insolvency in 2001, and it was bought in 2004 by Commerzbank for € 60m. *PFE*

## Boston's Taurus targets €1bn at Germany, rediscovers its roots

The Boston-based investment fund Taurus Investment Holdings LLC, originally founded in Munich in 1976, has earmarked € 1bn for investment in Germany in the next two years, its Chairman Lorenz Reibling said.

The €190m purchase of a property portfolio including assets belonging to the DIY group Hornbach Baumarkt was just the beginning, Reibling told the Immobilien Zeitung newspaper.

Aside from Germany, Taurus had made recent European allocations in Sweden and The Netherlands, totalling around \$400m. Taurus CEO and Partner Peter Merrigan, and Taurus Capital Markets Managing Partner Scott Tully structured the financing of the transaction with the Anglo Irish Bank.

Reibling said Taurus would aim its capital allocation principally at office, retail and logistics real estate. It was also interested in long-leased sale-and-leaseback properties, preferably those with exposure to trans-national European companies.

Taurus has a stable group of around 300 investing institutions and individuals. The fact that many are in German based is shown by its bilingual marketing and web presence. Reibling said it is keeping a close eye on developments in G-REITs. Its

objective of achieving annual returns of at least 10% would largely depend on the quality of the exits available in national locations.

The commercial real estate portfolio of the Taurus group of funds is currently valued at some \$ 1.5bn, Reibling said. Around 20% of the portfolio is turned over annually. "We do not see ourselves as long-term holders," Reibling said. "We leave this up to the Deka's of this world."

The new interest in Germany had been helped by the entry into the market of funds such as Fortress and Lone Star. This had immensely helped the price-formation on German property.

US investors considered properties such as those of Deutsche Telekom, popular with German investors, to be overpriced. US investors in such properties risked unpleasant surprises. Yet the opposite was also true; many German investors and institutions had bought into substantially overpriced US properties or portfolios.

Reibling said the newly-strengthened European focus was just the first step for Taurus in internationalising its portfolio.

In the next five years it will seek exposure to property in Asia, particularly China, and to South America, where the focus will be Chile and Argentina. Preferred investment size was around \$ 100m.

The aim is that, by 2010, the Taurus allocation would be around 40% US, and 30% Europe and South America/Asia, Reibling told the newspaper. *PFE*

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Lehman offices keep the original Frankfurt Goetheplatz facade

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