Management for Professionals

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Editors

Understanding German Real Estate Markets

Second Edition

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Foreword

The German real estate markets are highly attractive to investors worldwide. With an estimated volume of over 50 billion euros in 2015, Germany represents one of the largest investment markets in the world. Many investors see the German real estate market as a “safe haven,” thanks to the stable economic outlook, the relatively low volatility of real estate yields and rents, and also thanks to the low interest rates. The German real estate industry in particular benefits from this reputation—with positive consequences for the entire German economy. The real estate industry’s gross value added increased by nearly 3 % from 2013 to 2014, compared to the total German GDP, which increased by only 1.6 % in the same period. The German real estate industry represents nearly 20 % of Germany’s GDP and provides 3.8 million jobs (10 %).

For all these reasons, it is important to integrate representatives of all segments of the real estate industry, and from the entire real estate value chain in the German Property Federation (ZIA), and to work together with them to create value and demonstrate the attractive real estate market every day to our investors.

The ZIA also focuses on improving real estate market transparency, in order to meet the demands of foreign investors. Germany ranked only 12th in the JLL Global Real Estate Transparency Index, not only because of a lack of data but also because of structural differences compared to other countries. One major difference is the lower home ownership rate, which is only about 50 % in Germany. Therefore, the volume of housing transactions is relatively low, and it is possible to gather only limited transaction data. But the relatively low home ownership rate also implies that the German rental market is well established and that no household needs to own a flat or a house. This fact also helped the German economy during the last financial crisis, when the German economy shrank significantly, while the real estate industry continued to grow by 2 %.

There are also differences regarding the German commercial real estate market (CRE), compared to other countries. The owner-occupier rate in this sector amounts to nearly 70 % and is more than twice as high as in the UK or in the USA. This high German ownership rate may imply challenges for real estate investors. But the sector is important, especially for small and medium-sized entities, because the commercial real estate investment industry provides a quasi-financial service to other corporates, by offering premises on flexible terms that can accommodate changing needs. Without this industry, small and growing businesses in particular would face considerable challenges in securing appropriate premises. Businesses would be forced to build or buy commercial premises, and opportunities to adapt quickly to changing market environments would be far more limited. The CRE industry thus plays a vital role in supporting and enhancing productivity for small and medium-sized companies (SMEs).

In order to provide its quasi-financial services to the wider economy (including SMEs), the CRE investment industry needs a combination of equity and debt capital. This is particularly the case in regional and smaller ticket markets—which are key to SME growth.

In addition, the German real estate market not only includes the capital of Berlin but consists of several major cities—the so-called Big Seven A-Cities—as well as a set of interesting B-Cities with growing economies and positive population developments. These B-cities are often popular university cities. Therefore, the investment universe is very broad regarding the regional aspect and the different asset classes, e.g., multifamily houses, hotels, retail properties, offices, logistics, and light industrial buildings. Moreover, investors can choose from many ways to invest in German real estate—directly or indirectly—via open-end or closed-end funds or via the shares of public listed real estate companies. The coexistence of direct and indirect vehicles in fact helps to stabilize the real estate market; a recent report indicated that returns and equity collections of different German real estate vehicles do not move in sync.

One of the major challenges of the last 5 years has been to obtain the structural elements needed to stabilize the German real estate markets, e.g., different vehicles with a tailored product regulation. It has also been important to explain to the authorities the elements of the real estate financing system. Both the residential and the commercial sector are financed primarily by long-term mortgages with fixed interest rates, and they are refinanced via the well-established covered bonds—the Pfandbrief. It is of course important to design market regulations so that market volatility remains low without jeopardizing the efficiency of real estate markets. The ZIA facilitates an intensive discussion with all relevant parties, in order to achieve both efficient and effective real estate market regulation, e.g., the Alternative Investment Fund Managers Directive and its implementation as German national law via the "Kapitalanlagengesetzbuch."

The real estate sector also plays an important role in achieving the ambitious aim of increasing energy efficiency. ZIA members are aware of their key role here and attempt to find ways to reduce the carbon emission of buildings. But again—an investor-friendly, i.e., an incentive-based, framework is crucial for achieving this goal cost-efficiently. More recently, the industry has started to respond to the digital revolution and advances in sustainability practices. Even more important is the need to provide affordable housing, and also here, the industry has reacted adequately to market developments and is ready to tackle the current challenges. This applies particularly to the need to provide sustainable shelter for refugees. I am convinced that the German real estate industry will find reasonable solutions—a stable and reliable market environment is important, in order to promote market-oriented but socially relevant investment projects.

Today, the German real estate industry and its players are stronger than 10 or 20 years ago and are also more transparent and more professional. I doubt that this process will end any time soon. The German real estate market has woken up, and we look forward to closer cooperation with foreign players as well.

With this book, the authors' main aim is to describe the broader framework for investments in Germany. I wish you pleasant reading.

Zentraler Immobilien Ausschuss (German Property Federation)
Berlin, Germany

Andreas Mattner

Foreword (1st edition)

The German economy is the largest in Europe and ranks fourth in the world. Property values in Germany reflect that importance; net fixed assets currently amount to approximately 8 trillion euros, of which approximately 60 % is residential property, 25 % commercial, and 15 % public real estate and infrastructural construction. This market size ensures liquidity, market access, and importance to investors, analysts, and university graduates.

I am convinced that international investors, project developers, financial auditors, bankers, lawyers, tax experts, and, last but not least, scientists find it exciting to study German real estate markets, as they are unique in some respects and have changed considerably during the last two decades. At the forefront of this change was the German reunification, which led to investments in trillions of euros. Within 10 years, the real estate markets in the New Länder (the former East Germany) were integrated into the free market economy system of the Old Länder (West Germany). This rather difficult integration process is still continuing and will continue to have an impact on future developments, e.g., the ongoing decline in the number of residents in eastern Germany. The experiences gained from changes in the German real estate sector are of interest to various regions in Europe and throughout the world, where countries will be facing similar demographic problems in the next few decades.

It is important to point out that the property markets in Germany were able to escape the problems that affected many other markets in industrialized and nonindustrialized countries before and after the financial crisis. Many people within and beyond Germany wondered about the stability of the German real estate sector. Specifically, what were the reasons for this stability, and is it possible to derive conclusions for other property market regulations from them? Investors may ask whether the unique development of the German property markets could present a good opportunity to commit financially to this sector. As I have mentioned, it is indeed worthwhile to deal with and invest in German real estate markets.

I would like to draw your attention to another fact: many building standards in Germany are considered to be pioneering. Moreover, in terms of energy efficiency, German real estate is considered to be of the highest standard, not only for a small group at the top but also for a broad mass market segment. Such is the case, despite the fact that the German Certificate for Sustainable Construction was established only recently. It is also true that properties in Germany still have huge potential for energy-efficient upgrading, which will result in billions of euros in investment in the hope that the renovation of buildings will be an appropriate response to the challenges of climate change. I believe we can also learn from the experiences that Germans have gained and will still gain in this area.

The characteristics of the German real estate markets, however, have yet to be fully described. Investors must deal with special tax regulations. A look at various asset classes can be surprising; although REITs were installed in Germany in 2007, this segment is still small. Open-ended and closed-ended property funds suffer from serious problems. The global convergence of investment vehicles is slower than expected, which is why specific national approaches still need to be taken seriously.

This book covers a wide range of topics, as there are economic as well as real estate, legal, and tax characteristics. To deal with all these properly, extensive expertise is required. The two editors have commissioned knowledgeable authors for the various topics. I do not know of another English-language publication that provides such a profound and simultaneously entertaining overview of German real estate markets.

The book, of course, is mainly addressed to readers abroad, especially to investors, finance and valuation companies, developers, and consulting firms. In addition, the book contains numerous new facts that domestic market players, and especially students, may find highly rewarding. Those looking for a quick introduction to German real estate market issues will find answers not only to important questions but also to questions that have not yet been raised.

Last but not least, I hope that all of you will enjoy reading the book.

HonRICS Karl-Werner Schulte
Geisenheim, Germany

Acknowledgments

A second edition of a book calls for a justification. Has the world changed that rapidly since the first edition? Were there flaws in the first version? Did we omit important issues? In our case, the world has indeed changed quickly. The deep recession of 2009 forced interest rates in Europe to historical lows. Germany has gained importance as safe haven for many international investors, and what is more, many traditional bond investors feel compelled to invest in alternative investments. Real estate is seen as the biggest alternative asset class. Accordingly, this second volume also targets readers who are not yet familiar with real estate markets, but rather with capital markets. Finally, the legislator has changed the regulatory framework for direct and indirect investments since our first edition, and this required updates of many of our chapters.

We would like to thank our authors for having again dedicated themselves to the project, despite their enormous workload. The year 2015 has been one of the strongest real estate years ever in Germany. And still, both academics and professionals were happy to contribute—almost always just in time.

Furthermore, we would like to thank those who often remain unmentioned, even though they enable such projects in the first place: Philipp Schäfer, who reliably supported us and was in charge of formatting this edition. He mastered this task with accuracy and passion. We are also grateful to the colleagues at Springer, who again guided us professionally through the second round.

Finally, of course, we thank you, dear reader, now holding this book in your hands, for having been our real inspiration. Without you, we would have never have written it. We would be delighted if you find the book interesting and use it as a starting point for a study of German real estate markets. Perhaps the book will also allow for more rapid networking with market players. We look forward to new ideas and stimuli from you.

Tobias Just
Wolfgang Maennig

Contents

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