In discussion with REFIRE: Curth Flatow of Flatow Advisory, Berlin

REFIRE sat down in his Berlin offices recently with Curth Flatow, the managing partner of Flatow Advisory Partners, an independent real estate finance consultancy founded in 2005 which specialises in debt financing, restructuring and equity financing for German real estate. Flatow had attracted our attention a while ago with his assertion that there is no real credit crunch for German property financing, but rather that while the framework has changed, debt financing was poised to become available from other sources. We simply had to find out more. Some excerpts from our discussion:

REFIRE: *What's the background to the shift in financing that we're witnessing?*

Flatow: Commercial real estate financing in Germany is still dominated by the classical mortgage banks and the large Landesbanken. However, in view of changed market conditions with Solvency II, the financing of real estate and project developments has become interesting for insurance companies and occupational and other pension funds, since relatively less capital has to be committed than in the case of direct or indirect real estate investment.

Such institutional investors may also find it lucrative to provide third-party finance, or indeed to be joint venture equity partners in a development, as part of a strategy of diversification. The reason is clear - providing finance is a valid alternative to the hard graft of finding and investing in low-yielding 'core' property investments, while at the same time achieving a reasonable spread across asset classes and geographical locations, as well as asset managers and operators. It also allows for the allocation of resources into new and potentially interesting sub-categories.

And this is where you come in…

It's now possible for insurance companies and pension funds to position themselves as capital providers above the classical level of bank financing i.e. at a maximum LTV of 60%. Financing levels of 70% to 85% LTV can be sustainably made, since it's only superficially that real estate risk on assets with more than 70% leverage is too high. For example, financing 85% of the current LTV of the market value risk is still less (at a theoretical risk buffer of 15%) than investing directly in the same property, if the insurance company or pension fund is paying 100% of the current market value.

So why isn't everybody jumping in to fill the gap?

Well, because of the lack of know-how in commercial property markets, most players have still been shying away from really developing a property financing strategy, and still tend to orientate themselves around the traditional bank models. With the result that the insurers and pension funds remain fixated on the conservative primary financing of 'core' properties when providing financing – at a maximum lending ceiling of 60%.

We've already seen several of these deals on the German market. But they are not the solution for non-core, value-added or management-intensive assets or project developments. Finding loans for these assets takes a great deal more time, and requires delivering far more information to potential lenders – often in vain.

This is a pity, since it means that many builders and developers who are being refused financing by the banks for all the obvious reasons, are all dependent on the handful of pioneers in the market for their finance. This is where the bulk of the insurance companies and pension funds are NOT to be found – nor are they out there providing mezzanine finance or subordinated lending for commercial property. They don't have the knowledge, competencies or personnel – and are, in most cases, blocked off from access to the market in any event since they lack connections in what is a specialised market.

What should potential new capital providers do about this?

These deficits can be overcome without having to build up unwieldy new structures by working with suitable partners. For example, it could be handled in parallel with the traditional business of investing directly in property or indirectly through funds, where institutional investors likewise don't have to develop their own in-house teams (for asset management, for example), but buy in third-party expertise. There is a lot of potential here, which could provide a big boost to the commercial property financing sector. It just has to be tapped.

Are these financing sources just targeted at new projects?

...from Page 20

No - given the level of investment over the boom years in Germany, and with many of those investors now having to find new capital, refinancing activities have become much more prominent over the last 18 months. Companies needing restructuring or recapitalisation are faced with much harsher conditions than back then when rolling over loans. The number of these difficult situations is set to soar over the next 2-3 years as we hit the debt financing bottleneck in earnest.

National banks in Europe are withdrawing from overseas adventures – how is this affecting local financing here ?

We are obviously in contact with plenty of international banks who are now keen to offload their German loan portfolios, both performing and non-performing, as they pull back from the market. Frequently, they're still here because they can't yet get potential buyers to pay the prices they're looking for. At some point they will have to clear their balance sheets, but so far optimism is still holding sway. Many are still holding out hoping to sell at better prices.

Most of your clients are international – where's the money coming from right now?

We're seeing a lot of Asian capital and capital from the Middle East coming in, via London, to look for opportunities. Some of these are core investors, others value-added, looking for distressed situations. Others are debt financiers looking for more exotic opportunities further along the risk spectrum. During the boom years, for example, one of the best exit strategies for financiers was securitisations. Although this market is dead right now, should it come back – which we expect it will in the medium-term – this will provide tremendous refinancing opportunities. END

Germany/Listed Companies

Higher apartment sales boost Patrizia Immobilien revenues, opens London office

The listed Augsburg-based property investor, trader and fund manager **Patrizia Immobilien AG** saw sales figures for its own investments 33% above the corresponding figures for last year, largely due to a higher number of apartments sold on its own account. The company also saw its first sales of residential property from a residential co-investment, an increasingly significant part of its business model.

Patrizia has been increasingly internationalising its business over the past three years and repositioning itself as a fund manager and co-investor, and moving beyond its traditional business of buying and selling residential property on its own account and largely in its own Bavarian heartland. Earlier this