German Property Breakfast: ABBA strategies still secondary as Berlin, Big 7 keep core appeal

PIE's Germany Property Breakfast on 11 February in London brought six experts together to discuss the theme: With core-prime prices high, is it time to look for ABBA values outside the big seven cities? Held at the London offices of law firm Mayer Brown, PIE welcomed (left to right) James Bauer, managing director at REAG Germany, based in Frankfurt; Sönke Ezell, senior manager at Corpus Sireo, based in Frankfurt; Curth-C. Flatow, managing partner at Flatow Advisory Partners, based in Berlin; Frank Steffen, senior director international clients, Germany, at pbb Deutsche Pfandbriefbank, based in Munich; Sven Stricker, managing director at BNP Paribas Real Estate, based in Berlin; and Anna Zabrodzka, Central and Eastern Europe economist at Moody's Analytics, based in Prague.

Core Germany still well priced despite demand surge

Investors need massive firepower to compete in deals in Germany's largest cities against wealthy international groups but can still find attractively priced investments even if foreigners are now taking half of all deals, PIE's Germany Property Breakfast heard last month.

"If you are coming into Germany looking for core assets, you are going to need a big money bag because the investments are €100m upwards. If you have just €80m you won't get far," James Bauer, MD at REAG Germany. Last year was a busy one for German real estate with prices and appetite going back to pre-crisis levels. Some €4bn of investment came from Asia, with overseas capital accounting for around 50% of all activity, Sven Stricker, MD at BNP Paribas Real Estate Germany said. That marks a change for a market in which domestic investors have traditionally dominated. "The appetite is stronger than it was 12 months ago," Stricker added.

The weight of capital and drive to invest is naturally pushing yields lower. Where investors might have expected to pay between 4.5% and 5% for a top property in a top city a year ago, yields are below 4.5% in some cases, Bauer said. But while those levels may make core property purchases appear expensive, deals are still attractively priced, the panel argued. "Core assets may look expensive but are a good investment if you look into other asset classes. German bunds for examples are yielding virtually zero," Frank Steffen, senior director for international clients in Germany at pbb Deutsche Pfandbriefbank. Similarly core German assets compare favourably with other European hot spots. "German property, especially core property is getting really expensive, but you need to look at it as relative. For example, the UK and France are more expensive than Germany," Sönke Ezell, senior manager at Corpus Sireo said.

For those who find core asset pricing too rich, there are alternatives, however. Curth Flatow, managing partner at Flatow AdvisoryPartners is seeing investors arrive who are looking for debt investments.

"Yes, there is yield compression and people are moving out to A locations in B cities," he added. Some clients have bought retail in smaller cities at yields of up to 10%, he added.

While many investors remain positive about Germany's position as the powerhouse economy on continental Europe, concerns are growing about the health of the euro zone and the potential impact of a Greek exit from the currency union. "We saw very strong growth at the beginning of last year, but unfortunately it has slowed down mainly because of external factors. It very much depends on what's going to happen in Europe in general and how that impacts the German economy," Anna Zabrodzka, Central and Eastern Europe economist at Moody's Analytics said. "Still the main cities, the big seven, are going to drive the economic development in Germany." ■ **pie**

Foreign investors lack knowledge for ABBA moves

Germany's economic strength acts as a significant draw to foreign investors, and Moody's analytics is expecting GDP growth of 1.3%-1.4% this year, with the weaker euro boosting exports still further.

"There are a lot of interesting Tier 2, smaller metropolitan areas that are developing very strongly, sometimes surpassing economic growth in the likes of Munich or Hamburg," Zabrodzka told the Breakfast. Most are in the south of the country, where manufacturing, logistics and research and development, are driving local economies. However, the northern part of the country is catching up thanks to new sector expertise such as healthcare in Munster.

While these areas are attractive, they are unlikely to draw large Asian institutions any time soon, Stricker added. "If you are an Asian investor and you have decided to spend €1bn in Germany and you start with B cities, then good luck, it will take 10 years." Only large shopping centres closer to smaller cities can allow investors to put large sums of capital over €500m to work, and even then, such locations present a challenge to Asian investors who know relatively little about the market, and even less about B locations.

Ezell commented: "I was with an investor team from Singapore. They are asking really basic questions. Why should we invest in Germany? Why do investors sell these assets?" Those investor teams also need to present their findings to investment committees that know only the core cities. "How do you convince them to invest in Aachen for example?" Corpus Sireo is putting together a fund for investors to access deals in smaller cities, and also operates separate mandates for its clients looking for that exposure. ■ **pie**

Capital flowing to Berlin housing, retail; but office risky

Investors are not yet flooding smaller cities looking for deals, the panel agreed. One reason is the German capital. Berlin is pulling in new inhabitants and new companies fast, building a reputation as a tech centre for new, future-oriented enterprises.

BNP Paribas Real Estate's Sven Stricker (top left) told the Breakfast that Asian inflows are changing the German market, previously dominated by domestic firms. Sönke Ezell, senior manager at Corpus Sireo (top right), said core property may be expensive but it is still priced below the UK and France. Frank Steffen from pbb Deutsche Pfandbriefbank (above) said LTVs are being extended above 70% but he does not see much appetite beyond that.

Anna Zabrodzka, CEE economist at Moody's Analytics (top), said a lot of smaller German metropolitan areas are developing strongly, surpassing growth in Munich or Hamburg. James Bauer of REAG Germany (centre), said that for a top property in a top city now the weight of capital and drive to invest is pushing yields below 4.5%. Flatow Advisory Partners' Founder Curth-C. Flatow (above) said financing is available for B locations so long as there is ongoing cash-flow.

"Berlin is seen as a hip city among younger people and that's what is driving them to the city – 40,000-50,000 a year for the last couple years," Bauer told the Breakfast. Those people are drawn by its emerging technology reputation, cemented by groups like Rocket Internet. Stricker added: "Everyone is talking about Berlin. It's a very good story. The development of Berlin market is incredible." The vacancy rate of more than 10% over a decade ago has halved to 600,000 sq.m. And the influx of people is having a direct impact on residential demand, Bauer noted. "A couple of years ago, no one would buy condos, but now they are fetching top prices." New districts like Mediaspree on the banks of Berlin's Spree River are springing up, with homes, offices, retail and leisure in abundance.

Lending to projects and investments is following. Pbb Deutsche Pfandbriefbank opened an office in Berlin two years ago and provided €50m in financing to fund manager Tristan for its recent Neukölln Arcaden deal. However Steffen does not see equal attractions in all sectors. "On office I am a little more reserved. There are still no tax companies located in Berlin. Let's see how sustainable all that start-up business is going to be." Ezell agreed: "In Berlin, you already have anticipated prices. Investors pay high prices but the development of these sub-markets needs to be established."

For those thinking that money can be made from office development in the fast-growing city, there could be disappointment, Flatow warned. Rents are low and growing slowly, while costs are soaring. "It is very hard to find building land for a reasonable price and construction costs have increased," he said. "So you have to question: what's the relation to the potential exit price or the potential rent?" In fact, despite all its recent bustle, Berlin's economic convergence with Germany's other major cities that started with reunification all but stopped when the financial crisis hit.

However, Zabrodzka noted that the German capital, coming out of its history within a Communist bloc, is a special case. It is starting from a point well behind other western German conurbations. "In order for Berlin to catch up in terms of economic development or even prices in the next 10-15 years, the growth will have to be two-to-three fold what it is now," she said. ■ **pie**

Asset mgt is key to securing debt for ABBA strategies

Although investors might not be ready to flood into all cities or indeed all investment sectors, debt is increasingly available on attractive terms for whatever they might want to buy, even in A locations in B cities or B locations in A cities, the Breakfast heard.

Flatow's firm arranged financing for a residential portfolio deal comprising 60 homes in smaller towns across northern Germany in December. The borrower secured senior debt for 85% of the purchase price at a margin of 160bp above Euribor, he said. "This is an exception because the market is still much lower. But you can see where there is ongoing cash-flow in a B location, there is also financing available," he said.

"Lending is very dependent on asset type," Steffen said. "LTVs are already being extended slightly above 70%, but I don't think there is appetite for LTV much above that." Crucially, pbb is prepared to lend up to that level on prime offices in B cities, or secondary locations in top tier cities. That could mean retail deals in smaller cities, or undermanaged offices in fringe locations in top cities. "We really focus on who is the local partner and who will manage these assets. There is much more focus on the asset management and how the plan can be implemented, if there sufficient money to invest capex," Steffen added.

Having the right asset management partner is something buyers need to consider carefully, Bauer added. It applies to international groups without staff on the ground looking to enter the market, as well as domestic buyers hoping to protect their capital with well-selected small prime assets on city centre streets that might yield under 3%. "It's not a stock certificate that you put in the closet and pull out ten years later. It might be empty and you might need to put some more money into it. You need good asset management skills to keep that level of return you are looking at." ■ **pie**