Analysis of Different Dimensions for Property Allocation Process within Real Estate Investment Companies

Author: Christian Steinke
Supervisor: Björn Berggren
# Master Thesis

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Christian Steinke  
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Abstract

Property companies are offering a range of financial vehicles (indirect investments) which enable investors to participate in cash-flows of voluminous properties or real estate portfolios. Effective indirect real estate investments generally consist of three main components, which ought to be synchronized:

Demands of investors - property characteristics - investment vehicle

However, in practice this synchronization (allocation process) turns out to be way more complex and sophisticated. The question regarding the utilization of properties within real estate investment companies is embedded in superordinate dimensions like the overall corporate strategy, which is in turn embedded in an overall economical and political environment.

The purpose of the thesis at hand is to give some insights what factors and dimensions should be considered in order to implement a thoughtful allocation process. The author bases his qualitative analysis on his work experiences in two major German property companies. In this connection the author conducted several interviews with employees of different departments (e.g. Corporate Development, Controlling). Furthermore, the author’s purpose is to transfer the complex practical approach into a well-structured and clearly organized framework which presents the most important dimensions and factors and in turn have an impact on the allocation process. The thesis concludes with an outlook for the overall German economy and in particular the market for indirect real estate investments which will be followed by an emphasis of the most important factors regarding company’s property allocation process in the near future.
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My sincere thanks go also to Lars Silver and especially Björn Berggren who supported me as my supervisors at the Royal Institute of Technology (Kungliga Tekniska Högskolan). Their guidance, encouragement and insightful comments helped me throughout my thesis.
1. Introduction

1.1. Background

Indirect real estate investment vehicles enable investors to participate in cash-flows of voluminous properties or real estate portfolios, which they either cannot or will not afford in a directly way. Over the years the asset class of indirect investments experienced many structural changes and complementing product innovations in order to meet the needs of a high diverse range of investors and to adjust to a varying economical environment. Today there are two main vehicles: shares of listed companies and shares in funds. With these instruments not only does the investor take a position in the real estate market, he/she also acquires different risk-return structures, which are varying according to the characteristics of the underlying asset (property). Effective indirect real estate investments generally consist of three main components, which ought to be synchronized:

Demands of investors - property characteristics - investment vehicle

My initial idea regarding the subject of a master thesis was to scrutinize the suitability of properties’ characteristics to the different investment vehicles (“What kind of property is suitable for which vehicle?”). However, especially in the case of major listed companies which are actually offering a range of indirect vehicles many other factors come into play (Morawski, Rehkugler & Füss, 2008). Furthermore, on principle all different real estate investment vehicles are in the pursuit of properties with similar characteristics given an analogue risk-return profile (e.g. core products) so that the initial idea would consist of a rather trivial analysis. The harmonization of the fore mentioned three components (“allocation process”) is embedded in superordinate dimensions like the overall corporate strategy, which is in turn embedded in an overall economical and political environment. In this context for instance legislator reacted on the effects caused by late 2000s financial crisis and initiated a change which influences the overall economical and political dimension. Based on that investment companies may reconsider their overall corporate strategy and will eventually conduct changes on the fundamental level of product-investor matching. The entire process of property allocation turns out to be a very complex procedure consisting of different dimensions which all have to be taken into considerations. The revised idea of the following master thesis will present an analysis of the different dimensions and influencing parameters which have an impact on the basic allocation process of properties for real estate investment companies.
1.2. Purpose

The purpose of the thesis at hand is to give some insights what factors and dimensions should be considered in order to implement a thoughtful allocation process. In practice this is a sophisticated and comprehensive framework consisting of an interplay between many different dimensions and factors. Especially for listed property companies who have a range of possibilities in utilization of properties (REIT, closed-end and open-end funds, own investment, short- or long-term self management and so forth) it is important to consider the different influencing factors within the decision making process for the property allocation. The author’s purpose is to provide a well-structured and clearly organized framework presenting the most important dimensions and factors which have an impact on the allocation process.

1.3. Limitations

Due to countless country-specific peculiarities of the vehicles and the respective markets the author focuses on the German market. However, the thesis tries to cover many different dimensions and factors which have an influence on companies’ decision making process regarding property utilization, it is still just reflecting a summary of the practiced approach. Furthermore, the qualitative analysis is based on experiences within just two German major property companies, which also may just reflect an incomplete picture of the German market of real estate investment companies.

1.4. Outline

After a basic introduction of real estate investments and a brief presentation of the German market of indirect real estate investments a qualitative analysis is followed. Mainly based on experiences and interviews in three German major real estate companies for indirect investments, the author presents a qualitative analysis about the different angles and dimensions as well as the most important influencing factors on a property allocation process against the background of various investment vehicles. Thereupon the thesis takes a closer look at practical implementations of allocation process in real estate companies. Finally the author will present an overall economical outlook complemented by the view on the German market of indirect real estate markets.
2. Introduction of Real Estate Investments

For investors real estate investments are basically investments in buildings and land in order to obtain income - or even better - profit through rental cash-flows. Investors are mainly interested in **growth potential** regarding rents and property value (capital appreciation) as well as **portfolio diversification potential** and **inflation hedging** of their invested capital. Further considerations as favorable tax shelters, appealing interest or currency exchange rates and for the sake of completeness of course for self occupancy may be the basis for real estate investments. Exposure to the real estate investment markets can be attained through two general types – direct (physical) and indirect (securitized or financial).

2.1. Direct Investments

Direct real estate investments imply the acquisition and management of physical properties. The benefits of including property investments in an investor’s mixed-asset portfolio are undisputed and well documented (see Miller & Geltner, 2005 and Hoesli & MacGregor, 2008). Especially the fact that property returns generally have just a low correlation with other asset returns like for instance stocks or bonds represents risk diversification potential and therefore one essential benefit for investors. Further research analyzed and underlined also the diversification potential of cross-country real estate investments (Eichholtz 1996; Sirmans & Worzala 2003 (1); Hoesli, Lekander & Witkiewicz 2004).

However, direct real estate investments come at a cost. In particular the combination of a large lot size (capital intensive investments), high transaction costs, and the illiquidity of direct investments (absence of exchange traded market place) contain unsystematic risks and therefore diversification is just a limited hedge for investors (Hoesli & Lekander, 2008). Besides, direct real estate investments are management intensive over the whole property cycle, which is demanding expertise regarding a range of fields from the investors (ibid.).

Due to a lack of frequent transaction data real estate marketplaces generally have just a low transparency which induces information asymmetries between the market participants (Georgiev et al., 2003). This circumstance complicates the investor’s analysis of return distributions which makes the use of appraisal-based series necessary (ibid.). This in turn
increases uncertainty\(^1\) about returns and property values along the investors. All these aspects are even further reinforced considering transnational investments, since different market practices, laws, taxation, currency and inflation rates, and cultures must be considered (Hoesli & Lekander, 2008). However, measurement issues, market opacity, and other aspects of uncertainty affecting both direct and indirect real estate investments, combined with the above mentioned drawbacks (large lot size, high transaction costs, and illiquidity) especially direct real estate investments become a very risky business for investors. Let alone the required capital volume of direct investments which simply keeps out most of private investors of real estate markets.

2.2. Indirect Investment

There are multiple routes of indirect investments that investors can follow in order to partly overcome the above mentioned obstacles of direct investments and therefore improve risk-return structures. Or enable private investors to participate in real estate investment markets at all. Besides property derivatives (Swaps, Futures) and debt instrument (CMBS, CDOs), which will not be considered any further, main entities tend to be divided into two large groups (Suárez & Vassallo, 2005):

1) Listed real estate companies
2) Non-listed collective vehicles and funds

2.2.1. Public Real Estate Companies

Listed real estate corporations have real estate investments and other property related activities as their main business purpose. They function as an intermediary, transforming direct ownership of properties into share ownership, thereby provide investors a vehicle that is easier to manage, and feed them with aggregate and easily analyzable information. (Morawski, Rehkugler & Füss, 2008). These shares are traded on stock exchanges where prices are determined daily by current supply and demand. However, the fundamental value driver is still the performance of the underlying properties other components like management know-how, corporate strategy, non-core business activities (besides real estate), economical and political environment have an impact on the share price and thereby on the value of the company (ibid.).

\(^1\) Main problems of appraisal-based return series are the inherent artificially seasonality, lack of objectivity, and smoothed volatility (see Georgiev et al., 2003)
Within this framework one fundamental research question is: What are real estate stocks? Do they represent rather the stock or the real estate market? In the former case the intended diversification through investment in real estate markets may be limited. A paper by Sirman & Worzala (2003 (2)) summarizes various findings of studies about the benefits of diversification using real estate stocks within an international context. This literature review covers papers from 1991 - 2002 and almost all of the studies come to the conclusion that diversification benefits are possible but are often reduced if currency risks are considered within the analysis. Morawski et al. highlighted that the answer to the fore mentioned question is highly dependent on the investment horizon. With the focus on markets in the USA and UK short-term (daily to one year) investments in real estate stocks cannot truly be considered as real estate investments. However, for long-term investment horizons, the interdependence between direct and indirect real estate is much stronger (Morawski, Rehkugler & Füss, 2008). Other research works emphasize that diversification power is time-varying for different real estate vehicles (REITs, stocks, funds) explained by macroeconomic variables (Fei et al., 2008). Another crucial aspect for shareholders is that most listed real estate corporations are subject to corporate income tax and engage in costly and time-consuming activities that minimize their exposure to that tax (NAREIT: Tax Transparency). Thus profits are first taxed at the corporate level and once again at the individual tax rate of the investor, which affect will influence return distribution in an unfavorable way. Serrano & Hoesli stated that tax transparency\(^2\) is likely to lead real estate securities to behave more like the underlying real estate assets (Serrano & Hoesli, 2010).

Even if possessing shares of real estate companies prevents investors from most risks accompanied with direct investments, the main aim of investing in real estate markets - diversification potential - may be threatened, if among others above-mentioned aspects will not be considered.

2.2.1.1. Real Estate Investment Trusts (REITs)

Speaking of tax transparency automatically leads to a special form of a listed real estate company. The Real Estate Investment Trust (REIT). Most common REITs (equity REITs) are companies that mainly own, and in most cases, operate income-producing real estate such as apartments, shopping centers, offices, hotels and warehouses (NAREIT: What is a REIT?).

\(^2\) see Glossary
Mortgage REITs mostly lend money directly to real estate owners and operators or extend credit indirectly through the acquisition of loans or mortgage-backed securities. The shares of many REITs are traded on major stock exchanges (ibid.). However, the REIT status is tied to particular (country-specific) requirements like for instance dividend distribution, shareholder allocation, and income origin. In return corporate income taxes are reduced or eliminated for REITs in contrary to regular listed companies. Although REITs had already been issued in America in the 1960s, only several improvements of taxation and regulations turned REITs into one of the major investment vehicles in the 1990s (Chen et al., 2011). In 1995, REITs were only present in six countries, but by 2007, over 30 countries had introduced REIT vehicles and several others considering the implementation (Serrano & Hoesli, 2010). There are two general perspectives on REITs. On the one hand as an investment vehicle which complete the investment spectrum for private and institutional investors, second, REITs as a tool for companies to place their real estate properties at the stock market in order to unleash tied-up capital (hidden assets). In his book “Investing in REITs” Ralph Block pointed out that especially REITs offer diversification potential for investors due to its low correlation with other investment peers like share indices as S&P 500 (Block, 2006).

2.2.2. Funds Participation

Real estate investment funds are non investment institutions which differ depending on type and number of investor; public or private (Suárez & Vassalo, 2005). Another distinction is between closed-end funds, which have a limited life, in contrast to open-end funds, which are always open to further investments, so that their assets increase and decrease over time (ibid.).

2.2.2.1. Closed-end property funds (CEPFs)

Closed-end funds in general come in many varieties. They can have different investment objectives, strategies, and investment portfolios. They also can be subject to different risks, volatility, and fees and expenses (SEC). Closed-end property funds (which can be considered as specific German vehicle) are business partnerships which invest generally in a small portfolio consisting of just few, often just one property with an a priori given investment volume. Except for so called “Blind Pools” the properties are acquired in advance and are transferred to a specifically created fund company. After the conception and market launch of the fund shares there will be a limited period of time for equity financing, this will repay the

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3 Due to country-specific peculiarities following information are already mainly based on German property funds.
bridging financing by the fund issuing house. Once the required equity is deposited the fund will close. In case of lacking required equity within the determined period fund issuer often guarantee to fill up in order to secure the investment product. Additional to the limited time of financing the fund itself has a limited time as well, which requires an exit strategy for certain future points in time. Normally the planning horizon for CEPF covers 7-20 years; thereby it is principally the investment vehicle with the longest investment period. Theoretically the shares are relatively liquid on secondary markets (Cherkes, 2009); however, in practice a secondary market is the platform for selling poor performing shares. Resale of CEPFs shares is also an option in case of hardship like unemployment or inability to work. In that case investors have the chance to trade their shares often at considerable discounts on secondary market. The fund issuer is responsible for the property selection, cash flow prognosis, authoring sales brochure and later on fund management. Other tasks are often transferred to third service provider like for instance the share distribution, property and facility management. To simplify administration matters for hundreds of investors fund issuer often insert trustees as intermediaries. CEPFs have high upfront costs (legal costs, agency fees, marketing costs) which requires a critical investment volume in order to eventually amortize these costs. The minimum subscription for closed-end funds are in practice usually €5,000 - €50,000, the total volume of equity usually lies between €2.5 and €300 million. Thus, the vehicle has the largest minimum capital lot size and at the same time displays minimal risk spreading due to its rather small portfolio. Due to its long-term planning horizon the prognosis displaying future cash flows can be shaky and inaccurate. To compensate investors for these weaknesses CEPFs offer high tax advantages, which in turn often requires complex fund constructions in order to meet various requests by tax legislation.

**Figure 1: Exemplary conception of closed-end property funds**

![Conception of closed-end property funds](image)

Source: German Association Closed-end Funds (“VGF”)
2.2.2.2. Open-end property funds (OEPFs)

The basic idea of an open-end property fund is similar to listed real estate companies. Both types of these securitized investments pool money by selling shares to many investors and invest it into a portfolio of income-producing properties (Maurer, 2004). However, their institutional design is quite different. In Germany OEPFs are regulated by a comprehensive legal framework codified in the Investment Companies Act, and supervised by the Federal Financial Supervisory Authority (ibid.). This is also the most important aspect contrary to CEPFs, since CEPFs belong to the part of the financial markets, which is not subject to state supervision or any similar financial regulations.

**Figure 2: Exemplary conception of open-end property funds**

![Basic conception of open-end property funds](image)

Source: Economical Encyclopedia

While investing in OEPFs investors bring in their money in the so-called separate estate, managed by an investment company, which in turn may be operated only in the legal form of a joint stock company or a limited liability company (Maurer, 2004). The investment company is responsible for the overall management of the fund including primarily acquisition, development and sell of the properties. Furthermore, it is in charge for tenancy, property and facility management, marketing and research, which are also often transferred to third service provider. According to the Investment Companies Act a custodian bank must be entrusted to handle the entire fund related payments through separate accounts. A supervisory board, which monitors the board of management on behalf of the investors, has to be implemented anyway, since it is a statutory requirement for joint stock company or a limited liability company. Finally, OEPFs are obliged to assign a professional committee of experts to
evaluate each property on an annual rolling basis. Further regulations including risk diversification of properties, minimum liquidity reserve, and restriction on financial leverage create a more conservative risk-return structure by law. Besides, investors have the right to give shares back, which makes the investment theoretical as liquid as stocks and bonds, which in turn makes a secondary market not essentially important (Focke, 2006). In that sense the number of units and therefore the funds’ volumes change, as the funds are continually enable to both sell new shares to investors and to redeem old shares on demand from these (Maurer, 2004). In general German OEPFs differ between public property funds (“Publikumfonds”) and special property funds (“Spezialfonds”).

2.2.2.3. Special Property Funds

In Germany, apart from public open-end real estate funds also special property funds exist, which are designated for a small limited number of institutional investors which must be legal personalities (Bannier et al., 2007). So contrary to regular public OEPFs, which are accessible for every investor (among private and institutional investors), institutional funds are tailor-made to particular needs and preferences of its clients. These special funds are usually managed by the same investment companies that offer also public open-end property funds.

Main target group consists of insurance companies, pension funds, and industrial corporations who seek long-term investments that come with attractive risk-return structures satisfying specific investment preferences. Usually the equity capital of a given institutional real estate fund must amount a critical size of three-digit million euro. There are two different investment options to choose from: *Pool funds* - *Individual funds*

The term “pool fund” refers to an open-end institutional real estate fund whose share certificates are held by several investors who jointly define the investment strategy in cooperation with funds specialists. Institutional investors also have the option to invest in real estate according to individual investment criteria. Investors can define the investment strategy and target of the fund in a way that reflects their individual objectives. Another variant of special real estate funds for institutional investors are *transfer funds*. Similar to REITs these bring the option to transfer real estate properties into a special real estate fund. The idea is again to release internal resources previously tied up in the real estate management, and simultaneously to let the investor benefit from the know-how of the funds management company.
Figure 3 gives a first impression of the volume and performance of German special property funds based on a survey by IPD (Investment Property Databank). The performance study looks at the assets and returns of 120 special funds within 2006-2009. The survey’s coverage of Germany’s overall equity assets of special funds is approximately 62% for 2009. That depicts an overall size of approximately € 25 billion with respect to the fund’s equity assets of all special property funds in Germany. The performance study by IPD is the only available structured evaluation of individual fund managers.

**Figure 3: Survey of 120 German Special Property Funds 2006-2009**

<table>
<thead>
<tr>
<th></th>
<th>Equity fund assets in € billion</th>
<th>Total fund assets in € billion</th>
<th>Ø return</th>
<th>Ø growth rate equity fund assets</th>
</tr>
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<tbody>
<tr>
<td>2006</td>
<td>17,71</td>
<td>22,12</td>
<td>4,39 %</td>
<td>-</td>
</tr>
<tr>
<td>2007</td>
<td>19,74</td>
<td>24,10</td>
<td>5,83 %</td>
<td>11,46 %</td>
</tr>
<tr>
<td>2008</td>
<td>20,22</td>
<td>24,47</td>
<td>4,84 %</td>
<td>2,43 %</td>
</tr>
<tr>
<td>2009</td>
<td>15,47</td>
<td>19,29</td>
<td>2,90 %</td>
<td>-23,49 %</td>
</tr>
</tbody>
</table>

Source: Investment Property Databank GmbH; © IPD 2010

Figure 3 also shows unsurprisingly that fund assets of special property funds and so the market for indirect real estate investments were severely affected by the late-2000s financial crisis and so by the overall conditions on financial markets. The question is to what extent are the different vehicles affected by these macroeconomical circumstances and what other factors can have an impact. Against the background of property utilization within a corporate allocation process this becomes a crucial approach, since a thoughtful allocation can be protective and beneficial for the products and eventually for the company. Berry et al. explaining in a paper from 1999 the relationships between funds, public property companies, use of properties, the rental situation, and the according suitability for the different products (stock shares vs. shares of funds). As mentioned before the thoughtful selection of the underlying property and its according characteristics is the fundamental driver for the performance of both shares of funds and shares of listed companies. However, especially in the case of listed companies the influence of the underlying properties’ characteristics may be diluted, since many other factors come into play (Morawski, Rehkugler & Füss, 2008). Depending on the economical and political environment, form of enterprise, or further risk considerations, the allocation decision can deviate from the suggestions by Berry.
3. **German Market of Indirect Real Estate Investments**

The products and vehicles for indirect real estate investments are throughout the international markets differently designed and structured. As notified before all types of direct or indirect real estate investments have country related peculiarities regarding constitutional forms, taxation, legislation, and many other factors, which makes it impossible to consider all different kinds of local specifications. Since the qualitative analysis is based on the German market of indirect real estate investments, the author presents a brief introduction of the German market. All presented information and data are against the background of the recent financial crisis which causes an overall upheaval within the German market of indirect real estate investments.

3.1. **Volume and Distribution**

*Listed Companies*

Germany’s real estate market represents the largest property market in Europe. In 2009 the real estate industry had a turnover of approx. € 400 billion and was thereby the second biggest industry in Germany's economy (Real Estate Market Report Germany, 2009). Due to its investment volume and number of employees it is playing an important role in the overall economy, however, regarding liquid exchange-traded property investment vehicles the sector has been seen as underdeveloped compared to other European markets (Schacht & Wimschulte 2008). Since the turn of the century the list of quoted German property companies becomes longer, as each year all kinds of companies transform their real estate holdings into separate companies in order to go public. Based on the E&G DIMAX (stock index for German property companies) the German market currently consists of 75 listed property companies with a total market capitalization of approx. € 11billions (Ellwanger & Geiger, April 2011).

*CEPFs*

For German investors closed-end funds possess a strategic advantage to other investment vehicles as it is possible to pass on tax benefits to the investors within the categories of income rentals and royalties (Berry et al., 1999). In Germany tax driven CEPFs were very popular. Due to loss allocation mainly based on high debt financing CEPFs enabled investors to reduce tax liabilities for other sources of income within the category of rentals and royalties. However, after several tax reforms the function of loss allocation faded into the
background and the focus lies again on profit oriented funds which secure high yields from the very beginning.

The complete capture of statistics about the market for closed-end property funds in Germany is rather complicated, since these funds are not subject of any kind of state supervision and thereby represent parts of the grey market. Casually spoken everyone can issue a closed-end fund by just following a few requirements regarding the sales brochure, which is the only subject of state regulation. However, a large proportion of the providers of CEPFs in Germany are willing to improve the transparency and reputation as well as the seriousness of the industry. The German association of closed-end funds (“Verband Geschlossene Fonds”) represents the interests of most providers on the German market and serves thereby as a good reference point for the representation of the CEF market. Currently VGF represents 59 members, including 44 providers of closed funds and 15 supporting members. The 44 providers manage currently a total investment of around € 165 billion. This is more than 80 percent of Germany’s overall market for closed-end funds. In 2010 the association's members have set up a fund volume of approx. € 7.8 billion (approx. € 4.4 billion in CEPFs). Based on the total emission volume of € 10.8 billion this represents a share of more than 70 percent.

**Figure 4: Volume and Distribution Closed-End Property Funds Germany**

<table>
<thead>
<tr>
<th>Equity and assets under management including agio in million €</th>
<th>Domestic Properties</th>
<th>Foreign Properties</th>
<th>Total Volume CEPFs</th>
<th>Total Market Closed-End Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity placed in 2010</td>
<td>1 624,2</td>
<td>723,1</td>
<td>2 347,3</td>
<td>5 835,1</td>
</tr>
<tr>
<td>Equity placed in 2009</td>
<td>1 113,1</td>
<td>1 352,9</td>
<td>2 466,0</td>
<td>5 141,7</td>
</tr>
<tr>
<td>Δ</td>
<td>46 %</td>
<td>− 47 %</td>
<td>− 4,8 %</td>
<td>13 %</td>
</tr>
<tr>
<td>Funds Volume in 2010</td>
<td>3 057,5</td>
<td>1 332,4</td>
<td>4 389,9</td>
<td>10 800,3</td>
</tr>
<tr>
<td>Funds Volume in 2009</td>
<td>2 178,3</td>
<td>2 124,5</td>
<td>4 302,8</td>
<td>9 386,9</td>
</tr>
<tr>
<td>Δ</td>
<td>40 %</td>
<td>− 37 %</td>
<td>2,0 %</td>
<td>15 %</td>
</tr>
</tbody>
</table>

**Source:** Verband Geschlossene Fonds 2011 © VGF | [http://www.vgf-online.de/](http://www.vgf-online.de/)

Figure 4 shows two remarkable facts. First, the shift of capital flow from funds which invest in foreign countries to funds which invest in German markets. This probably reflects the risk
exposure connected to foreign investments (see 4.1.4. “Cross-Country Investments”). Secondly, that the market of closed-end property funds finally reached the bottom of the recession initiated by the recent financial crisis and found its way towards recovery. Against this background Figure 5 confirms this observation while displaying the development of CEPFs in Germany over the last 10 years distinguished by equity and debt financing.

**Figure 5: Development CEPFs in Germany last 10 years (in € billion)**

![Bar chart showing the development of CEPFs in Germany over the last 10 years](http://www.vgf-online.de/)

As other asset classes the industry of CEPFs draws hope and optimism based on a cleansing thunderstorm in the aftermath of the financial crisis. Investors will scrutinize new products and issued funds in a more deliberate way and thereby dubious and poor performing providers will be eventually pushed out the market. Furthermore, the industry anticipates again more trust in foreign markets and an increasing demand in funds consisting of properties located in countries outside of Germany like for instance Holland, Australia, USA, or UK (Financial Times Germany, February 2011).
**OEPFs**

While in many countries listed property companies are the prevailing type of securitized real estate investments, in the German market the major role is played by open-end property funds (Maurer, 2004). German open-end real estate funds were for 50 years consistently successful and in that sense a positive exception on international markets. Bannier et al. make unique features of the regulatory and institutional design of OEPFs in Germany responsible for that. Features like for instance the requirement to hold 5 - 50% of the overall assets in cash or the opportunity to delay the repurchase for two years in case of too much liquidity outflow (Bannier et al., 2007).

According to the IPD Performance Survey 54 funds have the legal form of a public (or “retail”) open-end property fund (mutual funds) with an aggregate net asset value of € 89.1 billion to the date of 30.06.2010. However, due to high minimum investment limits and other restrictions only approx. 24 funds represent an investment alternative for private investors. These funds disposing € 77.4 billion aggregate fund assets to the date of 30.06.2010 (IPD Performance Survey, 2010). The total transaction volume of German OEPFs in 2010 was € 10.9 billion (BVI, 2011).

After many years of net cash inflows and an overall increase in volume the asset class of OEPFs had to face a first crisis around the turn of the millennium, since alternative investments related to the strengthened stock markets outperformed property funds (IPD Performance Survey 2010). When the dot-com bubble burst investors turned back to the alleged more secure investment class of property funds. After another minor crisis in 2005 the asset class of OEPFs was severely hit by the overall financial crisis of the late 2000s. During 2007-2009 the strongest, both absolute and relative capital outflows in the 50-year history of real estate mutual funds occurred and with the consequence that more and more funds had to suspend the share redemptions due to liquidity problems (ibid.). A phenomenon which is comparable to bank runs resulting from long-term illiquid property investments in conjunction with short-term daily callable liabilities (Maurer, 2004). The executed liquidity transformation of funds exposes these vehicles to substantial liquidity risk and makes them susceptible to liquidity crisis (Bannier et al.). Out of initially ca. three dozen German OEPFs one by one suspend the redemption of share units. Until now eleven funds have been frozen, and another three are in resolution, others have been fused. By today 13 out of the 24 most important private OEPFs are closed and three are already in liquidation.
Figure 6: Volume of important OEPFs which temporarily suspending redemptions
(October 2010, € billion)

The OEPFs Morgan Stanley P2 Value, Degi Europa, and KanAm US-Grundinvest are currently already in the process of liquidation, since these funds were not able to re-open the fund for redemption after they delayed the repurchase of shares already for two years. Since October 2010 further OEPFs had to suspend the redemptions of fund shares (e.g. UniImmo Global issued by Union Investment Real Estate). SEB Immoinvest and KanamGrundinvest prolonged just recently suspending for further twelve months. The opportunity to delay the repurchase for two years is evidently a double-edged sword. About three million investors who have shares in their deposit are affected by the recent disastrous developments of OEPFs (Consumer Advice Centre Hamburg, 2011). This series of events shows that there is not much left of the former glamour and glory of Germany’s asset class of Open-End Property Funds. However, to give it a positive note, 9 funds of the fore-mentioned 24 public OEPFs succeeded to resist the effects of the financial crisis and to keep their funds liquid and open. Sebastian & Tyrell concluded already in 2006 that open ended fund runs on redemption should be considered as natural phenomenon which reflects mismanagement and would be necessary in order to clean the market (Sebastian & Tyrell, 2006). As already mentioned in the CEPFs section the sector of OEPFs is hoping that the market experiences a cleaning process where poorly performing vehicles and dubious issuing houses will be pushed out the market so that investors’ trust can eventually be regained.
REITs

On 28.05.2007 the German government introduced retroactively the so-called German Real Estate Investment Trusts (G-REIT) to 01.01. 2007. As a recently quite successful financial vehicle throughout many countries the introduction of REITs was in view of many experts an overdue measure in order to compete within the worldwide competition of financial industries. The entire asset class of real estate investments should be strengthened, and thereby Germany as an investment location (Finance Initiative Germany, 2005). From an investor’s perspective the main benefit of a G-REIT is the combination of shares’ fungibility with the tax efficiency (tax transparency) of funds. Basically the REIT Act was designed in an attractive way; however, especially the timing of the introduction (mid 2007 as the beginning of late-2000s crisis) prevented the G-REIT of becoming a successful and popular investment vehicle in Germany by today. According to the German Federal Tax Office up to 15 companies registered in 2007 for achieving the Pre-REIT status. Pre-REITs can be considered as first phase within the process of going public and becoming a G-REIT. In order to facilitate the introduction period of REITs in Germany a so-called Exit-Tax regulation allows tax reduction of 50 percent if companies sell their real estate assets to a REIT (disclosure of hidden reserves). However, this reduction is conditional because after the registration as Pre-REIT the company is forced to go public within three years and become a G-REIT. Otherwise the tax benefits from the exit-tax regulations are retroactively invalid. Nevertheless only three Pre-REITs eventually transformed into a REIT and only 5 companies have the status as Pre-REITs by today.

German REITs by today (May 2011):


http://www.hamborner.de/Hamborner-REIT-AG.139.0.html?&L=1

Therefore the development of the G-REIT is by today quite disappointing for market participants and politics. The market of G-REITs is indeed rather underdeveloped, immature and extendable. The sector’s optimism is based on the overall economical upturn in 2010 and following years, when especially private investors’ uncertainty will vanish, mood will lighten up and REITs will be considered as an investment opportunity.
3.2. Transparency

Transparency includes comprehensibility of the vehicle, knowledge of all investment related costs, and an understanding of the conditions of the respectively markets. The participants on the market for indirect real estate investments try to increase the market transparency first of all of course for their own sake. Real estate companies want to overcome the recently emerged lack of investor’s trust while providing more information and understandable products. A paper by Schulte, Rottke and Pitschke analysed the degree of transparency on German real estate markets and how it noticeably improved over the years. Furthermore, it provides a good overview of all different information sources worth considering within real estate related markets in Germany (Schulte et al., 2005). REITs are by default obliged to offer transparency in order to secure their status as tax-exempt vehicle. Furthermore, as presented the German Market for REITs is clearly arranged by today. The same applies for the displayed market of public OEPFs. And based on the aforementioned expected market cleansing just a few major funds will represent the market in the near future. The self-contained creation of transparency refers to the markets for CEPFs and Special-Funds. As aforementioned CEPFs are part of the grey market which does not underlie a broad supervision or comprehensive statistical capture. However, the market of CEPFs made an important step while founding the German association of closed-end funds. Aside from the association future changes in legislation (see 4.1.1.) will further encourage the creation of transparency on the markets for property funds and especially for CEPFs. The question of transparency for special-property funds raises less concern, since institutional investors ought to be able to gauge investment opportunities without for instance the protection of a separate supervision. However, even institutional investors will appreciate rather easily understandable and thereby more transparent products in the near future. To sum up, not least the lack of transparency is often referred to as one trigger of the financial crisis and all interest groups (investors, investment companies, and politics) will either demand or offer more transparency on the markets for financial vehicles. The German market of indirect real estate investments is no exception.

N.B. “Transparency” will be also discussed in 4.3.1."Demands of Investors"
3.3. Legislation, Supervision, Taxation

The following overview serves as a summary of the above mentioned information supplemented by further details regarding legislation, supervision and taxation issues divided into the different vehicles.

**Figure 7: Overview German Market Indirect Real Estate Investments**

<table>
<thead>
<tr>
<th></th>
<th>Closed-end funds</th>
<th>Open-end funds</th>
<th>Listed company</th>
<th>G-REIT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Legislation</strong></td>
<td>GbR, KG/HGB</td>
<td>Separate estate InvG, KWG, InvG</td>
<td>AG/AktG, HGB, IFRS</td>
<td>AG/AktG, HGB, IFRS, REIT law</td>
</tr>
<tr>
<td><strong>Supervision</strong></td>
<td>None</td>
<td>Federal Financial Supervisory Authority</td>
<td>Stock exchange</td>
<td>Stock exchange</td>
</tr>
<tr>
<td><strong>Income at vehicle</strong></td>
<td>Rents, capital gain at sale of property</td>
<td>Rents, capital gain at sale of property</td>
<td>Development, rents, capital gains</td>
<td>Development, rents, capital gains</td>
</tr>
<tr>
<td><strong>Income at investor</strong></td>
<td>Rental income</td>
<td>Capital income</td>
<td>Capital income</td>
<td>Capital income</td>
</tr>
<tr>
<td><strong>Taxation</strong></td>
<td>Tax-exempt on fund level; losses can be netted with other rental income of investors in current and future years</td>
<td>Tax-exempt on fund level; taxation at investor level; netting only with other capital income in current year</td>
<td>Taxation at corporate and investor level (half income system)</td>
<td>Tax-exempt at corporate level; taxation at investor level; netting only with capital income in current year</td>
</tr>
<tr>
<td><strong>Diversification requirements</strong></td>
<td>Not required; usually investment in a few or a single property</td>
<td>Required; usually investments in several properties</td>
<td>Not required; usually investments in several properties</td>
<td>Not required; usually investments in several properties</td>
</tr>
<tr>
<td><strong>Risk</strong></td>
<td>High: low number of properties</td>
<td>Low: diversification via investments in many properties</td>
<td>Medium: diversification via investments in many properties but higher volatility due to listing</td>
<td>Medium: diversification level dependent on investment focus, i.e. diversified vs. sector REIT</td>
</tr>
<tr>
<td><strong>Liquidity</strong></td>
<td>Low: stake can be sold usually only in OTC market at high discount to NAV</td>
<td>High (but artificial): fund shares can be returned anytime; redemption can be postponed by fund for some time</td>
<td>High to low (in practice): usually increases with market capitalization and free float</td>
<td>High to medium (expected): minimum free float criterion and high (international) investor awareness</td>
</tr>
</tbody>
</table>

Source: Own illustration based on Schulte & Wimschulte, 2007

---

4 Institutional funds generally underlie the same legislation. Deviations can be implemented In agreement with investors (contractual relationship).
5 see section Abbreviation
4. **Qualitative Analysis – Different Dimensions of Allocation Approach**

The following qualitative analysis is based on my experiences within two German major listed real estate investment and property companies. I completed a 3-months internship in the department “*Conception of Closed-end Property Funds*” at the Commerz Real in the summer of 2010. Experiences during that time cover mainly the analysis of the dimension “Product & Investor Matching”, and especially company´s considerations regarding the underlying property (building, location, tenancy, sector). Within the cooperation with IVG Immobilien\(^6\) regarding this master thesis I conducted several interviews within different departments in February 2011. Interviews were based on open-end questions handling the question of property allocation not only from the department’s perspective, but also considering the positioning of the entire company.

**Figure 8: Overview Interview Partners IVG**

<table>
<thead>
<tr>
<th>IVG employees</th>
<th>Department</th>
<th>Covered Dimensions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Klaus Franke</td>
<td>Controlling</td>
<td>Overall Corporate Strategy</td>
</tr>
<tr>
<td>Jan Körner</td>
<td>Corporate Development</td>
<td>Economical &amp; Political Environment Overall Corporate Strategy</td>
</tr>
<tr>
<td>Tim Roß</td>
<td>Product Department Institutional Funds (OEPFs + SPFs)</td>
<td>Product &amp; Investor Matching</td>
</tr>
<tr>
<td>Michael Schnell</td>
<td>Product Department Private Funds (CEPFs)</td>
<td>Product &amp; Investor Matching</td>
</tr>
<tr>
<td>Oliver Voß</td>
<td>Research</td>
<td>Economical &amp; Political Environment Overall Corporate Strategy Product &amp; Investor Matching</td>
</tr>
<tr>
<td>Christian Seiler</td>
<td>Risk &amp; Process Management</td>
<td>Risk Considerations</td>
</tr>
</tbody>
</table>

Source: Own illustration

Since it turned out that the allocation process is in practice a complex interplay occurring on different dimensions and with a range of important influence factors, the most challenging task within the analysis section is to transfer all the comprehensive amount of information into a well organized and clearly arranged structure.

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\(^6\) see information about both companies in “Glossary”
In order to canalize all the information and to present the process in an illustrative way Figure 9 ministers to the reader as a guide throughout the paragraphs of the different dimensions which in turn consisting of various influencing parameters.

**Figure 9: Overview Different Dimensions**

<table>
<thead>
<tr>
<th>Dimensions of Allocation Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economical Factors and Political Environment</strong></td>
</tr>
<tr>
<td>- Legislation EU / National Level</td>
</tr>
<tr>
<td>- Prime (Interest) Rates</td>
</tr>
<tr>
<td>- Inflation</td>
</tr>
<tr>
<td>- ...</td>
</tr>
<tr>
<td><strong>Corporate Strategy</strong></td>
</tr>
<tr>
<td>- Corporate Type / Form</td>
</tr>
<tr>
<td>- Value Optimization</td>
</tr>
<tr>
<td>- Apart from Value Optimization</td>
</tr>
<tr>
<td>- Competition</td>
</tr>
<tr>
<td><strong>Product &amp; Investor Matching</strong></td>
</tr>
<tr>
<td>- Demands of Investors</td>
</tr>
<tr>
<td>- Trends &amp; Innovations</td>
</tr>
<tr>
<td>- Corporate Considerations</td>
</tr>
<tr>
<td><strong>Underlying Asset (Property)</strong></td>
</tr>
<tr>
<td>- Sector</td>
</tr>
<tr>
<td>- Building</td>
</tr>
<tr>
<td>- Location</td>
</tr>
<tr>
<td>- Tenancy</td>
</tr>
<tr>
<td><strong>Risks</strong></td>
</tr>
</tbody>
</table>

Source: Own illustration

4.1. Economical and Political Environment

4.1.1. Changes in Legislation


“The financial crisis has exposed a series of vulnerabilities in the global financial system. It has highlighted how risks crystallizing in one sector can be transmitted rapidly around the financial system, with serious repercussions for all financial market participants and for the stability of the underlying markets.”
Due to the financial crisis the demand for further, or rather reintroduction of regulations for financial markets increased. This entails a range of new upcoming regulations which will probably change the real estate investment industry, especially the part of non-listed funds. Three basic regulations with such specific impacts on the real estate investment sectors are EU AIFM Directive (Alternative Investment Fund Manager), Solvency II and Basel III. The following paragraphs provide some brief insights into the regulations’ contents as well as the according perception of the market participants based on the INREV Survey 2011\(^7\).

Basel III: After Basel I (1988) and Basel II (2004) the third version of equity regulations within the banking sector. Basel III focuses on strengthening the regulation, supervision and risk management of the banking sector. One of the main aims is to increase the capital reserves that the world’s banks must hold against losses. Basel III sets a new key equity capital ratio of 4.5% plus a new buffer of a further 2.5%. The new rules will be phased between January 2013 and 2019.

Solvency II: January 2013 a new EU Directive regulating solvency of European insurance companies will be implemented. As the regulatory equivalent to the banking sector’s regulation sets (Basel I-III), Solvency II regulates equity capital and risk management requirements of insurance companies and partly of pension funds in order to meet their obligations to policyholders. The framework is designed to harmonize the capital adequacy requirements of European insurance providers. As aforementioned especially insurance companies and pension funds represent a large proportion of institutional investors for property fund vehicles.

EU AIFM Directive\(^8\): After tedious negotiations, the final draft of the AIFM Directive was adopted in the European Parliament on 11\(^{th}\) November 2010. The aim of this directive is to establish a secure and harmonized EU framework for monitoring and supervising the risks that AIFMs pose to their investors, counterparties, other financial market participants. It obliges AIFMs to increase the transparency of the provided AIFs via publication of annual reports, additional market information and so forth. This directive is the most comprehensive (final draft 210 pages) and influential of the three mentioned regulations, thus contrary to the

\(^7\) see Glossary “INREV Survey”

both fore mentioned regulations the EU AIFM Directive will affect fund managers directly instead of investor’s capability to invest.

**Figure 10: AIFM Directive - Important Changes**

<table>
<thead>
<tr>
<th>General admission requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>For the management, administration and marketing of AIFs</em></td>
</tr>
<tr>
<td><em>Managers need the authorization by the responsible authority (in Germany “BaFin”)</em>**</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Code of behavior</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>Managers are basically committed to work honest, care, diligence and fairness,</em></td>
</tr>
<tr>
<td><em>that entails:</em></td>
</tr>
<tr>
<td>- to disclose and prevent conflicts of interest</td>
</tr>
<tr>
<td>- to establish a risk management system connected to the investment strategy</td>
</tr>
<tr>
<td>- to establish a liquidity management (stress testing)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equity requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>For authorization AIFMs need a minimum equity capital in the form of cash and short-term funds</em>**</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>- regular valuations of assets by independent appraiser</td>
</tr>
<tr>
<td>- separation of AIF’s assets from company’s portfolio</td>
</tr>
</tbody>
</table>

Source: Bone-Winkel; 1994

The 2011 “Investment Intensions Survey” conducted by INREV reveals that a large majority of market participants (investors & fund managers) is aware of these upcoming regulations. The respondents to the survey identified some possible impacts of the three regulations.

*Basel III* maybe reduces the demand for real estate investments from some investors since the reform increases the difficulties of refinancing and cost of debt. Especially, riskier investments will be affected as it will be more challenging and time consuming to secure these assets.

*Solvency II* may lead to a reduction of the relative attractiveness of real estate investments compare to other investment classes (fixed income, listed and private equities) and thereby insurance companies and partially pension funds reconsider their real estate asset allocation. Due to the high capital requirements for leveraged investments, companies will prefer equity financed vehicles. Bottom line; there is a high potential risk of less demand by major institutional investors for real estate funds. However, for 80 % of all responding investors, these regulations are not holding them back from making new investments
Almost all fund managers are aware of the **EU AIFM Directive**, which comes as no surprise as this device will include more constraints for fund managers. The main concern of fund managers is that the AIFM Directive probably leads to higher costs, less flexibility and tighter regulation of marketing activities. The increased administrative burden as well as more detailed and complicated processes may also have an effect on returns, since managers pass on the costs to investor’s level. However, the Directive will encourage the consolidation process of the market, which is even wished by the sector itself.

As described in section “German Market of Indirect Real Estate Investments”, all fund vehicles and its investors were severely hit by the financial crisis which encouraged German legislators to introduce some specific changes in national legislation. So far investors could redeem their shares at any time, but this daily take-back obligation for OEPFs will now be soften. The Federal Ministry of Consumer Protection initiated so-called investor-protection laws (“Anlegerschutzgesetz”) as reaction to the turbulences of OEPFs. As aforementioned by the withdrawal of large sums of mainly institutional investors, OEPFs ended up in turbulences while not able to keep the required liquidity. As a result OEPFs suspended the redemption of the shares leaving mainly small private investors behind who were unable to access their capital.

From January 2013 on, new investors must hold their shares at least 24 months after the acquisition. In addition, current and new investors must comply a cancellation period of twelve months. Regardless of these limitations each investor has a disposable amount of € 30,000 per half-year. Figure 11 summarizes the changes for OEPFs.
Figure 11: New legislation for OEPFs not later than 1 January 2013


However, most parts of these new investor-protection laws are tightening the requirements for the consultancy and distribution activities of investment vehicles on grey markets like CEPFs. The directive implies that bank consultants in Germany have to prove their qualification (e.g. five years of professional experience) and register in a central file of the BaFin (Federal Financial Supervisory Authority). If bank consultants evidently give a false advice or omit information about commission fees the BaFin is allowed to impose fines. As last resort the BaFin can even revoke consultants´ license for two years. However, this does only apply for consultants employed by banks, but not for independent working consultants (freelancer).

4.1.2. Interest Rates

Since real estate investments are generally voluminous, debt financing plays a significant role in the overall financial sourcing. Thus a well-functioning and active market of real estate investments is highly dependent on the conditions on debt markets. Besides debtor´s financial standing, the amenities of the collateral (underlying property), and a certain Loan to Value
ratio (LTV)\(^9\) the contractual determination of interest rates is mainly influenced by the prime rate of the according central bank. Prime lending rates display procurement costs for banks and thereby the main reference point within the negotiations regarding the mortgage rate between borrower and lender. Depending on the location of the securitized property and the responsible central bank as well as the duration of the credit business different prime rates has to be taken into consideration. Looking at interest rates of mortgage rates with a term commitment of 10 years, the last 10 years shows a steady reduction in interest rates for mortgages (VGF Closed-End Funds Industry Report, 2010). The background for the previous rate cut was first and foremost the economic crisis that was triggered by the bankruptcy of Lehman Brothers in September 2008 in the wake of the subprime crisis in the U.S.. Due to the financial crisis and its accompanied recession, the ECB gradually lowered the prime rates in order to increase investments and consumption and thereby reanimate the economy (see Figure 12) This development of prime rates implies that the mortgage interest rates are at a historically low level and thereby makes the purchase or construction of a property, or generally real estate investments very favorable (VGF Closed-End Funds Industry Report, 2010).

Of course cheap debt is welcomed regardless of the vehicle, since as long as the return on capital employed (ROCE) is higher than the costs of debt (interest rate) one can increase the return on equity (financial leverage). However, the accessibility of debt can make a huge difference especially between the funds structures. Closed-end fund vehicles are often depending on financial leverage in order to display favorable equity return prospects for their investors. On the other hand due to normally long-term fixed interest rates, CEPFs are generally less affected by medium-term prime rates. Open-end vehicles are less dependent on low priced debt, since the financing design consists of continuously available own capital.

\(^9\) LTV is expressed as a percentage and is derived by dividing the mortgage amount by the lesser of the selling price or appraised value
Central banks regulate the money supply via prime rates. A longer period of low prime rates and thereby increasing money supply raises the threat of money devaluation or at least the expectation of future money devaluation.

4.1.3. Inflation Rate

Longer periods of low prime rates raise the concerns about an uncontrolled growth in money supply and consequently rising prices. A rise in the general level of prices of goods and services in an economy over a period of time devalues the fixed capital, which investors have invested in assets. Therefore the ability of an asset to protect an investor from loosing purchasing power based on inflation becomes important while anticipating increasing inflation rates.
Increasing fear and anticipation of inflation due to the financial crisis and its according longer period of low interest rates fosters the escape into tangible assets. Real estate investments are usually considered as an inflation hedge whose return equals or exceeds the rate of inflation over longer periods of time (Hui et al., 2009). The theory is based on two main arguments. First, if I use a credit for a real estate investment the loan will be devalued over time by inflation (in case of fixed interest rates); however, the real value of the property may be stabilized. Second, parallel to potential value appreciation the rent may be tied to consumer price index (CPI) and increases as well, so that the capital income is inflated by that. In practice experts point out that inflation hedge through real estate investments is not given automatically. Investor’s inflation hedge through rental income is based on the tenancy contract, so in order to obtain inflation hedge the rent ought to be contractually linked to the CPI. Furthermore, decisive for the current and future value of a property are still the location and its according economical prospective. Hence the six top German locations of the real estate investment industry Berlin, Düsseldorf, Frankfurt, Hamburg, Munich, Stuttgart offer the most stable and constantly increasing property prices and thereby the best inflation hedge. Apart from these regions the German real estate markets are ambiguous and partly just limited qualified for inflation hedge through real estate investments. This applies also for other real estate investment markets throughout Europe. As already pointed out, German investors started to withdraw their invested capital from funds with underlying properties in foreign markets and shifted to German real estate funds, because of the general stability on German real estate markets.

4.1.4. Cross-Country Investments

As mentioned in section “2.1. Direct Investments”, a lot of scientific work confirmed the general diversification potential of cross-country real estate investments (Eichholtz 1996; Sirmans & Worzala 2003 (1); Hoesli, Lekander & Witkiewicz 2004). While doing cross-country investments currency exchange rates are often considered as a source of both risk and chance. Changes in exchange rates entail effects on the value of investor’s current income, on the property value and on the LTV which is connected to the underlying financing. However, due to its complexity and numerous influence factors professional forecasts of future exchange rates are everything but reliable, which makes it rather difficult to speculate for gains based on changes in exchange rates. Therefore real estate investment companies
reassure their vehicles with swaps\textsuperscript{10}, which make the above mentioned factors and thereby the success of an investment independent from the development of currency exchange rates. Especially due to the fact that most German investors have a moderate income in foreign countries they can gain from double tax treaty (avoidance of double taxation), which enables German investors to benefit from tax allowance within the framework of cross-country investments. Currently Germany has double taxation arrangements with over 100 countries (German Federal Ministry of Finance, 2011). For real estate investment companies and investors most important agreements are doubtless the ones with countries which have an interesting and profitable real estate market. In this context the arrangements with the UK, USA, Netherlands, Canada, Austria, and France are most worth mentioning. UK, more precisely London, as Europe’s number one location for financial businesses is by today the most attractive market for real estate investments. Although London’s market for commercial properties is characterized by high fluctuations in rents and values, in generally real estate investment companies are attracted by an on average high level in rents and property values. Depending on investor’s age the tax allowance includes an annual capital income of £7,475 and £9,490. When considering cross-country investments it is of particular importance to keep the fore-mentioned aspects (currency rate, tax treaty, diversification potential) in mind. The success of a real estate investment which generates income based on properties abroad is depending on the handling of currency exchange rate related risks and possible tax allowances.

\textit{In a nutshell:}
Real estate investment companies have to embed their overall strategy into the economical and political environment of the target market which is mainly determined by the general legal framework and the monetary policy by the central bank (controlling interest and inflation rates). Due to the financial crisis both fields are exposed to several changes which will have short-term impacts (interest and inflation rates) as well as lasting impacts (changes in legislation) on the market of indirect real estate investments. These changes will probably entail a more conservative corporate strategy focusing on secure investments and risk-averse products which in turn reflect investor’s nowadays cautious risk-return profiles.

\textsuperscript{10} see Glossary
4.2. Overall Corporate Strategy

Principally the overall strategy of any kind of Investment Company is just reflecting the requirements and demands of the investors who are giving the financial resources to the company. Since there is a diversified spectrum of investors, a wide spectrum of companies trying to meet the demands while using different corporate strategies.

4.2.1. Type of Enterprise

The overall corporate strategy goes along with the company type which is in turn oriented towards the different investors who have an interest in the company’s business and success. There is a wide spectrum of all different kinds of companies on the German market for indirect real estate investment. One basic distinction between real estate company types is connected to the different stages of a property’s life cycle which generally consists of:

\[ \text{development} - \text{management} - \text{transaction} \]

Hereby some companies cover all stages and some companies focusing just on parts of the cycle. However, the different stages go along with respective degrees of risks and thereby reflecting a certain strategy which in turn reflect the risk appetite of the investors.

A further distinction can be made between independent real estate investment companies and real estate divisions which belong most commonly to banks or insurance companies. Many major banks and insurance companies have real estate business departments and are thereby active on the market of indirect real estate investments. From an investor’s point of view the question of dependence entails two main considerations regarding the corporate strategy. On the one hand real estate subsidiaries are maybe able to offer products with more favorable risk-return ratios due to its embedment in a bigger company holding. This may represent a desirable safety net in that sense that the holding can jump in if problems regarding liquidity or the like occurs. On the other hand real estate divisions maybe are liable to an overall holding strategy, which is not unconditionally aligned with the interests of investors who investing money in products of a subsidiary. Further investors’ concerns can be about the sufficient know-how and independence in terms of consulting of subsidiaries (e.g. bank recommends subsidiary and vice versa).
A further basic distinction regarding the type of real estate investment companies is between a few major generalists and many rather small specialized companies. Generalists often are listed companies which are operating many business units and issuing a range of investment products and vehicles (CEPFs, OEPFs, Special-Funds, and of course the very own share). The counterpart is a specialized issuing house which is focusing on one vehicle. As part of the grey market and accompanied low requirements and thereby low market entry barriers, the most specialized real estate investment companies are focusing on CEPFs. Not least since the financial crisis investors more and more appreciate if they invest money in transparent companies which take an identifiable market position. That is why by trend generalists try to transfer their single divisions and vehicles into profiled brands in order to present a clear profile with an explicit strategy to investors. This desirable transparency generally entails that real estate investment companies will more and more profile their type and try to focus on core businesses (e.g. single product + one cycle phase). However, as mentioned in the beginning corporate strategies are oriented towards investors’ demands, wishes and risk appetite and this change over time.

4.2.2. Value Optimization

Value optimization basically refers to the twofold interplay of an investment´s risk-return profile. I.e. either lowering risk for a given return, or maximizing the return for a given level of risk. Companies’ efforts regarding value optimization take place on different levels. On the one hand for every single product and its underlying properties and on the other hand on an aggregate level where the overall value optimization is reflected by the operating results or the share price. Value optimization for a single property is performed by the deliberate analysis of the aforementioned stages of the property´s life cycle - development, management and transaction (exit). On an aggregate level different portfolio analysis methods and value multiples as benchmarks come into play as well as different part of corporate finance (capital structure).

*Investment companies use partly very complex and sophisticated tools, metrics and methods in order to obtain results regarding value optimization on the different levels. Additionally, the implementation of these tools and methods vary across companies and investments. In the following paragraphs the author only gives some insights into the main metrics and methods.*
The most common method to analyze value optimization on a single investment level is definitely the discounted cash flow (DCF) analysis. DCF analysis uses future free cash flow projections and discounts them to arrive at a net present value (NPV), which is used to evaluate the potential for investment. If the calculated value is higher than the current cost of the investment, the opportunity may be a good one (Investopedia).

**Figure 14: Formula Discounted Cash Flow Analysis**

\[
\text{DCF} = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \ldots + \frac{CF_n}{(1+r)^n}
\]

\(CF = \text{Cash Flow}\)

\(r = \text{discount rate (WACC)}\)


Besides the problematic of accurate estimations for periodical cash flows the crucial parameter is the discount rate. Most used discount rate is the weighted average cost of capital (WACC), which is the cost of each capital component multiplied by its proportional weight. However, considering single investments investors are interested in the internal rate of return (IRR), which is instead of the WACC (input parameter) the output parameter for a given set of cash flows (including purchase price or construction costs and selling price). So an IRR is (technically) the "discount rate" at which a set of cash flows has a NPV of exactly zero. Investors can compare the according IRR to returns of other investment opportunities.

On an overall corporate level other metrics and value multiples are used in order to secure value optimization. The list of metrics and value multiples which may present company's operating results in one way or the other is endless. Although depending on the corporate form value optimization on an aggregate level is mostly reflected by the operating result. In this connection the most noteworthy key number is EBITDA (Earnings before interest, taxes, depreciation and amortization). All interest, tax, depreciation and amortization entries in the income statement are reversed out from the bottom-line net income.

Depending on the aforementioned type of real estate company the focus lies on one phase or all phases of a property's life cycle. However, as aforementioned different stages are accompanied with different risks. The development stage for instance involves due to the many uncertainties, a number of risks, which ought to be systematically identified and

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11 see [http://www.investopedia.com/terms/w/wacc.asp](http://www.investopedia.com/terms/w/wacc.asp) for detailed illustration
evaluated within a risk analysis. If the acquisition is carried out after the development phase the potential of value enhancement lies as far as possible in the hands of the different management levels (see Figure 15). Value can be added via tenancy management (reduction of vacations), refurbishment, modernization and so forth. The final realization of the investments profit connected to value-add activities takes place in case of selling the property.

**Figure 15: Creation of value throughout the property cycle**

![Value added chain of properties](http://www.corereal.eu/asset-management.html)

The highest profit can be achieved while focusing on short-term realization of projects within the development and transaction phases. Here lies the maximum internal rate of return of an investment. However, investment companies who cover all phases try to find a good balance regarding investments and projects within the phases in order secure a minimum (worst case) return to their investors. Otherwise one can suggest that the strategy should be angled to the most profitable segments “development” and “transaction”, but in this case risk related aspects would be omitted.

4.2.3. Apart From Value Optimization

Value optimization and profit maximization are doubtless the main strategy for most listed companies and fund vehicles. Nonetheless it is now and then the case that companies may deviate from value optimization as main corporate strategy. Companies may focus on certain investment products, particular markets or property acquisition and product development which do not reflecting classic value optimization at first sight. Two prime examples for corporate strategies besides value optimization are a socially-oriented and an environmental-
oriented approach. By means of a sustainability-orientated attitude, the companies incorporate their responsibility (CSR\textsuperscript{12}) towards society, employees and customers. The main task of the management is not simply to achieve a high economic efficiency and productivity, but also to respect the achievement of humanity.

While following an environmental-approach; e.g. investments in green buildings, cooperation with partners (developer, external service providers, and investors) who obey standards of sustainability and so forth; investment companies may neglect considerations regarding more profitable projects. However, investors may favor green investments over return oriented investments (see 4.3.2. “Trends & Product Innovations”).

Due to the consideration of all three aspects; financial, social and environmental; real estate investment companies more and more believe that they can increase the success of their business in the long run. This may lead to a distinctive corporate investment culture which is veering away from a pure value optimization including the most favorable risk-return profile. In this case the corporate value optimization rather occurs via the goodwill instead of profit maximization on the paper (financial statement).

Further consideration regarding an overall corporate strategy can lead back to the history of the company. Special ties to a regional market or property type, which is also appreciated by for instance local investors, may also lead to the situation that investment companies neglect higher returns while doing other investments.

Within this framework it is arguable that some of these measures seen on its own may are deviating from value optimization; however, indeed leading to value optimization and profit maximization in the long run. By evidently doing green investments and taking social responsibility investment companies meet the demands of investors which lie besides solely value optimization (high IRR) and benefit in the long run from the showed trust of the investors.

\textsuperscript{12} CSR = Corporate Social Responsibility
4.2.4. Competition

Apart from monopolistic markets where the monopolist is not forced to consider the measures of other companies, company’s overall strategy is principally influenced by the actions and reactions of competitors. Based on Porter’s model for competitive forces within industries Bone-Winkel presents in a paper from 1994 a five-force model which enables property investment funds to determine their position in the industry (Porter, 1990; Bone-Winkel, 1994).

**Figure 16: Competitive Forces Affecting Property Investors**

<table>
<thead>
<tr>
<th>Force</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rivalry among existing firms</td>
<td>Bone-Winkel, 1994</td>
</tr>
<tr>
<td>Real estate investment companies and vehicles</td>
<td></td>
</tr>
<tr>
<td>Bargaining position of suppliers and sellers</td>
<td>Bone-Winkel, 1994</td>
</tr>
<tr>
<td>Developers, municipalities</td>
<td></td>
</tr>
<tr>
<td>Bargaining position of customers</td>
<td>Bone-Winkel, 1994</td>
</tr>
<tr>
<td>Tenants, investors</td>
<td></td>
</tr>
<tr>
<td>Threat of new entrants</td>
<td>Bone-Winkel, 1994</td>
</tr>
<tr>
<td>Real estate investment companies and vehicles</td>
<td></td>
</tr>
<tr>
<td>Threat of substitute products</td>
<td>Bone-Winkel, 1994</td>
</tr>
<tr>
<td>Despite of indirect investment vehicles (e.g. owner occupiers)</td>
<td></td>
</tr>
</tbody>
</table>

The most trivial competitive force is the rivalry among existing firms. Real estate investment companies compete against each other particular for investors, properties (see 4.3.2. “Corporate considerations”), and employees. At which the magnitude of competition is to a large extent depending on overall economical cycles. Bone-Winkel assumed back in 1994 that the industry will probably see a continuation of competition on a high level (Bone-Winkel, 1994). However, the contest for investors and properties has been steadied for many years in the forefront of the financial crisis. As there were enough investors with enough money as well as a sufficient amount of suitable investment opportunities (properties), the market has been flooded with new issuing houses and investment companies without creating much competitive pressure in the market. As already repeated, in the aftermath of the crisis investors’ bargaining position will be strengthened and at the same time competition along the investment companies created. The German industry for real estate investment firms is indeed subject to constant fluctuations which are reflected by numerous market entrances and exits, as well as mergers and processes of outsourcing. The upcoming changes in legislation will strengthen the market entry barriers, so that it becomes more difficult for new real estate
investment companies to enter the markets. The larger the magnitude of competition the more important is a deliberate corporate strategy. Within this context it comes down to a company’s ability to anticipate the demands and requirements of the investors. At best long before competitors initiate follow-up actions or - even better - before investors know what they eventually demand.

4.3. Product & Investor - Matching

Profitable and successful real estate investment companies are good in analyzing and anticipating the demands of investors. As with every other product the companies at best identify trends and future standards long before customers actually realize what they will eventually need.

4.3.1. Demands of Investors

Due to its general peculiarities (durability, construction time) real estate investments are normally by default long-term, voluminous investments with a low fungibility, and as mentioned before indirect real estate investments exist to ease these obstacles. However, based on these basic features investors’ preferences can be further distinguished according to the different investment vehicles. For instance investors should only invest in CEPFs if they definitely do not need their capital for the scheduled duration (≈ 7-20 years) of the vehicle. Combined with the rather large lot size of at least € 5 000 the target group for CEPFs narrows down to mostly high net worth and conservative investors.

**Figure 17: Investors´ preferences and according investment vehicles**

<table>
<thead>
<tr>
<th></th>
<th>OEPFs</th>
<th>CEPFs</th>
<th>Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment horizon</td>
<td>medium – long</td>
<td>long</td>
<td>short – medium – long</td>
</tr>
<tr>
<td>Liquidation (Fungibility)</td>
<td>theoretically daily</td>
<td>practically very limited</td>
<td>daily</td>
</tr>
<tr>
<td>Minimum amount to be invested</td>
<td>very small*</td>
<td>medium – large (min. € 5 000)</td>
<td>very small</td>
</tr>
</tbody>
</table>

* except for Special Property Funds
Source: Excerpt from Berry et al. (1999)

Scientific literature about modern management of financial investments is often based on the pioneering work of Markowitz´ Modern Portfolio Theory. The main finding of Nobel Prize
winner Harry M. Markowitz within the field of “Modern portfolio theory” is that as long as the returns of one asset are not perfectly correlated with returns of other portfolio assets it implies reduction (not elimination) of risk through diversification (Markowitz, 1959). However Markowitz suggests perfect capital markets and the aspect of liquidity is neglected. In practice though, investors face the so-called magic triangle of investment objectives (Bednarczyk & Eichler, 2002).

Risk - Return - Liquidity

However, these three objectives are in tension with each other. This means that a high yield, low risk and continuously realizable liquidation cannot be achieved simultaneously, and that is why the expression “magic triangle” is used for these three investment goals. After the recent financial crisis another aspect became important for investors - Transparency (Schirmacher, 2009). Transparency includes comprehensibility of the vehicle, knowledge of all investment related costs, and an understanding of conditions of the respectively markets. Already during the crisis more and more investors refused to invest in complex fund of funds structures and blind pool funds (Schirmacher, 2009). According to the INREV survey investors prefer core products, suggesting that they continue to be cautious in their investment strategies (67 %). Fund managers not only recognize that investors are taking a cautious approach; they even seem to overestimate the demand for core products from investors (88 %). After years of a rather risk-accepting investment mood investors apparently appreciate safe investments with conservative risk-return profiles. In this context it is worth to take a closer look at different risk-return strategies for real estate investments.

- Real Estate Investment Risk-Return Profiles (Strategies)

On the market of real estate investments the different investment products are labeled with additional terms in order to illustrate investment styles (or strategies) with different risk-return profiles, which in turn oriented towards investors’ risk appetite. Characteristics of market (maturity, transparency, currency risks and so forth), tenancy (occupancy rate, credit rating, and contract terms) and property (quality, usability, location) influence the expectations regarding risks and returns of the investments. Supplemented by a respectively financing structure (leverage ratio) one can basically distinguish the profiles between Core, Value Add and Opportunistic style.
There are no universally valid definitions of these risk-return strategies and its features. The following executions are therefore not strict definitions, but just broadly accepted guidelines.

1. Core / Core plus: \((\text{IRR target} \approx < 10\%)\)

Core investments aim at complete stabilized properties located mainly in primary markets with creditworthy tenants on long term leases. Core properties are up to 100% fully let and accommodating tenants with high credit standing. They are supposed to be mainly unaffected by short-term market fluctuations and crises. Investors are expecting safe reliable returns against the background of a low to moderate leverage ratio (< 50%). Core plus strategies display similar features with slightly riskier adjustments in sense of shorter rental terms, higher leverage and/or higher return expectations. Principally core markets reflect a rather conservative profile.

2. Value Add: \((\text{IRR target} \approx 10 – 18\%)\)

Value Add investors are looking for the opportunity to increase the value of their real estate investments. Vacancies and intermediate rental terms are considered as chance in sense of future lease up potential. The properties are often requiring redevelopments or repositioning for alternative use or upgrade. Value Add investors will try to buy these properties at a discount with a moderate leverage ratio between 30 – 70%, and work to increase the occupancy or fix the physical deficiencies. Once the property has been stabilized, these properties may be sold to Core investors.

3. Opportunistic: \((\text{IRR target} \approx 18 – 20\%)\)

There are a lot of different types of investments that fall into this category. From ground up development, investments including distressed properties and loans, to adaptive re-use. In addition investors may consider emerging markets beside core markets. The unifying principle is that the investor is willing to take entrepreneurial risk to achieve out-sized returns. Contrary to risk-averse core investments with stable long-term cash-flows opportunistic investments focus on rather short-term capital appreciation and are thereby risk-neutral with higher expectations regarding the overall return.

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13 One example on: inquire-europe.org/seminars/2007/papers%20Oslo/Hoesli%20sheets.ppt
Figure 18: Investment styles

Source: Own illustration

- Private vs. institutional investors

Furthermore one has to distinguish between the demands and requirements of private and institutional investors. It is not unusual that private investors’ investment strategies are driven by rather irrational not profit maximizing aspects. Especially within the market of indirect real estate investments private investors develop emotional ties to the investment, its underlying properties, or even to the according service provider and funds manager. For instance investors appreciate to become co-owner of a landmark building instead of holding certificates of derivatives or other intangible assets. Contrary to that institutional investors focus by default on profit maximization based on rational calculations and prognoses. Main argument is that institutional investors often act as intermediary in that sense that they are entrusted with the capital of their customers (e.g. insurance companies, pension funds). Against this background the initial capital provider would of course appreciate that investment strategies are not misled by emotional or irrational factors. Besides diversification aspects, risk-return appetite, taxation considerations, and not least personal conviction of the product with its underlying properties investors distinguish between the possible vehicles based on a few basic specifications.
4.3.2. Trends & Product Innovations

- Demographic change

The industry of indirect real estate investments will be also affected by further trends based on further upcoming circumstances. One major sociopolitical issue in Germany is the demographic change of the population. Decreasing birth rate, aging and shrinking population have moved into the center of the public debate in the recent years in Germany. The steadily growing number of elderly people is stressing state and social insurance companies. Contrary to that investment companies consider this phenomenon as an opportunity: Fund providers and investors discover nursing and rest homes as an investment. Besides the distressing effects for the overall economy the demographic change will have a twofold impact on real estate investment markets. First the target group of investors will change and with that the demands and expectations. Secondly the demographic change will facilitate the rise of adequate facilities and constructions (retirement and nursing homes, age-based housing) which in turn will come into consideration as investment target. Although this development is no secret for many years, the investment market for nursing home properties is still young, underdeveloped and adapts oneself just slowly. Main problem is the necessary special constitution of the land and its building. Free of barriers - that is, the suitability for handicapped - is an absolute must. In addition, there are special requirements for sanitary facilities or the layout of the rooms, so that for instance the privacy of the residents is respected. Another reason for the by today prevailing resistance of investment companies is the continuously change in state politics or insurance policies within the sector of geriatric care. Despite of these obstacles the demographic change is a phenomenon which is in the medium term irresistible and thereby soon or later also a matter for real estate investment companies.

- Green investments

Another investment area has been discussed since many years and remains probably newsworthy for further decades. As already implied within the paragraph about the building´s constitution the aspects of sustainability and environment protection dictate an intensive discussion as well on markets for indirect real estate investments. From an investor´s point of view it becomes more and more desirable to contribute to the general movement of sustainability and environment protection while investing capital in green and sustainable products. Furthermore, due to the lowered energy costs and potential state supplements more lucrative returns can be realized. Especially the energy consumption of a building will be a
central factor for future evaluation which in turn will influence both buyers and tenants. Within this framework investors and tenants attach importance to significant certificates which prove the sustainability and ecological soundness of a building. For fund managers it is important that the objects feature national or international recognized sustainability certifications. Hereby many countries have developed their own standards for energy-efficient buildings and certification systems.

Examples for different certification systems for sustainable buildings

- **LEED** Leadership in Energy and Environmental Design
- **BREEAM** Building Research Establishment Environmental Assessment Method
- **DGNB** Deutsches Gütesiegel Nachhaltiges Bauen
  - “German certification for sustainable construction”

The disadvantage in Germany lies in the fact that there is still a shortage in green buildings, so that investment companies just add sporadically green buildings to their portfolio. Additionally the certification can be expensive and thereby increase the overall costs for the vehicle. Investment companies are rather aiming to enrich the existing traditional portfolio gradually through green buildings. However, since CEPFs often consists just of one building a few fund companies have already launched green CEPFs which took a successful position on the market just in a little while. It is not unlikely that in the near future green investments will not be considered as trend, but as established standard demand by investors.

- **Airport cities**

  “Airport terminals are fast becoming luxurious shopping malls and artistic and recreational venues. No longer restricted to magazine shops, fast food outlets, and duty free, they now feature brand name boutiques, specialty retail, and upscale restaurants along with entertainment and cultural attractions.” *John D. Kasarda* - “The Evolution of Airport Cities and the Aerotropolis”

In the past airports were perceived simply as gateways for the transportation of goods and people from one region or country to another. Nowadays airports become more and more business destinations and economic engines for its region and nearby local communities. With

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14 see http://www.globalairportcities.com/
15 see http://www.aerotropolis.com/
airports typically surrounded by hundreds or even thousands of hectares of undeveloped land for environmental buffer for environmental reasons, it has been recognized that airports are sitting on a potential goldmine of real estate opportunities. These include, among others, time-sensitive manufacturing and distribution facilities; hotel, entertainment, retail, convention, trade and exhibition complexes; and office buildings that house air-travel intensive executives and professionals. In Germany especially the three biggest airports (passenger volume) Frankfurt, Munich and Dusseldorf are considered as future markets for real estate investments.

4.3.3. Corporate Considerations

Theoretically there are of course no boundaries for real estate investment companies regarding the composition of their products and the use of the properties. To put it bluntly as long as one can find investors who are willing to invest companies do not have to worry. However, statutory provisions and the fact that in practice one cannot always find investors who are willing to invest in any kind of product without caring about its composition, real estate investment companies have to think thoroughly about the use of properties and the following composition of the investment product.

Besides all different facets of a real estate investment vehicle, characteristics of the underlying property are still the fundamental driver for a successful investment. On principle all different real estate investment vehicles are in the pursuit of properties with similar characteristics given an analogical risk-return profile (e.g. core products). Related to the forementioned investment strategies the underlying property reflects different risk-return profiles via three basic indicators.

Building - Location - Tenancy

- Physical Building
One key feature of a building is its usability. Hereby the two extremes are most desirable for real estate investment companies. Either the use of the building is exactly tailored to the needs and requirements of its tenant, which makes a move-out generally very unlikely, or the building’s flexibility in use is so high that the demands of many potential tenants can be fulfilled. In the latter case the building’s constitution easily allows interior and exterior reconstructions (e.g. division into small sections and vice versa) in a cost-effective way. In this case a potential move-out of tenants does not entail major expenditures in order to meet
the demands of possible successive tenants and thereby does not threaten the cash-flow prognosis for the investors. Tailored usability is rather important within the sectors of industrial and logistic properties. Tenants whose business requires the use of capacious production plants or other special equipment have certain demands regarding the building’s constitution. In this case the initial construction of the building is often carried out in cooperation with developers so that the building’s constitution matches the specific requirements of the future tenant. Both circumstances secure a constant tenancy which in turn secures stable and long-term cash-flow based on the according rental income.

A further feature which becomes more and more important is the environmental soundness and sustainability of a building. Hereby the focus lies on the efficient use of energy, water and other resources, health protection of tenants (employees), and reduction of waste and pollution during the construction as well as during the use of the building. Especially in the developed world buildings of any sort are responsible for a high consumption of land, energy and water. Thus so-called “green buildings” are supposed to reduce ecological damage to a significant degree. Besides basic economical calculations the fact that sustainability and ecological awareness is generally in the centre of public and political attention facilitates the wish for green investments. The market of indirect real estate investments is no exception.

- Location

In real estate business the mantra is ’location, location, location’, since the location is claimed to be the feature which is mainly shaping the value of a property (Rosseau & Fried, 2001). The fact that the location is not changeable turns it into the most crucial factor while considering the acquisition of potential properties. Besides the macro location, which refers to the characteristics of a particular region, city or district, the micro location consists of the immediate vicinity and neighborhood, access to public transportation and road traffic, future developments etc.. Figure 19 shows checklists for the criteria regarding a certain location against the background of a possible real estate investment. The first column highlights factors important for both macro and micro. Here the criteria for micro location are referring to the proximate access.
**Figure 19: Checklists macro and micro location**

<table>
<thead>
<tr>
<th>Public transport system</th>
<th><strong>Macro</strong></th>
<th>Micro</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure (schools, medical care, retail facilities)</td>
<td>Political situation</td>
<td>Social standing of vicinity</td>
</tr>
<tr>
<td>Cultural opportunities</td>
<td>Economic strength</td>
<td>Appearance of vicinity</td>
</tr>
<tr>
<td>Public and private services</td>
<td>Labour market</td>
<td>Air and noise emission</td>
</tr>
<tr>
<td>Environmental quality</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Own illustration

- **Tenancy**

As mentioned in part “2. Introduction of Real Estate Investments” investors’ total return is based on the one hand on capital appreciation (increasing property value) and on the other hand on income returns (rental income). The latter one becomes particular important if one considers core investments which are based on stable and continual cash-flows. Stable and continual cash-flows are in turn secured by a long-term contractual tied creditworthy tenant. Within this framework most desirable are government related institutions which normally fulfill both criteria; long-term tenancy and excellent credit standing. Apart from that it is important to consider the combination of tenant, building and location. As aforementioned tenants may be tied to building’s characteristics, a fact which increases the willingness to accept long-term rent contracts. Furthermore tenants may have special ties to a particular region or city. In this context tenants tend to stick to their roots of origin or try to create local proximity to a particular target market. Especially the ties to a property which is declared as company’s headquarters are strong.

The interplay between risk-return profiles and these property criteria is pretty much straightforward. In a nutshell: The more the returns are secured by favorable indicators the more one can speak of a core product. See paragraph “Real Estate Investment Risk-Return Profile”. But this interplay is moreover influenced by the respective sector or property type. One fundamental determination of property types is residential vs. commercial properties. Both types have several subdivisions, however, within the framework of potential indirect real estate investments following major types are considered.

*Housing - Office - Retail - Industrial*
That a building’s basic physical constitution has to be suitable for its purpose is beyond all questions and tedious to discuss. One differentiation may be that the mentioned feature of environmental soundness corresponds rather to residential properties and the question of usability applies rather to commercial properties.

More manifold is the consideration of location vs. property sector and the consequences for investment’s risk-return profile. Due to different needs of infrastructure, valuation of vicinity or demand of services, an office property may reflect a core product, but an industrial one at the theoretically same spot rather a value add product. In rather rural areas retail properties may present an opportunistic investment (maybe future population), but it would be the perfect area for a logistics centre and thereby a core investment. So although the majority of tenants check the same criteria and value it similar there can be crucial differences depending on the property sector.

Type of property has also an impact on the design of tenancy contracts. Within the housing sector unlimited rent contracts with relative short periods of cancellation are prevailing in Germany. That circumstance reflects in general risk-return profiles which may be far away from core products. Investments within the retail sector generally also present non-core products, because retail properties often are divided into small sections which entail many tenants with short-term contracts. Most suitable sectors for core products are office and to some extent industrial properties, since those properties often inherent single-tenants equipped with long-term rent contracts.

As aforementioned most investment vehicles are in the pursuit of properties with similar characteristics as long as the focus lies on the same risk-return strategy. However, vehicle’s capability to compose certain risk-return profiles is strongly related to its underlying capital sourcing (financing). To illustrate this essential statement CEPFs serve as a prime example:

Due to its limited time and capacity of financing CEPFs consist of a few or often just one property. To secure nonetheless stable cash-flows CEPFs are often constrained to invest in single-tenant properties with long-term contracts. This circumstance basically excludes the housing sector, since required critical investment volume for CEPFs is here not accomplishable. Moreover since CEPFs are also depending on high rents and a remarkable capital appreciation over the life cycle of a property (profitable exit) in order to offer
favorable returns, this vehicle focuses mainly on the office sector. Bottom line: CEPFs are by far more constrained regarding the composition of core products than other vehicles. Contrary to that OEFPs, but especially own investments (on balance investments) of companies, have based on their underlying financing (e.g. issuing invariably new shares) much more possibilities to transform acquired properties into core products.

An old business proverb says “profit lies in the acquisition”. As implied above certain risk-return profiles are mainly based on the one hand on property’s characteristics and on the other hand on the conditions of the target market. Purchase prices, rents and yields are varying according to the political and economical stability and prospects prevailing on the corresponding macro market. Figure 20 gives an overview how yields and rents differ across European office property markets. The listed investment yields refer to a valuation of office property let at full market value which is of the best physical quality, in the prime micro location, and with the best tenant’s covenant and contemporary lease terms. The prime rate (PR) refers to headline rents in high quality buildings situated in prime locations and are assumed to be over 500 m². Within the market of indirect real estate investments the purchase price of properties (including acquisition costs) is often expressed as a multiple of the current annual net rent.

\[ e.g.: \text{rent } € 2500000 \text{ p.a.; purchase price } € 45000000 = \text{multiple factor of 18.0} \]

At the same time the reciprocal value of the factor serves as an initial rate of return for the investment (factor of 18.0 ≈ 5.56 %). Another view on the purchase factor is that it expresses how many years it approximately takes to amortize the purchase price.

**Figure 20: European Office Property Markets 2010/2011**

<table>
<thead>
<tr>
<th>Zurich</th>
<th>Geneva</th>
<th>London West End</th>
<th>Munich</th>
<th>Copenhagen</th>
<th>Milan</th>
<th>London City</th>
<th>Frankfurt</th>
<th>Stockholm</th>
<th>Paris</th>
<th>Istanbul</th>
<th>Moscow</th>
<th>Athens</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yield</td>
<td>Factor</td>
<td>PR</td>
<td>Yield</td>
<td>Factor</td>
<td>PR</td>
<td>Yield</td>
<td>Factor</td>
<td>PR</td>
<td></td>
<td>Yield</td>
<td>Factor</td>
<td>PR</td>
</tr>
<tr>
<td>4.25 %</td>
<td>23.53</td>
<td>€ 860</td>
<td>4.75 %</td>
<td>21.05</td>
<td>€ 885</td>
<td>5.00 %</td>
<td>20.00</td>
<td>€ 450</td>
<td></td>
<td>5.25</td>
<td>19.04</td>
<td>€ 700</td>
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</table>


The mechanism which leads to the price factor is actually similar to price mechanisms on stock markets. The majority of market participants estimate the future prospects of the investment (here property vehicle or property itself) considering all related influencing
factors. Higher prices are based on positive future prospects (at least expected) - and vice versa. In that case an above-average return probably suggests that the prospects are not so positive. Zurich, London or Munich are cities which are booming. Rents are high and purchase prices of real estate investments are horrendous. Nevertheless, investors are willing to pay and relinquish on a high initial yield. These cities are seen as prospering cities with long-term economical strength and functioning labor markets. By contrast, in many rather underdeveloped regions properties are available for lower prices and entail an alleged high initial yield. But whether such a property investment is a long-term safe investment is more than uncertain. The purchase factor can be used as reference point whether the property is traded at a fair price; however, this indicator is just slightly revealing without considering the above mentioned property characteristics against the background of the corresponding market.

- Alignment of interests

As already often indicated, besides the lost of large sums of money, real estate investment companies lost above all the trust of investors. One emerging measure to promote the alignment of interests between investment companies and its investors are co-investments. The alignment of interests with fund managers has been cited by a large percentage of investors (76%) within the INREV survey as one of the main reasons for not investing in non-listed real estate funds. The best proof for investors if the investment company is convinced by its own product is the investment of own capital. While companies invest a considerable amount of own capital it does not only just diversify the risks on paper, but also presents a trustworthy signal. Besides the above described general framework of product-investor matching real estate investment companies have to cope with upcoming trends and changes regarding investors´ interests and demands.

4.4. Risk considerations

All the above-mentioned considerations and dimensions occupy different facets regarding risks. The following paragraphs present a structured approach of the different risks within the markets of real estate investments. The three substantial determinants of real estate investment risks are leverage, diversification and quality of management (including the underlying property chosen by the management).
4.4.1. Leverage

To some extent tangible assets are of course also subject to value fluctuations, even if it is not directly visible for the investor. As long as the properties are fully let and ensure the rental income for a steady cash flow the main risk in this context is reflected by a contractual fixed LTV demanded by the financing bank. The breach of the LTV due to price decline of the underlying properties entails bank’s claim to inject more equity, which in turn can jeopardize the entire fund structure. Especially CEPFs which have just a limited period of time of financing are threatened by potential “LTV-breaches”, since it raises the question who will inject fresh capital in order to hold up the contractual fixed LTV. Because of that CEPFs leverage more conservatively by trend relative to aimed risk-return strategy (≈ 50% on average). But OEPFs are also affected by the risks caused by high leverage. In the course of the legislative changes in the aftermath of the crisis, OEPFs going to be forced to lower the limit for capital gearing from 50 to 30%. Besides, valuation of the properties must be carried out not anymore annually but quarterly, which ought to inform fund managers and investors early enough if LTV is at risk.

4.4.2. Diversification

The diversification benefits of cross-country real estate investments have been well documented within scientific literature in the past. However, in practice these benefits seem to diminish, since especially on European markets rents and prices move more and more together. Last published office property clock (Jones Lang LaSalle) with focus on European office markets points out that except for some outliers most European markets go hand in hand regarding rents. Although there is a basic correlation between European Cities´ rents and property price, some markets are more volatile than others. In this context the decisive role of the right timing regarding property acquisition within market cycles is strengthened. Different volatility of real estate markets has to be taken into consideration, for instance German real estate markets were less volatile compare to London´s real estate market within the recent financial crisis, so that the risk exposure applied to real estate funds invested in Germany was much lower. That enables investment companies to “ride the cycle” which in turn may serve as risk reduction supplementing considerations regarding diversification. Basically the expression “ride the cycle” describes the case when the investment takes place when the rents and thereby prices are low, and contrary to that the divestment when rents and prices are high, so that the profit margin is maximized. However, fund structures (especially CEPFs) will face several cycles in between before the final divestment.
Another way of diversification within the real estate sector is via investing across different property sectors, which is often a more efficient method, as apart from an overall economical crisis the different sectoral cycles are normally not moving together. A crisis within the car industry for instance hits first and foremost the industrial sector and thereby the according industrial properties. Bubbles on a housing market do (normally) not have an impact on the office sector and vice versa.

### 4.4.3. Quality of Underlying Property

The paragraph about corporate considerations referring to property characteristics reveals that investment companies can match their desired risk-return profile of the product to the three indicators building, location and tenancy. Although “poor” characteristics regarding the three indicators inherent a lot of risks for the investment, as suggested in paragraph “Value Optimization” especially a deliberate management followed after the acquisition can be a major source of value enhancement. So in general it is idle to discuss risks related to property’s characteristics, since the basic idea behind investing in properties with poor characteristics is often to display progressive investments with certain risk accepting strategies. Property companies should be nonetheless aware of their capability to manage properties in one way or the other. If the cores competency for instance does not imply property management consisting of value adding measures then properties with poor characteristics may expose more risks than to companies with adequate expertise (see also 5.2. Core Competencies & Expertise).
4.4.4. Further Aspects

As mentioned before risk considerations occur on all different levels within the allocation process and company’s strategical deliberations. The three above mentioned paragraphs handle risk considerations within the general framework of indirect real estate investments. In the following passages further aspects will be presented which have a rather feasible and applicable character.

4.4.4.1. Risk Management Tools

The simplest models of risk management consist of a probability multiplied by an impact. However, depending on the considered circumstances different tools are appropriate and applicable. The following tools are applied by IVG Immobilien AG and are again geared to the now already well-known different dimensions of an allocation process.

- Tenant Credit Rating Analyser

Since a safety cash flow is the essential ingredient for real estate investments, companies play it safe and give special attention to the tenant’s credit worthiness. Besides credit ratings of CRAs property companies consult different credit bureaus. Widely-used credit worthiness information about tenants is receivable by Dun & Bradstreet (D&B)¹⁶. D&B’s information are based on tenant’s current financial statements which lead to an objective evaluation of tenant’s probability of insolvency. D&B’s final score is weighted on 22 criteria plus filtering and labeled by a number between 1 and 100. In case of IVG Immobilien AG further filtering regarding the terms of contract (duration, rent, rentable area etc.) are incorporated to come up to a final evaluation of the tenant´s credit standing.

- Property Scoring

Within the fundamental dimension about the characteristics of the underlying property the tool “Property Scoring” is in use. It is a standardized platform for the quantification of qualitative features of properties. The focus lies on the property’s competitiveness (letting potential) within the relevant local market based on the 24 criteria regarding the micro-location (accessibility, immediate surroundings etc.) and 25 building parameters from tenants view (flexibility, equipment, parking etc.). Furthermore an adaptation to property’s type

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¹⁶ see Glossary
(sector) and to country-specific peculiarities is carried out through adapted sets of criteria and weightings. Eventually the data will be compromised to a property score. IVG annually determines a property score as well as before acquisition and after changes of basic conditions (reconstruction, urban development etc.).

Figure 22: Property Scoring

Figure 22 reveals why property scoring inherent many advantages regarding practical risk handling.

- Financial Risk Analyzer
The Financial Risk Analyzer is a tool within the dimension of Product & Investor -Matching, since it reflects the analysis especially in terms of fund duration, currency risks, or compliance of credit conditions which in turn have an influence on investors’ returns. Generally financial risk analyzer handles the entire analysis regarding the financial structure of funds structures (leverage, value enhancement, interest and currency rates etc.).
4.4.4.2. Ratings

Credit rating agencies (CRAs) play a huge role in financial markets through the provision of credit risk information to market participants like issuers, investors, banks and regulators (de Haan & Amtenbrink, 2011). There are around 150 CRAs, but the three largest competitors share roughly 95 percent of the market (ibid.). According to White (2010) the market shares (based on revenues or issues rated) of the three firms are commonly estimated to be approximately 40, 40, and 15 percent for Standard & Poor’s, Moody’s and Fitch, respectively. The ratings show a range from AAA to D and indicate the probability of defaulting on a loan. Especially as an alleged trigger for the financial crisis the agencies and its credit ratings moved into the focus of the public interest. Since ratings and its role within the financial crisis is not subject of this thesis, the following paragraph will just exhibit some examples at which occasions (dimensions) ratings come into the play.

Ratings often serve as a fundamental criterion within the decision-making process and the market of indirect real estate investments is at this no exception. One can relate different objectives which ought to be rated to the aforementioned dimensions. Within the dimension of “economical and political environment” one indeed considers rating by the above mentioned CRAs, because they evaluate the credit standing of countries and its government related institutions. Standard & Poor’s for instance currently rates 126 sovereign governments and has established transfer and convertibility (T&C) assessments for each country with a rated sovereign. Based on a country’s rating investment companies can already depict a certain risk-return profile of their investment and its adherent product.

Within the next dimension “Overall Corporate Strategy” CRAs evaluate and interpret information from a multitude of sources. Credit ratings provide a detailed opinion about a corporation’s credit risk and are also useful for comparing a company’s creditworthiness to that of its peers. Good ratings may have therefore a signaling effect for investors and credit grantors.

On the level of “Product & Investor - Matching” ratings may label the eventual investment product in order to signal the investor the according risk-return profile. In this context there are further agencies besides the common CRAs and its “big three” on the market which are specialized in rating and evaluating fund vehicles or of course stock analysts. In case of fund ratings it often comes down to evaluate if the communicated risk-return profile of the product
is conform to the investment’s inherent features. So to say a proof if the investor is getting what he/she is paying for.

Regarding the central corporate considerations about the constitution of the underlying property one can make further distinction referring to ratings. Real estate appraisal or property valuation represents a major professional field within the markets of real estate investments. In Germany real estate assessment is regulated by a given legislation procedure determined by the application of sound business management, legal and structurally engineered expertise. The valuation incorporates characteristics of the building (land) and its location in order to come up to an appropriate and objective market value. and depending on. Residual component of the underlying asset is the tenancy. Depending on the tenant investment companies can consult different kind of ratings and valuation. For major companies normally exists bond credit rating which assesses the credit worthiness of a company’s debt issues. For tenants who are rather small or medium size companies and in turn are not financed via bond issuing the above mentioned D&B credit ratings may serve as sufficient information.

5. Corporate Implementation of Allocation Approach

5.1. Top Down vs. Bottom Up

Considerations regarding the corporate implementation of an appropriate property allocation process often devotes to the interplay between Top-Down vs. Bottom-Up approach. In management and business administration areas, the terms "Top-Down" and "Bottom-Up" are used to indicate how and on what corporate level decisions are made. The former approach keeps the decision on the top level management within the company. This approach can be efficient in sense of time-saving and constantly internalizing superordinate corporate interests. However, as mentioned before the functioning of real estate markets depends on local peculiarities which in turn requires locally knowledge, expertise and networked business relations. Against this background the Top-Down approach discloses an important drawback, because it suggests that the top level management has the required knowledge and is perfectly informed about the details of the product and circumstances on the specific market (micro location, property characteristics and so forth). Overcoming this obstacle by filtering and transferring the information throughout the organization to the top management level can be very time-consuming and offset the intended time efficiency.
Ultimately, the best way is indeed to find a well coordinated interplay and coexisting approach in order to merge the vision of top level management with the skills and knowledge of lower level employees. Top level management creates guidelines for acquisition and allocation decisions based on considerations regarding the overall corporate strategy covering market positioning and stakeholder interests. The management board should internalize past and future economical and political circumstances and give out guideline principles within the lower management level has a wiggle room in order to make decisions in the presence.

**Figure 23: Exemplary Implementation of Allocation Process (Bottom Up)**

Source: Own illustration

Figure 23 shows an exemplary implementation of a Bottom Up approach. At this the basic decision about the acquisition of a property lies in departments at lower management level. Based on guidelines regarding purchase price, property’s characteristics and macro market conditions lower management departments are allowed to carry out acquisitions without further inquiry. After acquisition the decision about property utilization within a company may shift to a superior management level. However, within this framework an entire
operation from property acquisition to final utilization and resale (exit) can be carried out with the consultancy of top management.

5.1.1. Centralized vs. decentralized / Structured vs. Flexible

One further facet of the implementation of an allocation process based on the interplay of Top-Down and Bottom-Up is a corporate structure displaying an interaction of centralized and decentralized decision making. Local expertise and networked relations are often the crucial aspect within a competitive market of real estate investments. As mentioned before in real estate investment markets it often comes down to right timing in order to make an investment beneficial or prejudicial. Negotiations of any sort (with developers, tenants, investors, banks) ought to be conducted personally as far as it is possible. Depending on its size and its degree of internationality (spread of target markets) a real estate investment company should try to establish local departments in order to widen its network. Size and degree of internationality of a company is at this juncture the crucial indicator. Small and medium size investment companies who are focusing on their national market of course have no incentives to establish subdivisions abroad. However, if once the decision is made to conquer and to take roots in foreign markets a local subdivision becomes soon or later indispensable. Besides time inefficiency further drawbacks may occur while forcing decentralization. A too scattered organizational structure may disguise the “big picture” and the coordination of all subdivisions and the communication in between become impractical.

Another perspective on Top Down vs. Bottom Up approaches is represented by the question if a company wants to operate in a rather structured or flexible way. Here again a compromising way is often the best solution. A Top Down approach equates a rather structured organization which often cancels out company’s ability to react immediately to changes on local markets or occurring acquisition opportunities. Decentralized structure with many independent subdivisions may secure a company’s flexibility in reaction time, but especially in the case of major listed companies a certain degree of centralized coordination is necessary. Flexibility is often referring to the freedom of decision on a lower management level. This can be also a double-edged sword, since it may imply higher motivation for employees, but also that co-workers may eventually be overextended with the tasks they have.
5.2. Core Competences & Expertise

As mentioned before real estate investment companies need to regain the trust of investors. Real estate investment companies often communicate their track records within selling brochures or annual reports, which suggest the experience and past success of their issued products or performed transactions. Again it becomes more important to convince investors of company’s know-how, expertise and capability to fulfill investors’ demands. Based on a basic corporate strategy the allocation processes can be steered and improved by the deliberate selection and employment of experts with certain competences and expertise. One way in doing that is to focus on certain core competencies and/or strengthen specific product departments with the employment of experienced workers in that respective field. This can be for instance the employment of workers who are experienced in the conception of CEPFs with core character. Another example would be the employment of researchers and market analysts in order to promote product innovations or to take advantage of market cycles (“riding the cycle”). In the case of major listed companies which are offering a range of different investment vehicles (generalists) it is eminently important to establish distinguishable brands, since investors’ may have a blurry impression of the company and are uncertain about companies’ actual activities and core competencies.

6. Outlook

6.1. Overall Economic Outlook

*Extract from “OECD - Economic Outlook No. 89” published on the 25th of May in Paris:*

“The global recovery is becoming self-sustained and broader based. The recovery is taking place at different speeds, between advanced and emerging economies, but also within the first group of countries. Unemployment remains high across most of the OECD countries. In most, headline inflation has risen strongly, and expectations are also drifting up; however, underlying inflation seems likely to edge up only slowly. Vibrant domestic demand growth, negative supply shocks and strong capital inflows in non-OECD economies are generating inflationary pressures prompting policy restraint that could slow the recovery.”

In Germany the export-led recovery is continuing, with domestic demand, notably business investment and private consumption, increasingly contributing to growth. Employment
continues to rise and, coupled with wage increases, should support private consumption growth over the next couple of years. However, growth is supposed to slow down somewhat in 2012 as the output gap closes during that year. OECD’s outlook prognosticates a growth in GDP of 3.4 and 2.5 % in 2011 and 2012, respectively.

German national finances profited by strong economic growth. The deficit increased only marginally in 2010, to 3.3% of GDP, by far the lowest among G7 countries. Nevertheless, government debt rose significantly in 2010, mostly because of measures regarding the stabilization of the banking sector. The consolidation measures that the government has appropriately put forward should be implemented as planned to bring down the budget deficit and meet the fiscal rule.

The extract from OECD’s economic outlook points out that especially actual and anticipated inflation becomes a major economical concern in the near future. Additionally it is expected that the ECB will continue increasing interest rates in the long run, since it is the measure to counteract potential inflation and the ECB has a target inflation of 2%.

6.2. Market for Indirect Real Estate Investments

As suggested before the monetary phenomenon “inflation” fosters investors to escape into tangible assets. Because of that and referring to OECD’s latest economic outlook, markets for indirect real estate investments should benefit from these described circumstances. Besides inflation fears dollar weakness and euro crisis let tangible assets become a good alternative compare to other investments (VGF CEPFs industry report).

According to a survey conducted by Feri EuroRating\textsuperscript{17} and despite of bad experiences during the financial crisis and some current negative news about indirect real estate investments especially institutional investors are planning to increase their investment quota in the asset class of indirect real estate investments (Feri EuroRating Quarterly Report). In this connection of course tailored SPFIs are increasingly becoming the dominant form of investments for institutional investors. From the perspective of institutional investors CEPFs or real estate stocks will not benefit from the crisis of OEPFs. This statement is confirmed by institutional

\textsuperscript{17} see Glossary
investors’ decline in shares of CEPFs, which fell to 4.1 percent (minus 3.1 percent). Real estate stocks (including REITs) still do not play a crucial role within the portfolio of institutional investors (Feri EuroRating Quarterly Report).

However, the market participants need certainty regarding future regulatory changes and requirements at national and European level in order to accomplish a fast and successful implementation. In addition it is decisive that the industry of indirect real estate investments regains the interest and loyalty from institutional but particular from private investors (VGF CEPFs industry report). To achieve this aim a few circumstances are supposed to get together. First of all the industry itself has to take a clear position after the market adjustments based on the legislative changes and economical development (increasing interest rates and anticipated inflation). Secondly, after the cleansing of the markets when poor performing products and dubious issuer are pushed out the market, especially private investors will get a clearer picture of the market and abandon their cautious behavior. The recovery of the overall economies including labor markets will contribute to this movement.

As suggested in paragraph 4.3.3. new investment targets like airport cities, nursing homes and green buildings will more and more find a way into the market of indirect real estate investments. Furthermore, real estate investment companies will intensify co-investments for two reasons. On the one hand as described in order to regain investor’s trust on the other hand to diversify own risks. In this connection joint ventures (club deals or syndicated investments) will also increase.
7. Conclusion

The initial idea of an analysis which property characteristics are appropriate for an according investment vehicle (CEPFs vs. OPEFs vs. Own investment) and by that reflecting an underlying allocation process was mostly dismissed for following reasons:

Investment and property companies are in the pursuit of properties with similar characteristics given an analogical risk-return profile (core vs. value add vs. opportunistic) and that nearby regardless of the vehicle. Only the financing background of the vehicles can make to some extent a difference in the pursuit of suitable properties. Contrary to that the allocation process in which investment companies decide about the utilization of acquired properties has generally a range of facets and occurs within several dimensions consisting of many influencing factors. This thesis at hand identified the most important dimensions and influencing factors and transferred the information into a structured and organized framework.

One important aspect of the thesis is that all mentioned dimensions and described factors are influenced by the aftermath of the financial crisis. Due to the legislative changes on EU-level as well as on national level based on the failure within the crisis the German market of indirect real estate investments will experience a major transformation. Companies have to adapt their overall strategy not only to these legislative changes, but also to altering demands and requirements of the investors. Especially the wish for more transparency regarding products and vehicles must be satisfied. Providers for indirect real estate investments have to regain investor´s trust and encourage the willingness to invest via co-investments and rather conservative core products. Furthermore, product innovations like green investments, which may also include neglecting pure value optimization or profit maximization, and further target markets (nursing homes, airport cities) will play an important role.

In general every investment vehicle has its right to exist, since it completes the investment spectrum for investors and helps to diversify an investor´s portfolio. This is a fact which will not change in the future. However, it remains to be seen how the different vehicles will cope with the different market conditions and upcoming changes.
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### Abbreviations

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<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>AG</td>
<td>Aktiengesellschaft (Stock Corporation)</td>
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<td>AIFM</td>
<td>Alternative Investment Fund Manager</td>
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<td>AktG</td>
<td>Aktiengesetz (Stock Corporation Law)</td>
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<td>AuM</td>
<td>Assets Under Management</td>
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<td>BaFin</td>
<td>Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)</td>
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<td>BVI</td>
<td>Bundesverband Investment und Asset Management (Lobby of German Investment Fund and Asset Management Industry)</td>
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<td>CDO</td>
<td>Collateralized Debt Obligation</td>
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<td>CEF</td>
<td>Closed-end Funds</td>
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<td>CEPF</td>
<td>Closed-end Property Funds</td>
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<td>CMBS</td>
<td>Commercial Mortgage-Backed Securities</td>
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<td>CRA</td>
<td>Credit Rating Agency</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>DCF</td>
<td>Discounted Cash Flow</td>
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<td>EBITDA</td>
<td>Earnings before Interest, Taxes, Depreciation</td>
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<td>ECB</td>
<td>European Central Bank and Amortization</td>
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<td>EPRA</td>
<td>European Public Real Estate Association</td>
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<td>EVA</td>
<td>Economic Value Added</td>
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<td>GbR</td>
<td>Gesellschaft bürgerlichen Rechts (Private Partnership under Civil Code)</td>
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<td>G-REIT</td>
<td>German Real Estate Investment Trust</td>
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<td>HGB</td>
<td>Handelsgesetzbuch (German Commercial Code)</td>
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<tr>
<td>IFRS</td>
<td>International Financing and Reporting Standards</td>
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<td>INREV</td>
<td>Investors in Non-Listed Real Estate Vehicles (European Association)</td>
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<td>InvG</td>
<td>Investmentgesetz (German investment law)</td>
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<td>IPO</td>
<td>Initial Public Offering</td>
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<td>IRR</td>
<td>Internal Rate of Return</td>
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<td>Abbreviation</td>
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<tr>
<td>KG</td>
<td>Kommanditgesellschaft (Limited Partnership)</td>
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<td>KWG</td>
<td>Kreditwesengesetz (German Banking Act)</td>
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<td>LTV</td>
<td>Loan-to-Value Ratio</td>
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<td>National Association of Real Estate Investment Trusts</td>
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<td>NAV</td>
<td>Net Asset Value</td>
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<td>Net Present Value</td>
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<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>OEPF</td>
<td>Open-end Property Funds</td>
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<td>REIT</td>
<td>Real Estate Investment Trust</td>
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<tr>
<td>ROCE</td>
<td>Return of Capital Employed</td>
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<td>ROIC</td>
<td>Return on Invested Capital</td>
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<td>SEC</td>
<td>U.S. Securities and Exchange Commission</td>
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<td>SPF</td>
<td>Special Property Funds</td>
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<tr>
<td>WACC</td>
<td>Weighted Average Costs of Capital</td>
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Glossary

alstria office REIT-AG
alstria office REIT-AG is an internally managed Real Estate Investment Trust (REIT) solely focused on acquiring, owning and managing office real estate in Germany. alstria was founded in January 2006 and was converted into the first German REIT in October 2007.

Commerz Real AG
Commerz Real AG is a wholly owned subsidiary of Commerzbank AG which is the second-largest bank in Germany, after Deutsche Bank, headquartered in Frankfurt am Main. With approx. € 45 billion in assets under management, Commerz Real is one of the world’s largest property asset managers and providers of leasing and investment solutions.
http://www.commerzreal.com/

Dun & Bradstreet
D&B (NYSE: DNB) is the world's leading source of commercial information and insight on businesses, enabling companies to Decide with Confidence® for 169 years. D&B's global commercial database contains more than 177 million business records. The database is enhanced by D&B's proprietary DUNSRight® Quality Process, which provides our customers with quality business information. This quality information is the foundation of our global solutions that customers rely on to make critical business decisions.
http://www.dnb.com/

E&G DIMAX:
The first comprehensive stock index for German property companies – the E&G DIMAX – was created by Ellwanger & Geiger in 1995. With this index, Ellwanger & Geiger was a pioneer in the property stocks sector in Germany.
http://www.privatbank.de/en/eg_dimax.html

EPRA:
European Public Real Estate Association represents the publicly traded real estate sector in Europe. EPRA’s members are Europe’s property companies, investors and consultants that
together have more than EUR 250 billion of real estate assets. With more than 200 active members, EPRA is the voice of the European publicly traded real estate sector.

http://www.epra.com/body.jsp

**Fair Value REIT-AG**
Fair Value REIT-AG acquires and manages commercial real estate in Germany. Investment activities currently primarily focus on office and retail properties in regional centers.


**Feri EuroRating**
Feri EuroRating Services AG is one of the leading European rating agencies specialized in investment market and product ratings and also one of the leading economic research and forecasting institutes.

http://frr.feri.de/en/about-us/portrait

**Finance Initiative Germany**
The “Initiative Finanzstandort Deutschland” (IFD) is an action group for the German financial sector. It operates in cooperation with the Federal Ministry of Finance and the Bundesbank. Since its founding in 2003, the IFD has developed numerous measures and projects that have provided a stimulus for growth and thereby have had a positive impact on consumers and companies. Some of the IFD’s successfully implemented measures are: establishment of the Hesse Fund for the financing of small and medium-sized enterprises (SMEs), a common rating scale for the transparent classification of credit ratings of SMEs, the development of a concept for a new investment vehicle for real estate (REITs), as well as various building blocks for finance education in Germany.

http://www.finanzstandort.de/en/home/

**IPD (Investment Property Databank)**
A global real estate information business with services related to the commercial real estate market, which employs over 250 graduates worldwide to provide institutional investors, occupiers, advisors and researchers with objective, reliable real estate benchmarks and market indices.

INREV:
INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. Their aim is to improve the accessibility of non-listed real estate funds for institutional investors by promoting greater transparency, accessibility, professionalism and standards of best practice. As a pan European body, INREV represents an excellent platform for the sharing and dissemination of knowledge on the non-listed real estate funds market. The association’s primary focus is on institutional investors, although other market participants such as fund managers, investment banks, lawyers and other advisors provide additional support.

www.INREV.org

INREV Survey “Investment Intentions Survey 2011”
The 7th INREV Investment Intentions Survey provides insight into the expected trends among investors, fund of funds managers and fund managers in the non-listed real estate funds industry in 2011. The report is based on the results of an online survey that questioned INREV members and other participants in the industry. The survey attracted 121 respondents, which comprised 33 investors, 19 fund of funds managers and 69 fund managers. The investors responding represent a total of € 981 billion assets under management globally.

IVG:
IVG Immobilien AG is one of the major real estate companies in Europe. The company manages assets worth approx. € 22.0 billion and is located with approx. 595 employees (FTE) in 18 selected major German and European cities. Via this network of local branches, IVG manages inter alia on balance properties with a market value of € 4.3 billion.

In northern Germany IVG constructs and operates underground storage caverns for oil and gas. In the fund segment IVG is the leading provider of tailored property funds for institutional investors. In combination with the closed-end funds for private investors, IVG manages funds and mandates amounting to a volume of € 15.3 billion.

Hamborner REIT-AG:
HAMBORNER REIT AG is a stock exchange-listed public limited company that today exclusively operates in the property sector and is positioned as a portfolio holder for high-yielding commercial properties.

http://www.hamborner.de/Hamborner-REIT-AG.139.0.html?&L=1

LTV (Loan-to-Value ratio)
The purpose of establishing the LTV is to protect the lender from lending more money than the property is worth. However, banks as lenders are facing a basic risk related trade-off, since the higher the loan amount the more profit banks can gain. In turn, for debtors, the LTV weighs heavily on the interest rate. Since higher LTV imply higher risks for the lender, he wants to be compensated by demanding higher interest rate.

NAREIT:
National Association of Real Estate Investment Trusts is the worldwide representative voice for REITs and publicly traded real estate companies with an interest in U.S. real estate and capital markets.


SEC:
The U.S. Securities and Exchange Commission (frequently abbreviated SEC) is a federal agency which holds primary responsibility for enforcing the federal securities laws and regulating the securities industry, the nation's stock and options exchanges, and other electronic securities markets in the United States.

http://www.sec.gov/index.htm

Statista:
Statista is the leading German company for statistics available in the Internet. Statista.com is the world's first statistics portal which bundles statistical data of various institutions and professional sources. It provides users statistics to over 60,000 issues of more than 1,000 different sources.

http://de.statista.com/ (only in German)
Swaps:
Traditionally, swaps represent the exchange of one security for another to change the maturity (bonds), quality of issues (stocks or bonds), or because investment objectives have changed. Recently, swaps have grown to include currency swaps and interest rate swaps. A currency swap is a foreign-exchange agreement between two parties to exchange aspects of a loan in one currency. http://www.investopedia.com/terms/s/swap.asp

Tax Transparency:
A vehicle is transparent when it is itself not subject to taxation and investors’ investments are treated as if it would be direct investments. The initial investor is taxed only when the investment structure distributes its gains and revenues.

Verband Geschlossene Fonds (VGF)
VGF is the association which represents the interests of providers of closed-end funds on the German market. Currently VGF represents 59 members, including 44 providers of closed funds and 15 supporting members. The 44 providers manage a total investment of around €165 billion. This is more than 80 percent of Germany’s overall market for closed-end funds. In 2010 the association's members have set up a fund volume of approx. €7.8 billion. Based on the total emission volume of €10.8 billion this represents a share of more than 70 percent.
http://www.vgf-online.de/
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