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Investing in German Real Estate

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Published by PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft

By Prof Dr Florian Hackelberg (IWM) and Dirk Hennig

February 2018, 58 Pages, 23 Figures, 4 Tables, Soft cover

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Preface

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In recent years, the German real estate markets have established themselves as a safe haven for international capital flows both in terms of use types and locations. Although Germany is a popular investment destination among investors for being stable, it is far from being static.

In the last three years, market developments have gained additional momentum, made evident by rising transaction volumes and decreasing yields. This is mainly due to the excellent economic and political conditions, a highly professionalised industry and low purchase prices compared to other countries in an attractive interest rate environment.

Low interest rates are pushing further investment in real estate. However, a lack of product and high competition is continuing to put pressure on real estate yields. Many investors are looking for opportunities to invest in B or even C locations, value-added real estates, project developments, or in asset classes once reserved for specialised investors like hotels, health care properties, etc.

In our market study *Emerging Trends in Real Estate, Europe 2018*, we were able to identify digitisation and urbanisation as the industries' core topics. We analysed how these megatrends drive the markets today and, based on this analysis, deduced how the different real estate markets will develop. Driven by the digital revolution, former niche products such as logistics real estate have gained the status of core investments. Furthermore, data centres have emerged as a completely new asset class. Due to the strong demand for rare prime assets, it is more and more common to undertake extensive revitalisation efforts of properties under the manage-to-core strategy.

Both direct and indirect real estate investments in Germany are more popular than ever before. German as well as foreign companies are pursuing cross-border consolidation efforts to leverage synergies. Although the investment markets have been in global competition for several years, local market and industry expertise are essential in order to be able to make optimal investment decisions in the race to achieve targets. In our daily dialogue with customers, we keep our finger on the pulse of the markets, continuously redefine our comprehensive consulting approach and expand our product portfolio by applying innovative tools.

This study aims to contribute to a better understanding of the German real estate markets, their drivers as well as the regulatory framework. Please do not hesitate to contact us to talk about your experiences.

We look forward to constructive discussions and wish you an inspiring read.

Berlin, February 2018

Susanne Eickermann-Riepe **Dirk Hennig**

Preface

The German real estate sector has been stable for several decades, with only very moderate growth rates compared to other European countries. With the ending of the global financial crisis in 2010, this sideward movement changed and a dynamic market development gained remarkable momentum. Today Germany is one of the most promising real estate markets in Europe. Its diverse nature, however, means that most statements concerning "the" German real estate market as a whole are misleading; it is therefore necessary to take a closer look at the market structure, which is both geographically divided and sectorally diverse.

While many rural regions in the north and east are suffering from shrinking populations and a decreasing demand for real estate, the metropolitan areas are booming. Due to Germany's federal structure, there is not one predominant major city that represents the vast majority of the country's property market, as seen, for example, in France with Paris or in the UK with London. What makes the German market interesting is that Berlin, Hamburg, Munich, Frankfurt am Main, Dusseldorf and Cologne – the so-called Big Six – are all compelling investment destinations. Together with its strong economic base and stable growth rates, Germany is increasingly attracting foreign real estate investors, a development which led to a record number of international market participants in 2016 and 2017, surpassing even pre-crisis figures. With uncertainty in the European periphery and unclear Brexit negotiations on the way, this trend might go on with investors looking for safe havens and investment opportunities for their capital.

However, like any other real estate market, the German real estate market has its own dynamics and local regulatory framework that must be understood before investments can be successfully made. To this end, the following study includes an introduction to Germany's tax conditions and regulatory and legal frameworks in addition to providing an overview of market sectors and their respective developments. The last section outlines general procedures and due diligence steps to be performed when investing in the German real estate market.

This study is intended to provide a solid overview of the German real estate market and to be the first step towards making a successful investment. If you have questions or would like further information, please do not hesitate to get in touch with us (info@iwm-institute.com).

Berlin, February 2018

Prof Dr Florian Hackelberg

Prof Dr Florian Hackelberg
IWM Institute

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A Basics of the German real estate market

1 Structures of the real estate market

1.1 Location structure

More than one metropolis

In Germany, the country's federal structure means that there is no one dominant metropolis like London in the UK or Paris in France. Rather, the important real estate markets are spread over several metropolitan regions. The most important ones are Berlin, Hamburg, Munich, Frankfurt am Main, Cologne and Dusseldorf. Together they are referred to as the "Big Six", or, with the addition of Stuttgart, the "Big Seven". In the first half of 2017, those major locations alone generated some €1.56 billion, comprising about 44% of the entire German investment market.

In addition, cities like Hanover, Dresden, Leipzig, Nuremberg, Essen and Dortmund represent promising second-tier real estate markets.

Fig. 1 Major real estate locations in Germany

Reurbanisation leads to shrinking villages and booming cities

The economic situations of the individual regions in Germany differ somewhat and the gap between growing and shrinking areas is increasing. In economically weak areas with decreasing populations, the real estate sector is confronted with vacancies as well as price and rent declines. At the same time, there are growth regions in which rents and property prices are rising. Here significant new construction investments will be necessary as a result of economic prosperity and population growth.

Generally, the trend towards reurbanisation continues. While cities experienced growth stagnation in the 1980s and 1990s, as people moved to suburbs and smaller towns, this situation has changed fundamentally over the last decade. A large proportion of jobs in Germany are now concentrated in cities, and the number of residents in large and medium-sized cities has steadily increased.

This was already predicted by the results of a representative study conducted across Germany by Immowelt AG in 2012, which reported that 67% of residents of small towns and villages wish to move to larger cities. Reasons cited are the greater cultural offering, better shopping options and attractive job prospects as well as the desire for a more modern life and a shorter commute. As a result, small towns and villages in rural areas such as Brandenburg or Thuringia in eastern Germany and certain areas in North Rhine Westphalia in the west are shrinking. In contrast, 84% of the urban population are generally satisfied with the choice of their place of residence and only 8% consider moving to a small town or village. As a result, major cities like Munich or Frankfurt am Main have already experienced a population increase of up to 20% in the first 15 years since the turn of the millennium, reports the *Handelsblatt*.[1]

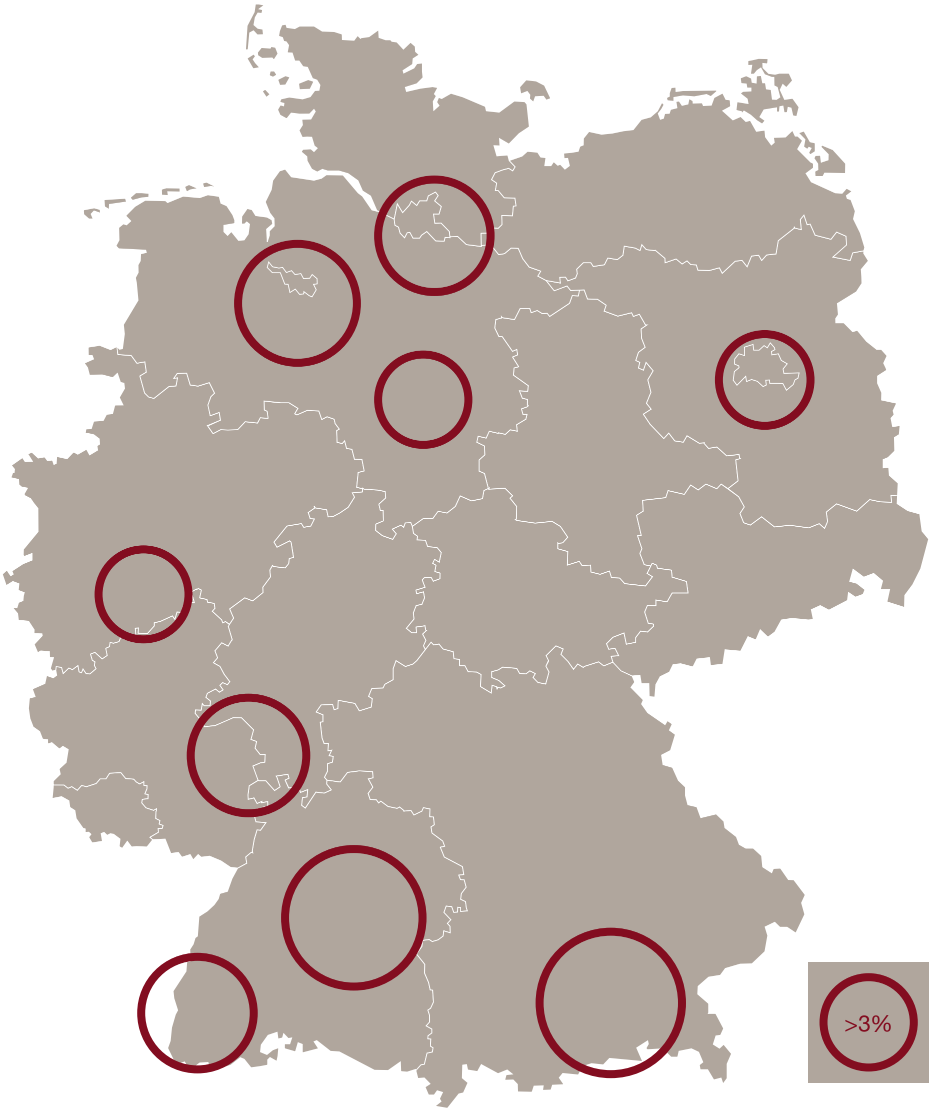
Given this context, the German Bundestag's current report on the housing and real estate sector predicts that the demand for business and residential properties will further increase in economically dynamic regions. In rural areas, however, there is an oversupply, which may lead to high local vacancy rates.

Figure 2 illustrates the increasing divergence in the structure of the German real estate market.

[1] Cf. Handelsblatt, 13/01/2017.

Fig. 2 Regional shift and population concentration in metropolitan regions

Forecasted change in the population figure from 2005 to 2025.



Germany's diversified market structure and the current reurbanisation – and ensuing rapid development – of large German cities offer tremendous opportunities for institutional real estate investors.

1.2 Institutional real estate investment structure

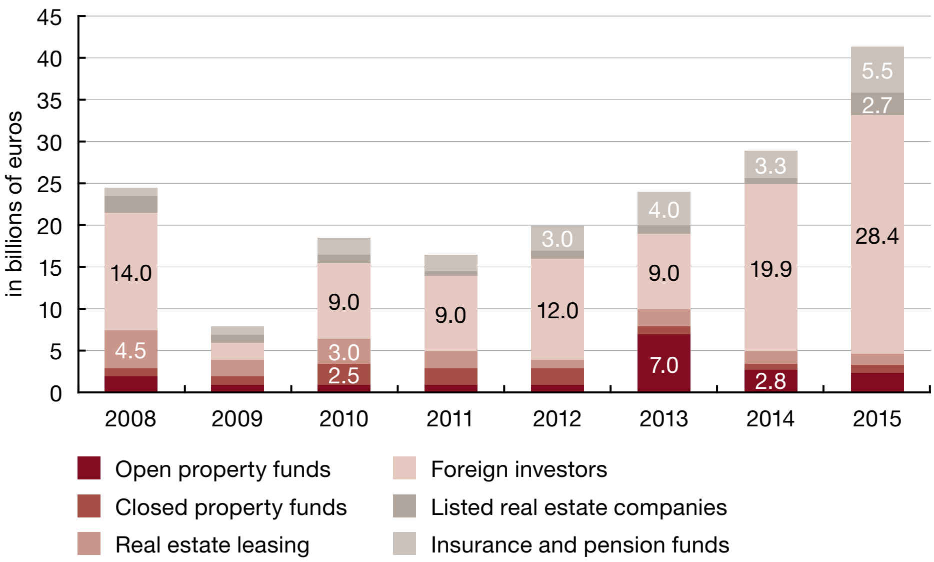
Stable development of institutional real estate developers

The German investment real estate market has witnessed extraordinary growth rates over the last decade and remained a hotspot in the international real estate transaction market in 2017.

In the third quarter of 2017, investment volume reached a new high of €39.5 billion, showing an increase of about 20% compared with the same period in 2016, which saw a total turnover of almost €52.6 billion, the second-best result to date.[2]

As outlined in Figure 3, this development attracted foreign investors in particular. Apart from in 2016, their share in the overall commercial real estate investment market has constantly risen since the financial crisis in 2009. Despite high international demand, domestic players still dominate the market with around 55% of the transaction volume. Special funds, in particular, as well as insurance companies and pension funds, have increasingly manifested themselves as buyers in the past few years. In addition, in 2016, there was an increase in the transaction volume of listed real estate companies of around 65% compared with the previous year. For 2017, a large transaction volume of at least €50 billion is expected once again for commercial real estate.[3]

Fig. 3 Individual and portfolio investments in commercial real estate by institutional investors

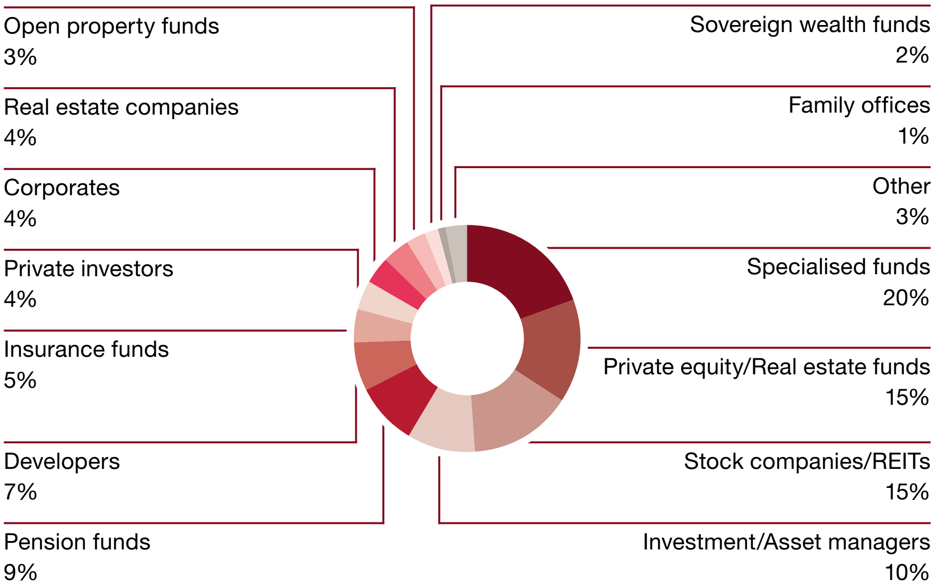


Source: BulwienGesa AG/Drees&Sommer, Die 5%-Studie – wo Investieren sich noch lohnt, 2017.

Another notable development is the resulting structure of institutional real estate investments. As outlined in the pie chart below, specialised funds are still the largest group of investors, contributing 20%, followed by private equity/real estate funds and listed real estate companies (both 15%) and investment and asset managers (10%).

[2] Cf. BNP Paribas, Investmentmarkt Deutschland Q3 2017.
[3] Cf. BulwienGesa AG/Drees&Sommer, Die 5%-Studie – wo Investieren sich noch lohnt, 2017.

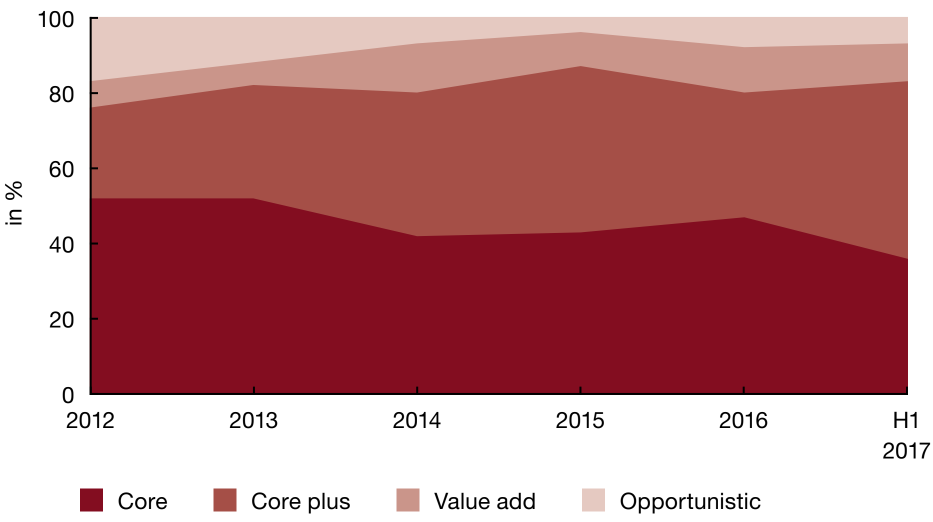
Fig. 4 Institutional real estate investment structure



Source: BNP Paribas, Investmentmarkt Deutschland Property Report 2017.

When assessing the commercial investments in terms of risk profile, there is a clear trend away from core investments and towards more risky ones. Investors are willing to take higher risks despite a lack of sufficient core assets or because the prices of core assets are too high to meet internal hurdle rates. When bringing this into prospective with the development of commercial real estate investment volume outlined in Figure 3 on the previous page, it might be fair to conclude that investment value in both 2016 and 2017 would have been even higher if more suitable core investments had been available, especially for institutional investors.

Fig. 5 Transaction volume according to the risk profile of the investment



Source: Jones, Lang Lasalle, Investmentmarktüberblick Deutschland 2. Quartal, 2017.

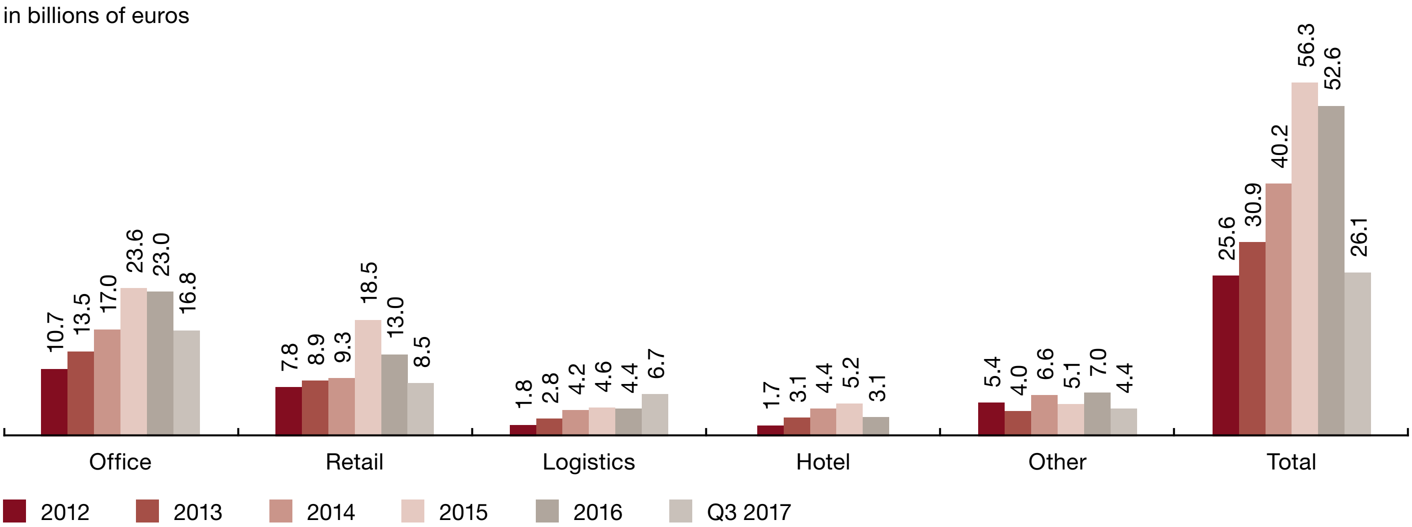
1.3 Investment turnover

The German investment markets have developed positively overall since 2012. The investment turnover of €56.3 billion in 2015 exceeded the previous year's figure by 40%. In 2016 the figure decreased by 7%.

Already in the first half of 2017, investment turnover had reached €26.1 billion. Overall, the sales volume is at a very high level. As a result, the German investment market is also highly attractive on an international level. The transaction volume generated at the country's six most important locations – Berlin, Dusseldorf, Frankfurt am Main, Hamburg, Cologne and Munich – totalled some €19.58 billion, or almost 50% of the total investment volume in Germany in the third quarter of 2017.

With regard to commercial use, office real estate made up the most significant part of turnover at €16.8 billion, accounting for 42.5% of total turnover. This was followed by investments in retail real estate valued at €8.52 billion, comprising 21.6% of total turnover. In these times of e-commerce, people are able to purchase goods and services easily from home, and the demand for faster delivery in big cities has led to an increasing demand for logistics real estate over the last five years. At around €6.67 billion, retail real estate was responsible for some 16.9% of the transaction volume. The smallest part of the transaction volume came from hotel real estate, with a turnover of €3.07 billion or 7.8%. Experts predict a further positive trend and expect a total investment volume of at least €50 billion for 2017.[4]

Fig. 6 Investment in commercial real estate by type of use

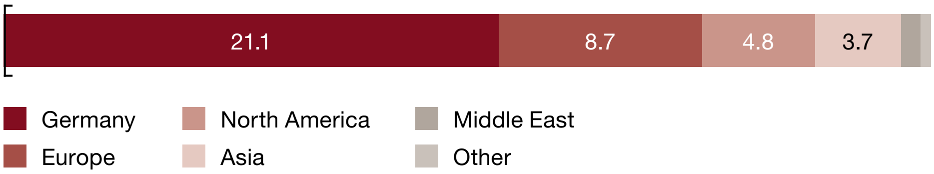


Source: Own depict according to BNP Paribas Real Estate, Property Report Investmentmarkt Deutschland 2014–Q3 2017.

[4] Cf. BNP Paribas Real Estate, Property Report – Investmentmarkt Deutschland Q3 2017.

In the third quarter of 2017 more than half of investors in commercial real estate were German. A further 22% of the capital invested is from other parts in Europe. North Americans invested €4.8 million or 12%. Germany has also become a very popular and attractive investment country for Asian investors (€3.7 million), who contributed 9% of investments. Minor contributions were made by investors in the Middle East and other parts of the world.

Fig. 7 Origins of capital according to region



Source: Based on BNP Paribas Real Estate, Property Report Investmentmarkt Deutschland Q3 2017.

B Market conditions

1 The residential property market

The German residential property market is not an "owner market"

The residential property market in Germany was comparatively stable for several decades and experienced only moderate growth rates in both sale prices and rents. This has changed dramatically over the last years. With the low interest rates maintained by the European Central Bank and thus massive amount of liquidity available in the market, as well as international investors acknowledging Germany as a safe investment haven, the Big Six real estate hotspots in particular experienced increasing demand for residential properties. This has led to significant increases in prices and rents.

From an international point of view, Germany is still not a home-owner market but rather a long-term rental market. Young people prefer to rent a flat instead of purchasing their own home at an early stage. On the one hand, this is due to the increasing flexibility of the labour market and changing family structures; on the other hand, there are also historical reasons for this choice. The German market for residential properties is characterised by state housing associations, which, in the second half of the last century, ensured that the population had a supply of affordable housing. However, state influence on the housing market has been pushed back over the last two decades as a result of the privatisation of state housing associations. The buyers were predominantly financial investors operating on the global level.

Another major factor is German tenancy law, which in international comparison is quite tenant-friendly. Moreover, apart from certain booming metropolitan areas, the general rent level is comparatively low, which further strengthens the case for renting.

On the basis of the latest figures published by Eurostat in 2017, an EU-wide comparison shows that the housing ownership ratio is the highest in Eastern European countries. The high share of residential property in Central and Eastern European countries is mainly due to the privatisation wave following the fall of the Iron Curtain. Germany occupies second-to-last place with a home ownership ratio of 53%, followed only by Switzerland and thus well below the EU average of 71%.[5]

With the current low interest rates, many tenants find that it would be equally affordable to pay off a loan and they decide to buy their own home. This puts further pressure on the market, considering its larger effect given the low ownership ratio in Germany.[6]

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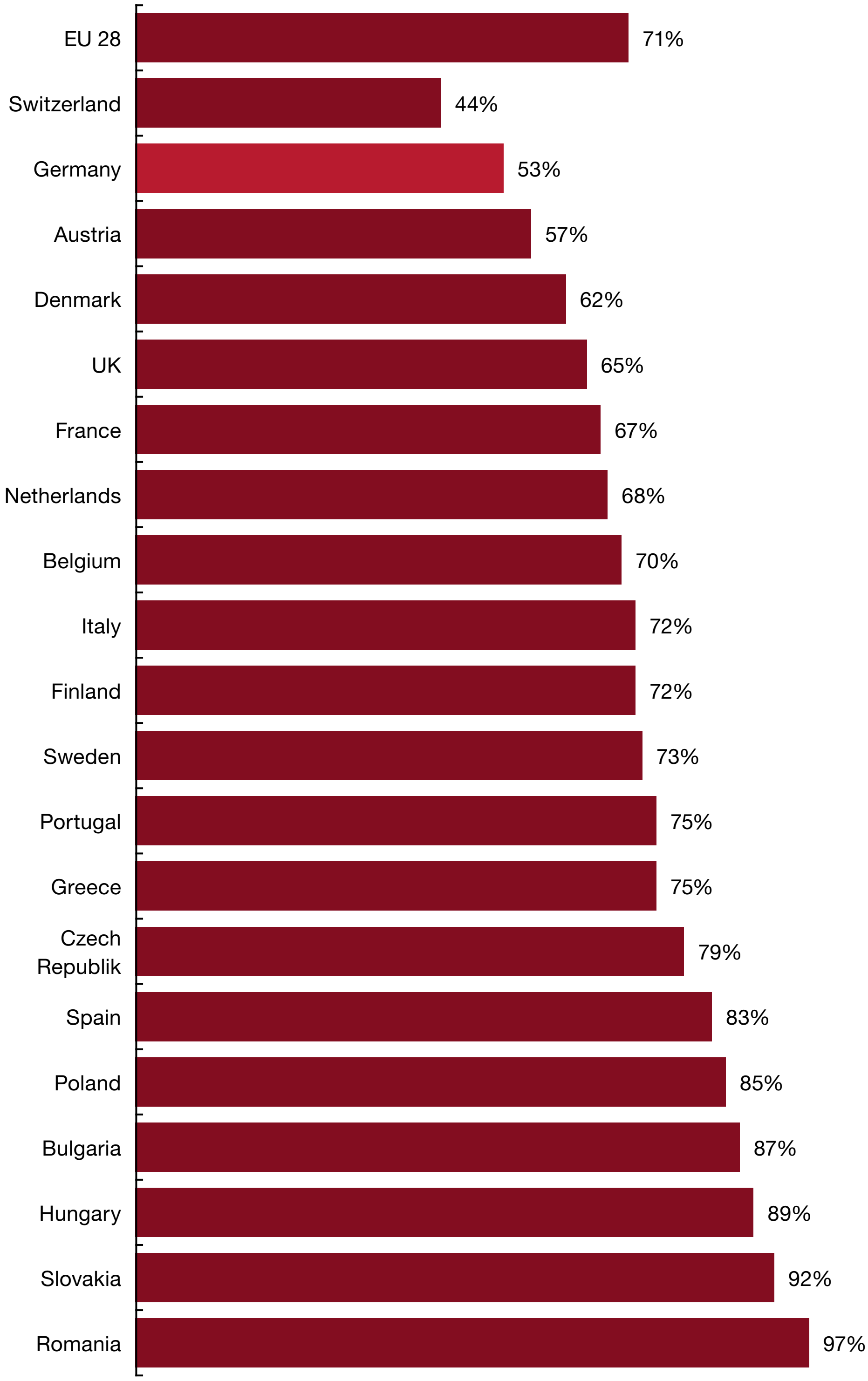
[5] Cf. Eurostat, Distribution of population by tenure status 2015 and LBS Research, 2017.

[6] It should be noted, however, that this survey takes into consideration the population and not the number of households. According to LBS Research, owner households are on average larger than tenant households. For this reason, the rate calculated is higher than the home ownership rate as calculated per unit or household, which has yet to exceed the 50% threshold despite the increase in recent years.

Fig. 8 Distribution of population by tenure status, 2015

(% of population)



Source: Eurostat, Distribution of population by tenure status 2015, 2017, and LBS Research.

1.1 Supply

Differentiated offers for residential properties

The number of building permits issued and flats completed in Germany has risen again since 2010, reversing the downward trend seen in the first decade after the turn of the millennium. According to the German Federal Statistical Office, 277,691 flats were completed in Germany in 2016. Compared to the previous year, this represents an increase of almost 12% (2015: 247,722) and is the highest figure since 1999. In addition, construction was approved for 375,388 flats in 2016, an increase of around 20% compared to 2015, when a total of 313,296 flats were approved.[7]

Overall, the expansion of the supply in the medium term may have a damping effect on further rent rises and price growth rates, especially in rural areas where too many new single-family houses were built.[8] However, despite a general increase in construction activities, there is a marked undersupply – with increasing demand in urban areas.[9] Hence in the coming years, both prices and rents are likely to rise even further, especially in large cities.

1.2 Demand

The two main factors that influence demand for housing are population development and the number of households in existence.

While the number of households is predicted to increase, especially until 2035, the population is expected to decline from today's 83 million to about 68 million in 2060. The latest migration development will lead to a net plus of about one million people in Germany. Overall, the population of Germany is shrinking and growing older.[10] Nevertheless, large regional differences in development are expected.

In contradiction to the shrinking population, the number of households is increasing.

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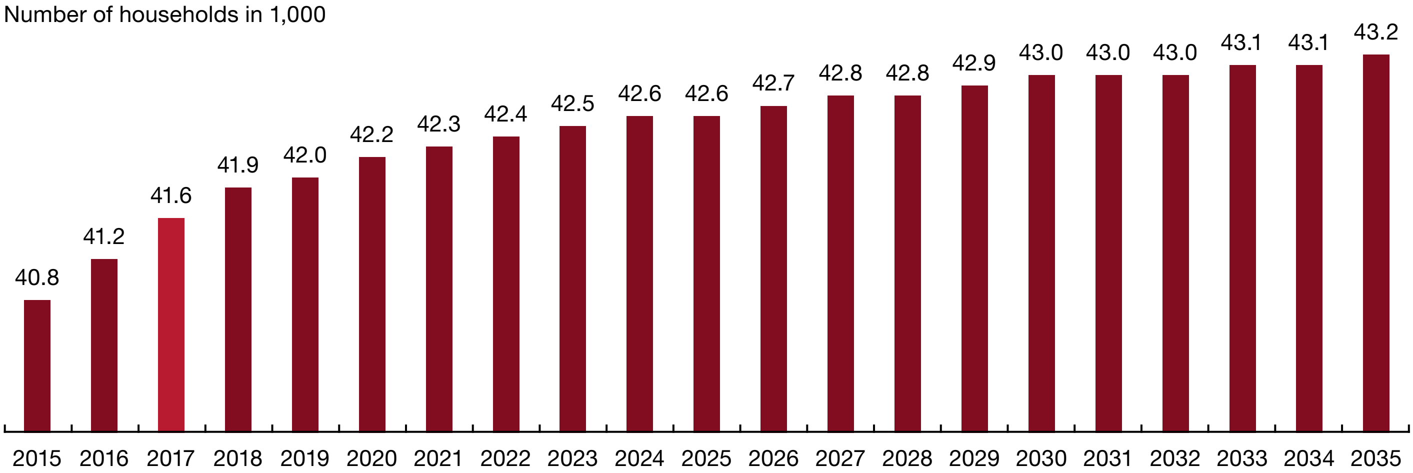
7 Cf. Statistisches Bundesamt, Bauen und Wohnen, Baugenehmigungen und Baufertigstellungen im Hochbau, 26/07/17, www.destatis.de.
8 Cf. Institut der deutschen Wirtschaft Köln, Wohnungsmangel in den Städten, Leerstand auf dem Land, 19/06/17.
9 IVD, Wohn-Preisspiegel 2016.
10 Statistisches Bundesamt, Entwicklung der Privathaushalte bis 2035 – Ergebnisse der Haushaltsvorausberechnung, 2017.

Fig. 9 Expected future development of households until 2035

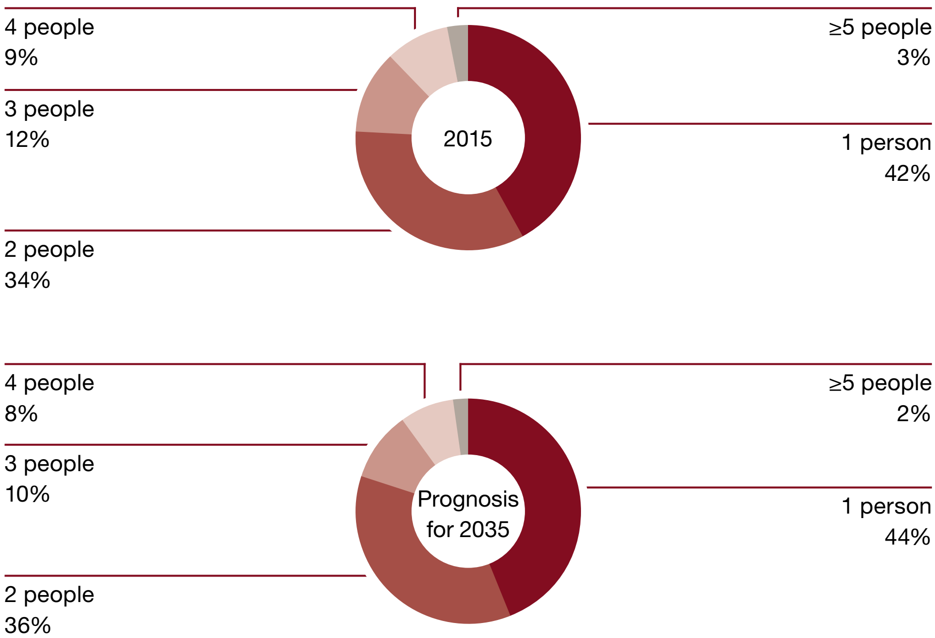


Source: Statistisches Bundesamt, Entwicklung der Privathaushalte bis 2035 – Ergebnisse der Haushaltsvorausberechnung, 2017.

For the time being there is a rising number of households and thus stable demand

The trend towards a reduction in the number of people per household will continue. By 2035, for example, the share of single-person households is expected to further rise from 42% in 2015 to 44% by 2035.[11]

Fig. 10 Development of size of households



Source: Statistisches Bundesamt, Entwicklung der Privathaushalte bis 2035 – Ergebnisse der Haushaltsvorausberechnung, 2017.

[11] Cf. Statistisches Bundesamt, Entwicklung der Privathaushalte bis 2035 – Ergebnisse der Haushaltsvorausberechnung, 2017, www.destatis.de.

This development will further drive positive developments in the housing market in economically attractive growth regions. At the same time, increased vacancy will be evident, especially in the regions of the former East and structurally weak western regions such as the Ruhr area.

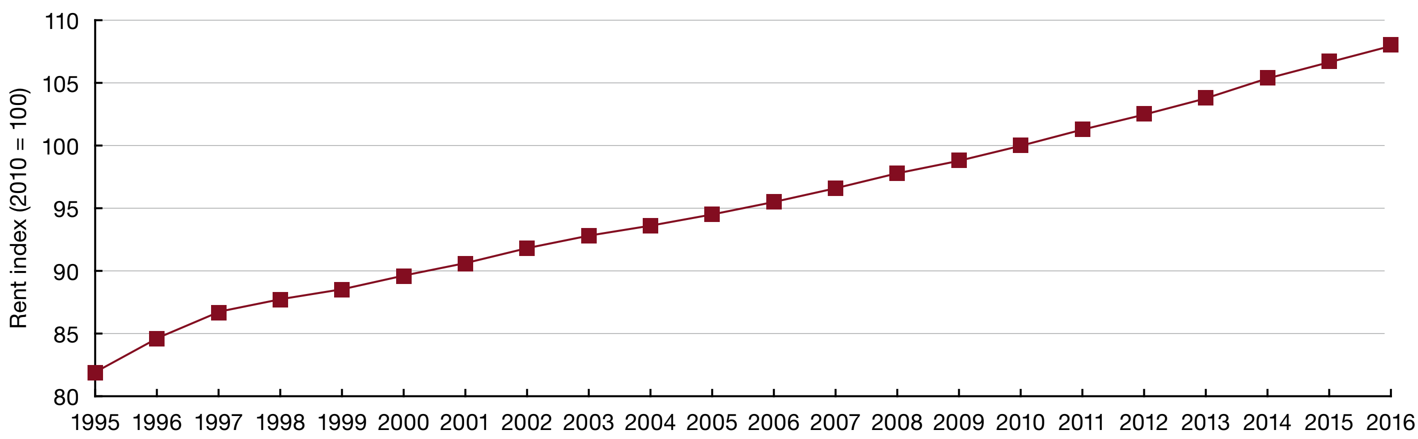
1.3 Rental price development

Residential rents in Munich are the highest

Rents have been rising in Germany since the mid-1990s, with statistics on residential rents showing an overall steady increase in rental prices.

The analysis of rental price development is based on the *Wohn-Preisspiegel* (Residential Rent Index) published by the German Real Estate Association (IVD), which records the development of the housing market in some 390 cities in Germany. In 2016, rents in Germany rose by an average of 1.3%. Taking into account the inflation rate of 0.5% for the comparative period, this shows a moderate price increase.

Fig. 11 Residential rent index 1995–2016, 2017



Source: Statista, Mietindex 1995–2016, 2017.

While this increase as seen in Figure 9 seems quite moderate, there are also differences in rental prices in the individual segments and cities. In general, large increases in rental prices are to be found in the major cities rather than in medium-sized and small cities. In the top 10 cities the average increase in rental prices was around 3.2% compared to the previous year.[12]

[12] According to IVD-Wohn-Preisspiegel 2016/2017, this includes the cities Bremen, Hanover, Dresden, Cologne, Dusseldorf, Hamburg, Frankfurt am Main, Stuttgart, Munich and Berlin.

Tab. 1 Residential rents for selected German cities in 2016 (in euros/sqm)

Location	Excellent	Good	Average	Poor
Berlin	–	9.40–12.50	7.80–10.50	5.88–6.00
Dusseldorf	–	11.00–13.00	9.00–11.50	7.50
Frankfurt am Main	15.00	12.00–13.00	9.50–12.00	8.50–9.00
Hamburg	14.90–16.10	12.30–14.10	9.60–12.30	7.90
Cologne	–	12.50–14.50	10.00–12.50	7.80
Munich	18.50–21.90	14.90–17.00	12.90–15.30	10.50–11.00
Stuttgart	14.60–15.10	12.30–13.70	11.20–12.60	9.40–9.50

Source: IVD, Wohn-Preisspiegel 2016/2017.

There is obviously a huge difference between rents in rural and urban areas, and rental prices also vary greatly among metropolitan areas in Germany. While the cities in northern and eastern Germany have below-average rental prices, the southern and western regions have rents that are above average.[13] Residential rents are historically highest in Munich, with ongoing strong demand due to its strong economic and industrial background and high employment rates.

In Berlin, where rents have always been comparatively low due to its status as a (once) divided city with limited economical capabilities, the situation has also substantially changed in recent years. Since Berlin began developing into one of Europe's most sought-after hotspots for young international creatives, demand for housing has increased sharply. According to a study conducted by PwC and the Urban Land Institute, Berlin has become the most popular destination for people under the age of 40 in Europe. This has led to an annual population increase of an average of about 50,000 people in recent years[14,15] a change which is reflected in residential rents.

[13] Cf. BulwienGesa AG, Immobilienindex von 1975 bis 2016, 2017.
[14] Cf. PwC, Emerging Trends in Real Estate – Reshaping the future® – Europe 2018.
[15] Cf. www.stadtentwicklung.berlin.de/planen/bevoelkerungsprognose/.

1.4 Purchase price development

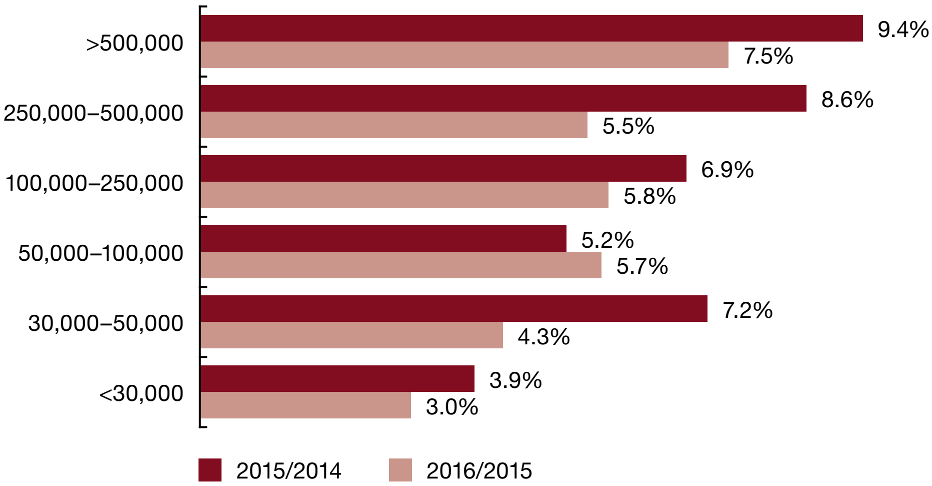
Moderate increases in value of residential properties

Since the mid-1990s, the price increase in German real estate has been relatively moderate until recent years. Compared with rental prices in other European countries, which, by 2010, had seen increases of 16% (Netherlands), 65% (France) and 96% (Luxembourg), prices in Germany have largely remained stable.

This sideways trend for German housing prices has changed dramatically in recent years, however. While in rural areas and cities with fewer than 30,000 inhabitants prices have maintained stable, cities with more than 100,000 inhabitants and metropolitan regions have experienced tremendous development. This trend was even amplified in 2016. Prices for residential property increased in 2016 in all segments more sharply than in previous years. In the German cities in particular, significantly higher price increases for condominiums and single-family houses can be observed than in the past years.

There are significant differences in the price levels depending on the size of the city, as outlined in Figure 10.

Fig. 12 Residential price increase by city size

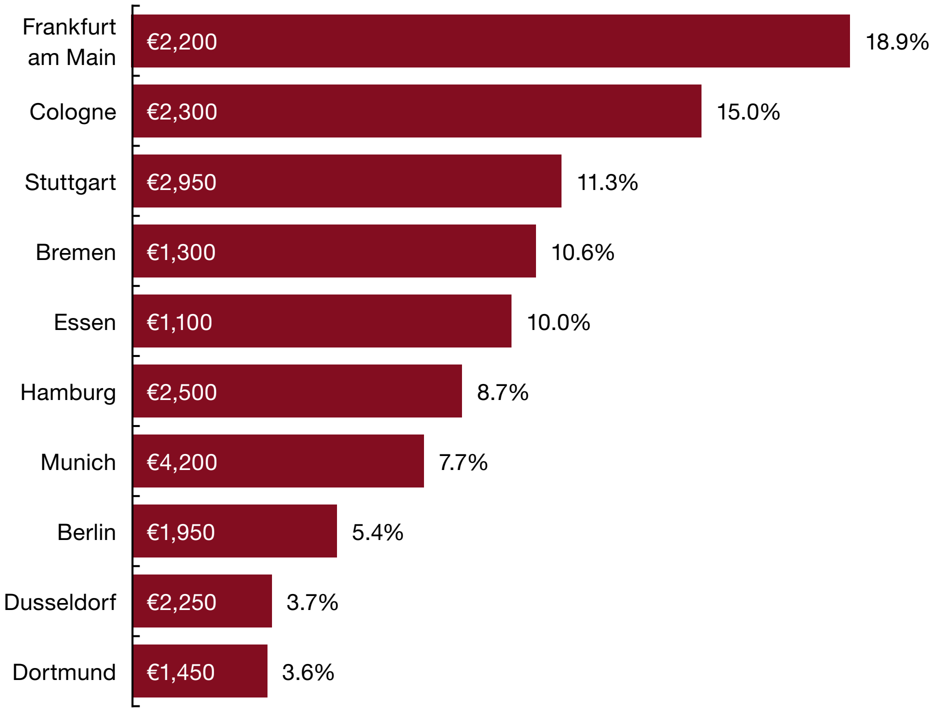


Source: IVD, Wohn-Preisspiegel 2016/2017.

In the case of residential housing prices, there are also strong regional differences within Germany. In the cities of Munich, Heidelberg, Ingolstadt, Freiburg, Stuttgart and Frankfurt am Main, as well as in their surrounding regions, house prices are tenfold higher than in the cheapest municipalities. While average prices for flats increased by more than 9% up to about €2,000 per square meter in cities with over 500,000 people, flats in small cities of fewer than 30,000 cost just half of that, with a price increase of only about 4%.[16]

[16] Cf. IVD, Wohn-Preisspiegel 2016/2017.

Fig. 13 Flat prices per square meter in large German cities with price increase in per cent in 2016



Source: IVD, Wohn-Preisspiegel 2016/2017.

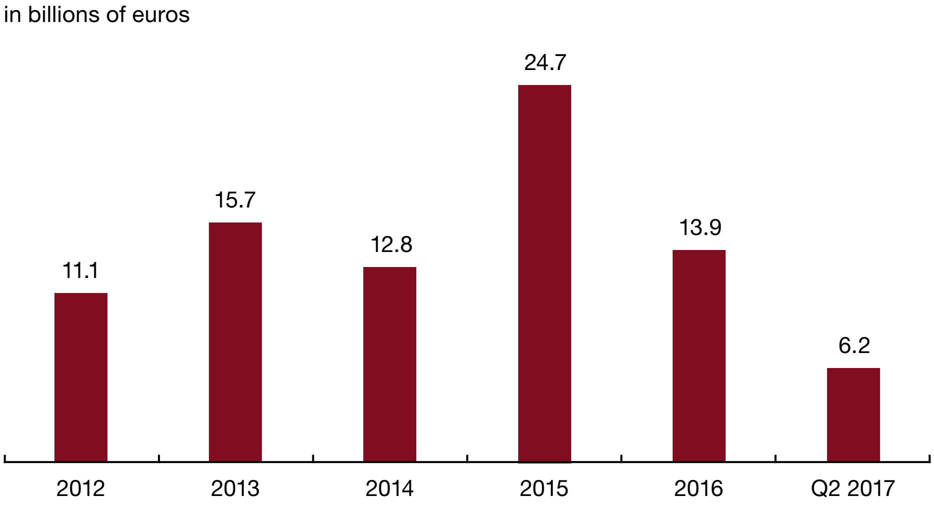
The price increase in 2016 was the highest in Frankfurt am Main at 18.9%, reaching an average price of €2,200 per square meter. However, when looking at the price per square meter outlined in the above chart for each city it should be noted that these represent the average price ranges for the entire metropolitan area. Hence prices may vary significantly within the cities. For example, while the average price in Berlin is given as just €1,950 per square meter, prices in central parts of Berlin may be far above this average.

1.5 Investment turnover

The German market for residential property has been characterised by volatile development in recent years. In 2015, the investment market for residential property portfolios in Germany experienced the its highest turnover since 2002 at €24.7 billion. In the following year turnover decreased by nearly 44%. The transaction volume of residential portfolios in the second quarter of 2017 totalled around €6.2 billion.[17] Development projects or forward deals make up almost 30% of the portfolios.

[17] Cf. Jones Lang LaSalle, Investmentmarktüberblick Deutschland 2. Quartal 2017.

Fig. 14 Development of transaction volume for residential portfolios in Germany



Source: Based on Jones Lang LaSalle, Investmentmarktüberblick Deutschland 2. Quartal 2017.

However, when looking at those figures it is crucial to understand that the decrease in transaction volume is due less to decreasing demand by investors and more to the lack of sufficient supply of adequate residential assets. The following table provides an overview of the development of the residential portfolio investment market in Germany comparing the figures in 2016 and 2017.

Tab. 2 Overview of traded residential portfolios in 2017

	Q2 2016	Q2 2017	Change from the previous year
Number of traded portfolios	283	260	–8.1%
Number of traded portfolios with more than 1,000 units	17	167	+882.4%
Number of traded units	40,404	46,868	+16.0%
Units per portfolio	410	550	+34.1%
Transaction volume	€3.9bn	€6.0bn	+52.0%

Source: Based on Savills Research, Marktüberblick-Wohninvestmentmarkt Deutschland Q2 2017.

2 Market for office properties

Munich has the largest number of office properties, while the highest rents are paid in Frankfurt am Main

The market for office properties developed favourably in 2016. Turnover for office spaces in most German locations clearly exceeded the previous year's level. The vacancy rate was also further reduced due to the high level of demand. This trend continued in 2017. In 2016, the prospects for German office markets were influenced by different trends. First, overall economic growth since the global financial crises, and especially over the last five years since 2012, has led to in an increasing demand for office space. Moreover, an optimistic outlook and healthy sales among companies have led to positive developments in the office property market. The decline in unemployment and the expected increase in disposable income also made domestic demand more important for the German economy.

Tab. 3 Market for office properties, Q2 2017

Location	Take-up (m^2)	Prime rents ($euros/m^2$)	Prime yield (%)	Vacancy rate (%)
Berlin	437,000	29.2	3.3	2.7
Dusseldorf	190,000	26.5	4.0	6.9
Frankfurt am Main	245,000	37.5	3.9	10.8
Hamburg	287,000	26.0	3.4	4.8
Cologne	151,000	21.0	4.5	4.8
Munich	416,500	35.5	3.3	2.5
Stuttgart	116,100	24.0	3.8	2.6

Source: Colliers International, City Survey Deutschland 2012 up to Q2 2017, Büro- und Investmentmärkte im Überblick, 2017.

With more than 430,000 square meters of newly occupied office space, Berlin is the fastest developing office location in Germany. The highest rental level for prime locations was €37.50 per square meter in Frankfurt am Main.

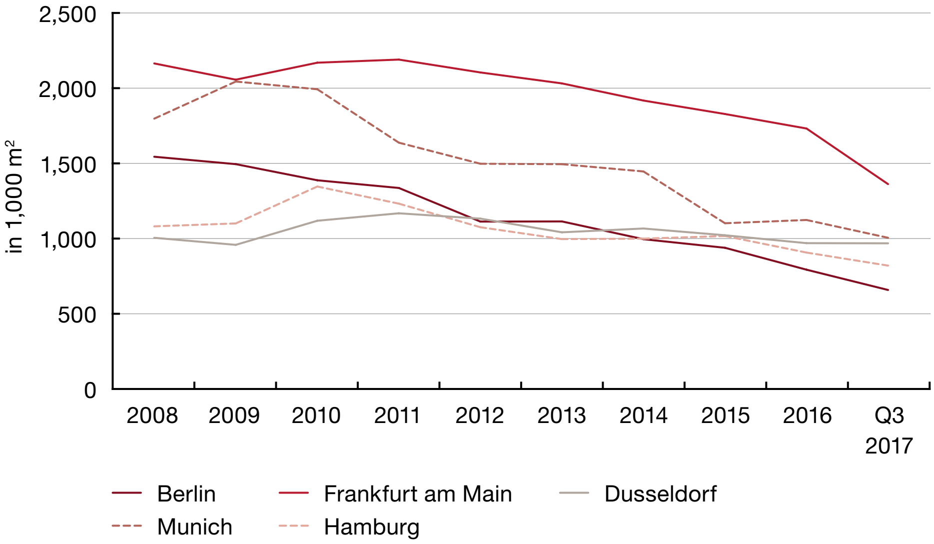
2.1 Available office space offer

In terms of the amount of office space available, calculated as the sum of vacancy and available space under construction, all major German cities show a uniform trend. Since 2010 the strong demand and limited new supply has led to a decrease in available office space. Munich has experienced the sharpest decrease in available office space compared to other German cities over the last seven years.

However, in Berlin the amount of available space is also at a record low, with less than 750,000 square meters of office space available in 2016. In Dusseldorf, the amount of available office space has stagnated and the vacancy rate has decreased. In the third quarter of 2017, the amount of available office space in the remaining Big Six cities fell by 13.2% compared to Q4 of 2016 as a result of the reduced vacancy rate. Frankfurt am Main had the largest amount of office space available at 1.35 million square meters.[18]

[18] Cf. BNP Paribas Real Estate, Büromarkt Deutschland Property Report 2009–2017; Büromarkt Berlin, München, Frankfurt, Hamburg, Dusseldorf Q3 2017.

Fig. 15 Available office space, 2008–Q3 2017



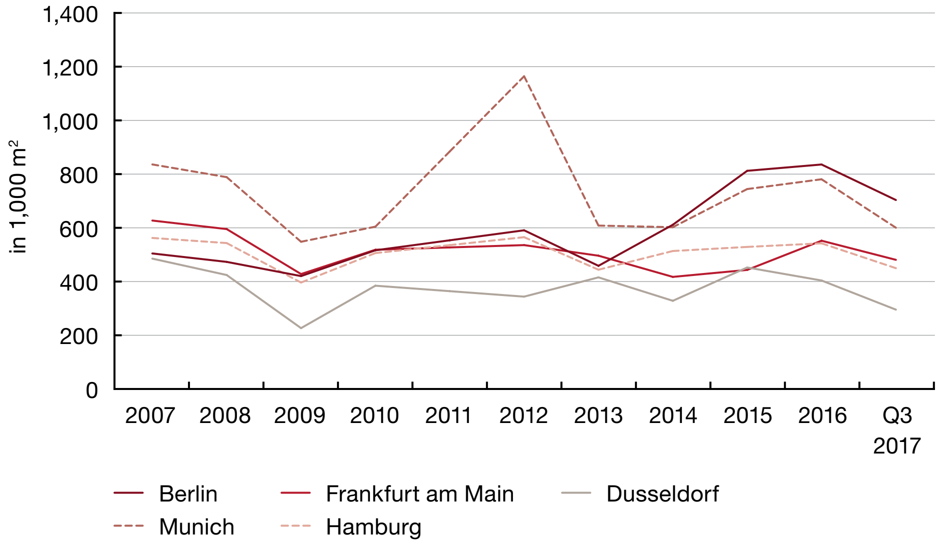
Source: Based on BNP Paribas Real Estate, Büromarkt Deutschland Property Report 2009–2016; Büromarkt Berlin, München, Frankfurt, Hamburg, Dusseldorf Q3 2017.

2.2 Office space turnover

Growing demand for office space

A growing economy and low interest rates have led to a greater demand for office space. These factors have had a visible impact on office space turnover in recent years. Following the last peak in office space turnover in 2012, the numbers steadily increased at the five most important locations for office space until 2016. In 2016 nearly 3.11 million square meters of office space was rented or leased, an increase of 4.6% compared to 2015. The exception was Dusseldorf, where development has been volatile over the years. In 2016, office space turnover totalled 403,000 square meters, which is approximately 11% less compared to the previous year. The largest volume was recorded in Berlin, with 838,000 square meters of total rented office space in 2016. The positive trend was also maintained in Munich with an increase of nearly 5%. Hamburg saw an increase of 2.65% while Frankfurt am Main recorded the biggest growth, at 25.8%.

Fig. 16 Office space turnover, 2007–Q3 2017



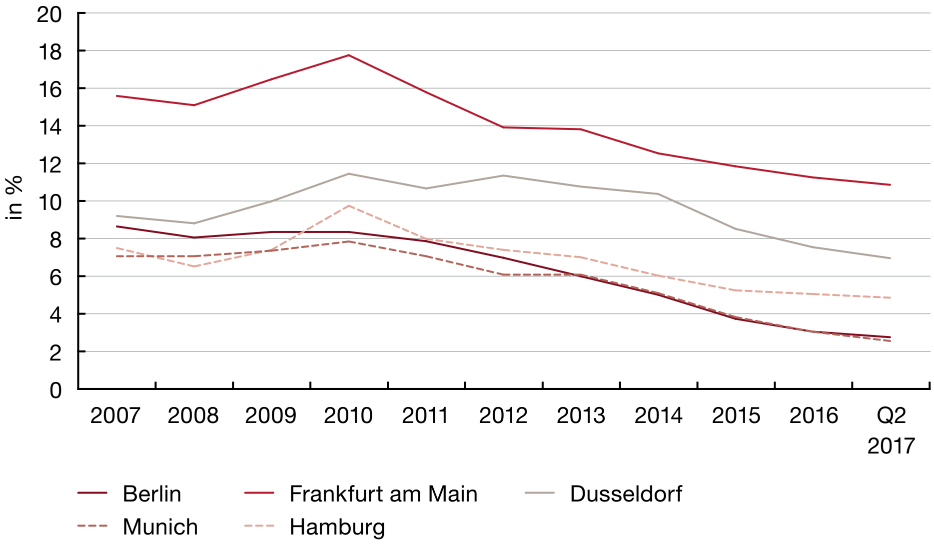
Source: Based on Colliers International, City Survey Deutschland 2012 – Büro- und Investmentmärkte im Überblick; BNP Paribas Real Estate, Büromarkt Deutschland Property Report 2014–2016; Büromarkt Berlin, München, Frankfurt, Hamburg, Dusseldorf Q3 2017.

2.3 Vacancy rate

Munich recorded the lowest vacancy rate at 2.5%

As a result of the increasing demand for office space, especially in the large metropolitan areas, vacancy rates declined further by the first half of 2017 and are now at their lowest in more than a decade. At the five top locations shown in the figure below, the vacancy level decreased from an average of 12% between 2012 and Q2 2017. During this period, the highest average annual reduction in the vacancy rate was recorded in Berlin, at 17%. A decrease in the vacancy rate of at least 4% was registered in all the cities shown below from Q4 2016 until Q2 2017. In Q2 2017 the highest vacancy rate of 10.8% was seen in Frankfurt am Main and the lowest of 2.5% in Munich. However, with the ongoing Brexit developments, Frankfurt am Main, as one of the main financial hubs in Europe, is anticipated to receive further attention from financial institutions looking for an alternative to London. Hence further declining vacancy rates may be foreseeable and will help Frankfurt am Main to contend with the other members of the Big Six.

Fig. 17 Office vacancy rates, 2007–Q2 2017



Source: Based on Colliers International, City Survey Deutschland 2012 up to Q2 2017 – Büro- und Investmentmärkte im Überblick, 2017.

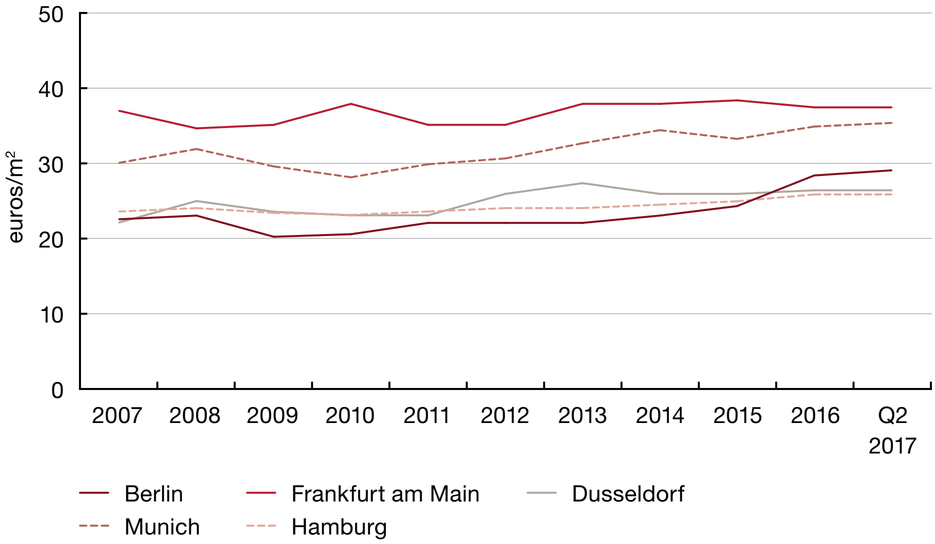
2.4 Top rents

Moderate rental development

The stable (eg, Frankfurt am Main) to positive (eg, Berlin) development of rental prices is indicative of the shortage of office space supply, and the booming office rental market continued to thrive in 2017. Prime rents increased in Berlin, Munich and Dusseldorf while remaining stable in Frankfurt am Main and Hamburg.

Among these five major cities, Frankfurt am Main leads the ranking again, with a price of €37.50 per square meter for high-quality office properties in a prime location, followed by Munich (€35.50 per square meter) and Berlin (€29.20 per square meter). At €26.50 and €26.00, the lowest square meter prices were recorded in Dusseldorf and Hamburg, respectively.

Fig. 18 Prime office rents, 2007–Q2 2017

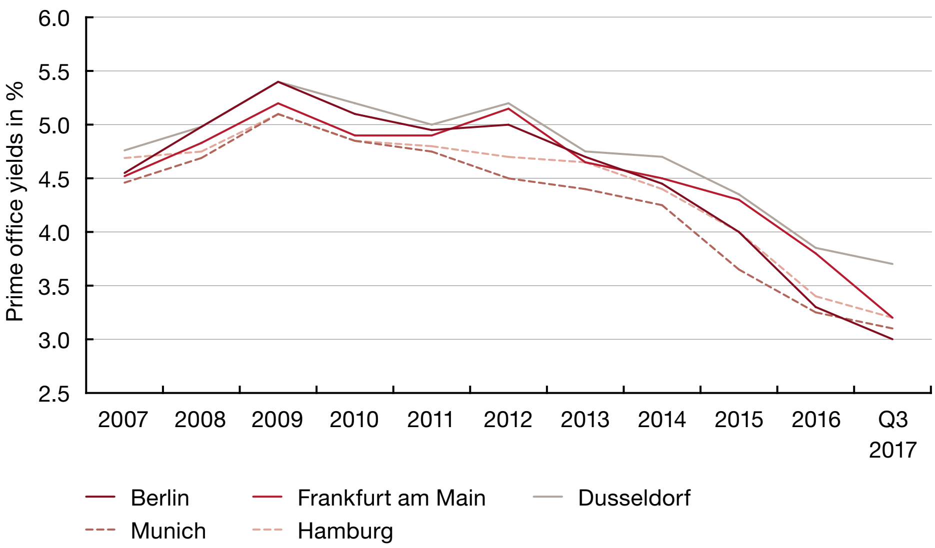


Source: Based on Colliers International, City Survey Deutschland 2012 up to Q2 2017 – Büro- und Investmentmärkte im Überblick, 2017.

At 3.1%, Berlin currently has the lowest prime yield for office space

The resulting rising price level and comparably stable development in rents led to a further reduction in office space yields in 2017, a trend which has continued since 2009. After 2016, the prime yields in the office locations shown below fell further by the third quarter of 2017, due to the sustained high demand from investors and the simultaneous lack of exclusive office properties. The highest prime yield of 3.7% was recorded in Dusseldorf and Cologne. Relatively speaking, Berlin is currently the most "expensive" location with a prime net yield of 3.0%, closely followed by a prime net yield of 3.1% in Munich. Frankfurt am Main and Hamburg also showed a decline to 3.2% prime net yield. Should the high level of competition in top office properties persist in individual cities, a further slight decline in the top rate is to be expected.

Fig. 19 Prime office yields 2007–Q3 2017



Source: Based on BNP Paribas Real Estate, Investment Market in Germany 2017 up to Q3 2017.

3 Market for retail properties

The growing economy and decreasing amount of unemployment also had a continuously positive impact on retail property investment turnover. In 2016, retail sales reached a total of €482 billion – the largest figure since 2001. This positive development was also attributed to a change in consumer behaviour. E-commerce has gained importance in the last seven years,[19] leading to increased demand for suitable retail space in central city locations.

3.1 Available supply of retail space

Demand for the top locations in the large German cities is still healthy. Nevertheless, different developments can be observed in individual submarkets. For smaller shops, there are still enough prospective investors who are usually willing to pay the high rents. However, some longer marketing times can be registered here, since the number of users and therefore the competition among them is slightly lower than in previous years. In the case of medium-sized shops and large areas, where fashion concepts are often the focus of attention, the adaptation processes are more evident. Here, in principle, declining demand can be observed. Marketing processes in this segment are not only going to be longer than in the past years, but are increasingly being concluded with concessions in terms of rental charges or performance-based contract arrangements. In addition, international brands are still among the most important buyers, but they need considerably longer to make decisions. Given these developments, future demand may shift more strongly to areas that are adjacent to the top locations in order to benefit from lower rents. In some cities, the first steps in this direction can already been seen.[20]

3.2 Rent development

The highest retail rents are paid in Munich

The growing demand and limited space available led to a further increase in top rents for retail real estate in Germany in 2013. In 2016 the highest prime rent was reported in Munich at €370 per square meter, having remained at the same level since 2014. Berlin comes in second place with €320 per square meter (3.2% increase compared to the previous year), which is €20 per square meter ahead of Frankfurt am Main. Besides Frankfurt am Main, other top locations like Hamburg (€275 per square meter) and Dusseldorf (€280 per square meter) showed lower prime rents compared to 2015.[21]

In 2016, in about 38% of a 64-city sample, top rents rose compared to the previous year. In most cities observed, the maximum rents have remained constant.

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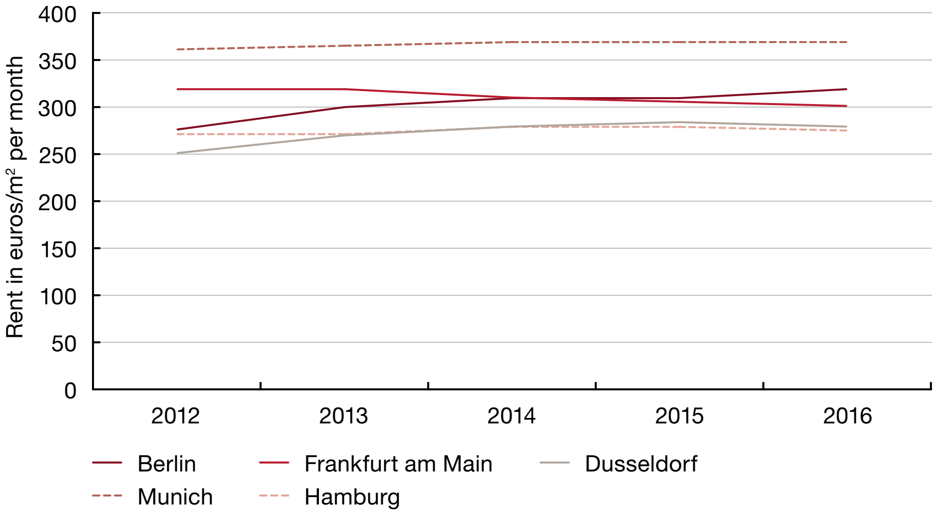
[19] Cf. BNP Paribas, Retail Property Report – Investmentmarkt Deutschland 2017.
[20] Cf. BNP Paribas, Retail Property Report – Investmentmarkt Deutschland 2017.
[21] Cf. BNP Paribas, Real Estate Property Report – Retailmarkt Deutschland 2017.

Fig. 20 Development of prime retail rents at the top five locations



Source: Based on BNP Paribas Real Estate, Property Report – Retailmarkt Deutschland 2015–2017.

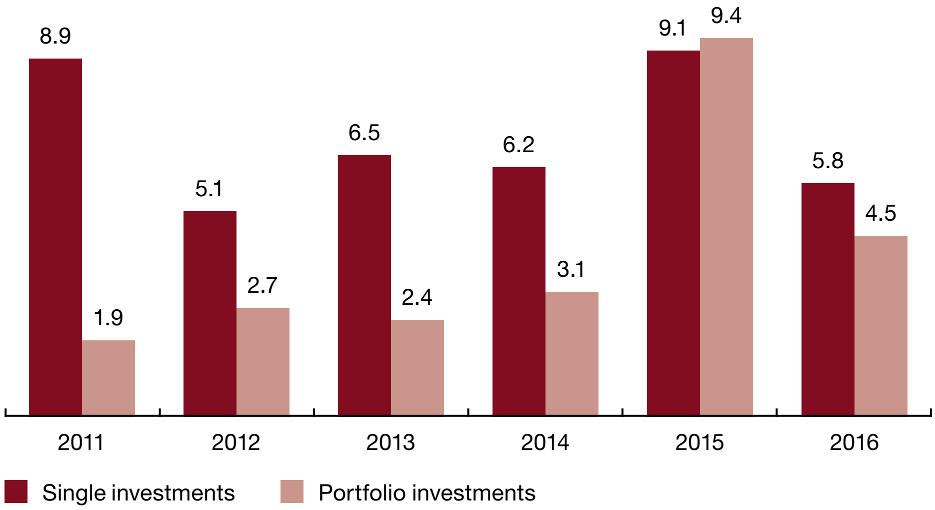
3.3 Investment turnover

The success of 2011 was exceeded by retail investments in 2015, by which transaction volume for retail real estate had grown by more than 70% since 2012 to a total of €18.5 billion. Single-investment volume increased by about 40%. In 2016 the total investment volume declined by 44.5% to €10.3 billion. Individual investments accounted for €5.8 billion of the total investment volume in retail real estate, 36.3% less than in 2015. The turnover of portfolio transactions dropped by more than half compared to the previous year to €4.5 billion.

However, this decline is by no means due to a lack of investor interest, but is rather a result of the undersupply of tradable core assets in the retail sector. The resulting competition among investors for the low-priced core properties leads to a decline in the top yields.

Fig. 21 Retail investments in Germany 2011–2016

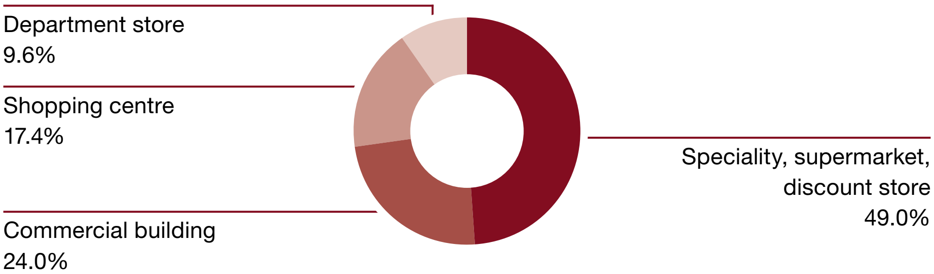
in billions of euros



Source: Based on BNP Paribas Real Estate, Property Report – Retailmarkt Deutschland 2012–2017.

The overall focus of investment segments has changed in the last years, but fell on the speciality, supermarket and discount store segment in 2016.

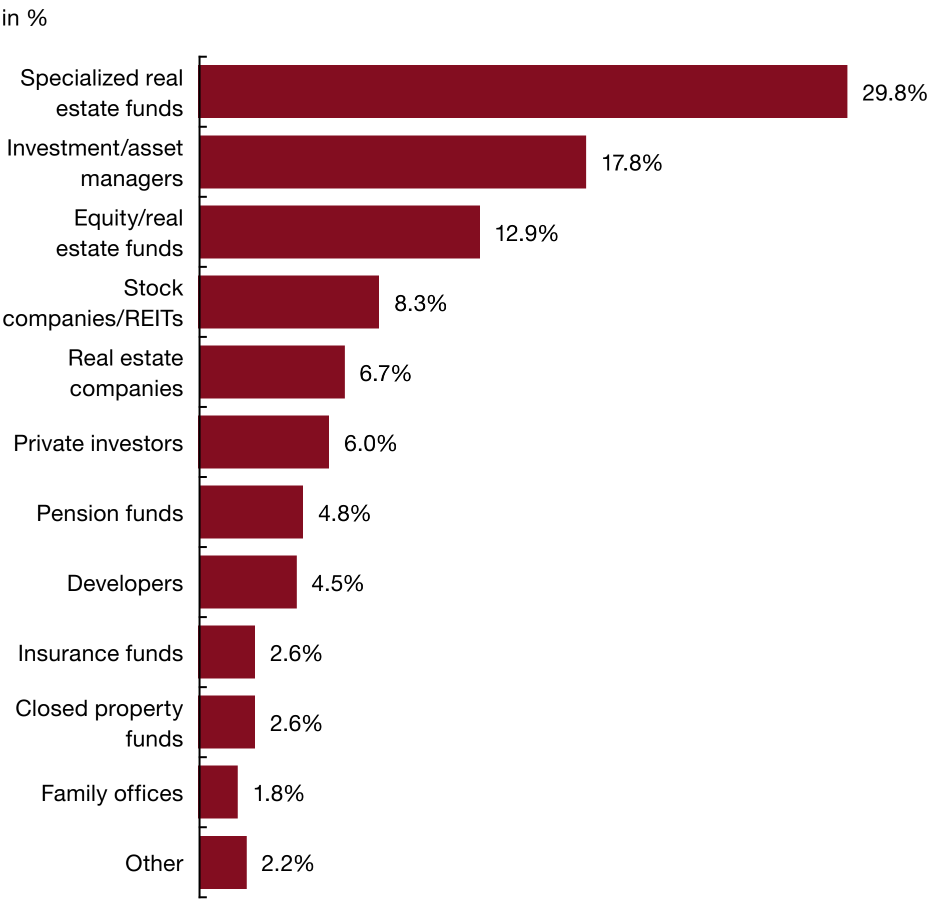
Fig. 22 Retail investments by property type in Germany in 2016



Source: Based on BNP Paribas Real Estate, Property Report – Retailmarkt Deutschland 2017.

Almost half of the transaction volume was realised in the speciality, supermarket and discount store segment. The volume of transactions in the commercial building segment was around €3.11 billion in 2016, whereas shopping centres generated around €2.26 billion. The department store segment made up 9.6% of the total retail investment volume at €1.24 billion.

Fig. 23 Retail investment volume by investor groups in Germany in 2016



Source: Based on BNP Paribas Real Estate, Property Report – Retailmarkt Deutschland 2017.

C Regulatory framework

1 Legal restrictions

There are no specific legal restrictions on cross-border real estate investment in Germany for foreigners. A valid passport and adequate capital are sufficient to purchase property. It should be noted that private investors will not be given resident status merely by acquiring property in Germany, as is the case in some other European countries such as Cyprus.

With regard to indirect real estate investments, however, some general rules apply. They are laid down in different laws and are binding for both foreign and domestic investors.

2 Legal protection of property in Germany

2.1 Property ownership

Germany offers a high level of legal certainty

In Germany, the owner of a property is generally in possession of both the plot of land and any buildings upon it. The rights to ownership and inheritance are guaranteed by law.

Property is only rarely appropriated by the state and then it is only permissible if the welfare of the public is at stake. Appropriation is always carried out in accordance with a law which regulates the nature and extent of compensation. This is to be determined with a just balance of the interests of the general public and the parties involved.

According to private law, the owner has the freedom to use and dispose of the property and the privilege of arranging legal relations through contracts.[22]

Despite these freedoms, however, certain social obligations are also associated with property ownership. Property and the use thereof are intended to serve the good of the community. Such obligations may arise from planning law and social welfare considerations, in particular.[23] Examples include the provisions of the building permit, compliance with land use regulations and development plans and the pre-emption right.

2.2 Housing ownership

If an investor acquires a single flat in a multi-family house, it is a matter of property ownership. However, this property ownership does not entail (sole) ownership of the land and building(s) associated with the property[24]; instead, the investor obtains a co-ownership share of the jointly owned property which the flat is a part of.[25] This condominium is subject to the Act on the Ownership of Apartments and the Right of Permanent Residency (Wohnungseigentumsgesetz, or WEG).

[22] Cf. Weirich; Ivo; Mackeprang;Voltz, Grundstücksrecht, 2006, p. 4.
[23] Cf. ibid.
[24] Cf. sections 93 and 94 of the German Civil Code (Bürgerliches Gesetzbuch, or BGB).
[25] Cf. Weirich; Ivo; Mackeprang;Voltz, Grundstücksrecht, 2006, p. 486.

3 Regulatory framework for property acquisition

Two steps in the acquisition of landed property: purchase contract and land register entry

The purchase of land and property in Germany is carried out in two steps: the first step consists of the conclusion of a purchase contract, and the second is the entry of the property relations in the land register.

3.1 Purchase contract and land register

A purchase agreement for property in Germany always requires a notarised deed of sale. In Germany the principle of freedom of contract applies. This means that there is no compulsory content for a land purchase contract. The handling and design of such a contract may, however, be very complicated, so a legal notary must be involved – not at least due to the potential complexity of the process.[26]

Ownership of property in Germany only passes to the buyer when an entry is made in the land register, not when the purchase contract is signed or the purchase price is paid. The land register is a public register and lists the legal relations of the property, such as the ownership and the potential rights of any third parties on the land.

3.2 Procedure for transfer of ownership

Contrary to the purchase of many other economic assets, the transaction process for property is somewhat more complex, as the buyer and seller have different interests. The seller does not want to lose the property before receiving the payment and the buyer does not want to pay the purchase price before the property is registered in the land register. In order to safeguard the interests of both parties, there are in practice various forms of contracting. Before the buyer pays the purchase price, the following aspects must be examined.[27]

Release from encumbrances

The property should be exempt from all charges recorded in the land register that are not taken on by the buyer. However, the property has often already been financed by the seller via a credit institution, so mortgages or basic debts are registered. The seller may demand from his creditors the solution of the right of mortgage as soon as the loan is repaid. As long as the loan sum has not yet been paid, part of the purchase price is used to satisfy the creditors. In this case, the buyer must pay part of the purchase price directly to the respective credit institution instead of to the seller. This ensures the exemption release and is usually done by a notary acting as a trustee.[28]

Authorisations

The buyer must also check which authorisations are necessary in accordance with private and public law to ensure the legal effectiveness and the legal execution of the land purchase contract and confirm that they are all fully and fully enforceable.

[26] Cf. Gondring, Immobilienwirtschaft, 2009, p. 212.
[27] Cf. Reithmann; Albrecht, Handbuch der notariellen Vertragsgestaltung, 2001, p. 261.
[28] Cf. Limmer; Friederich, Informationsblatt über den Grundstückskaufvertrag, 2010.

Right of pre-emption
In order to secure the transfer of the property, a declaration of non-existence or non-exercise of the statutory pre-emption rights is required. In order to protect against municipal pre-emption rights, a corresponding "negative certificate" must be submitted to the land registry.[29] This certificate is usually collected by the notary on behalf of the parties involved.

Purchase price financing
When acquiring a property, the buyer often takes on debt, for example in the form of a loan. The credit institutions, however, usually prefer before the loan is paid, on a property security in the purchase object. However, the buyer is only in a position to obtain property rights once he has become the owner.[30] In order to become the owner, however, the buyer must have paid the purchase price in full and have taken the financing loan at this time.

One solution to this problem is as follows: the seller declares in the purchase contract that the purchase object is charged with property rights to finance the purchase price before the property is transferred to the buyer. This entry is then approved by the seller as the affected owner.[31]

Acquisition fees
The transaction fees include charges for the notarial deed, land registration and the registration of the legal amendment, as well as personal income tax. In addition, brokerage commissioning may also be required if a broker is involved in the land purchase.

The real estate transfer tax (*Grunderwerbssteuer*) has gradually increased in recent years and varies among the federal states. The fees for the notarial deed and the charges for the entry in the land register vary according to the status of the buyer. As a rule, the costs are 3% to 6% of the purchase price.

The distribution of these costs between buyer and seller should be clearly stated in the notarial deed. As a rule, the buyer bears the land register costs, including the notarial costs and, in some cases, the brokerage commission. In addition, he shall bear the land purchase tax burden, whereby both contracting parties are jointly and severally liable for these taxes as well as for the other costs of certification.[32]

Payment of the Real Estate Transfer Tax
It should also be noted that the property can only be transferred to the land register when the Real Estate Transfer Tax has been paid. After the payment of the Real Estate Transfer Tax, the tax office issues a certificate of harmlessness for the land register. Only then will the property transfer be entered in the land register.

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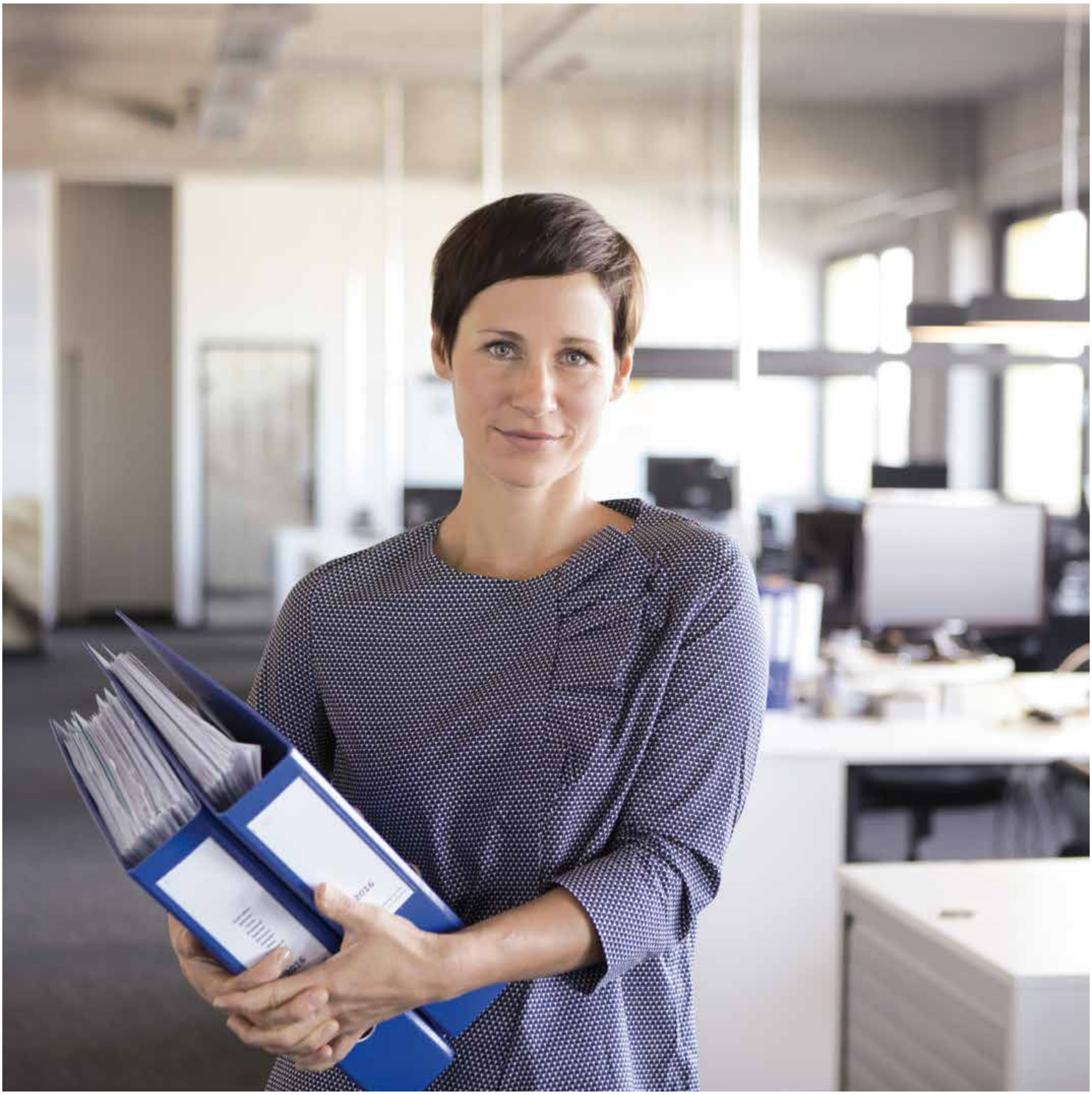
[29] Cf. section 28 of the German Federal Building Code (Baugesetzbuch, or BauGB).
[30] Cf. Weirich; Ivo; Mackeprang; Volz, Grundstücksrecht, 2006, p. 105, in conjunction with section 873 of the German Civil Code (Bürgerliches Gesetzbuch, or BGB) and section 19 of the German Land Register Code (Grundbuchordnung, or GBO).
[31] Cf. ibid.
[32] Cf. section 13(1) of the Real Estate Transfer Tax Act (Grunderwerbsteuergesetz, or GrEStG).

D Tax conditions



Optimisation of tax structures is indispensable

The issue of taxes has to be taken into account as a key factor when drawing up an investment concept. A lower tax burden can lead to increases in yields. Although the tax level in Germany is comparatively high, it can be influenced by the design of the investment. Knowledge of the German tax system and the double tax treaty with the respective home country of the investor are indispensable for making optimal use of tax-structure options.

1 Types of tax and real estate

The following table provides an overview of the main types of tax that are important for real estate deals:

Tab. 4 Types of real estate related taxes

Tax type	Tax rate	Comment
Land transfer tax	No uniform tax rate	Depending on the federal state between 3.5% and 6.5%
Property tax	No uniform tax rate	Tax burden rather low
Income/corporate tax	No uniform tax rate	Corporate tax: 15%; income tax: between 0% and 45%
Solidarity surcharge	5.5%	Based on income-/ corporate tax
Trade tax	No uniform tax rate	Between 7% and 17.5% (municipality-dependent)
Capital gains tax	25% plus 5.5% solidarity surcharge	In the case of the distribution of profits from corporations

E Financial framework

1 Traditional financing

The most widely used financing instrument in Germany is the bank loan. Depending on the scope of their offering, loan providers fall into two groups: universal banks and special banks.[33] Universal banks offer broad financing possibilities and are not obliged to carefully examine the property to be financed. If the investor decides to work with a preferred partner bank with whom long-standing relations exist (their principal bank or, in German, *Hausbank*), it often takes less time to process the loan application because the investor's creditworthiness has already been established.

In addition, the investor may be able to get more favourable conditions based on many years of good relations. Compared to universal banks, mortgage banks give very limited loans. Mortgage banks have what is known as a mortgage bond privilege (*Pfandbriefprivileg*), which allows them to offer cheaper refinancing options.[34]

A credit check is carried out when applying for a loan. This is done primarily on the basis of the documents to be submitted together with the loan application. As a rule, the documents contain a description of the investment project, a financing plan and corresponding creditworthiness and assets (targets) documents.[35] These differ according to the applicant and the object to be financed. In addition to the quality of the documents to be provided, it is also important to convey a positive impression on the loan application.

Fixed interest agreements are common in Germany

On the basis of the creditworthiness check, the bank decides whether and under which conditions it will grant a loan to the applicant. Conditions include in particular the maturity, interest rate, repayment and collateralisation of the loan. The duration of a loan agreement is generally between 10 and 15 years, taking into account the possibility of repayment before expiry of the contract term. With respect to the reimbursement of capital use, a fixed-rate agreement is customary in Germany. The interest rate period for the loan term corresponds to this. If the borrower does not use the agreed due loan amount in due time, the bank calculates the unpaid amount of the loan. In practice, the repayment usually takes place through an annuity loan.

In order to avoid insolvency or the reluctance of the borrower to pay back the loan, collaterals must be ordered for each loan. This ensures that the loan granted can be repaid as completely as possible by utilising the credit guarantees. In the case of a real estate loan, the collateralisation of mortgage rights in the form of a land charge or mortgage entered in the land register is customary.

[33] Cf. Brauer, Immobilienfinanzierung, 1999, p. 354.
[34] Cf. ibid, p. 355.
[35] Cf. ibid, p. 368.

The amount of the loan provided by a bank differs according to the bank and the investor. However, it is always dependent on the refinancing option. Mortgage bonds, or *Pfandbriefe*, which are customary in Germany, offer the submitting Pfandbrief banks a low-cost refinancing option. Pfandbrief banks are subject to strict legal requirements, in particular with regard to the value of loans. Pfandbrief banks are required to determine the loan value for each loan they wish to refinance through a mortgage bond. Only the long-term, sustainable characteristics of the collateralised real estate may be taken into account. In addition, the value of the loan may not generally exceed the market value. A Pfandbrief bank can refinance only 60% of mortgage bonds via a conservatively determined mortgage value.[36] Any additional loan amounts must be refinanced elsewhere. As a general rule, the more the sum exceeds the 60% limit, the more expensive the loan becomes.

This conservative financing is particularly suitable for private investment. It also meets the requirements of investors with a high equity base and is particularly widespread in times of crisis.[37]

2 Subsidies

Another important source of funding is the subsidy. As a matter of principle, subsidies can be split into two groups: energy efficiency subsidies and investment subsidies as part of a real estate investment.

2.1 Energy efficiency subsidies

In the area of energy efficiency, there are around 1,000 subsidy programmes in Germany from the European Union (EU), the German federal states and municipalities, and energy suppliers. These programmes are designed not only for individuals but also for trade, industry and public institutions. The subsidy can be provided in the form of a grant, an investment, a favourable loan or a guarantee. An overview of current funding opportunities can be found in *Förderkompass Energie*, a database provided by BINE Information Service.

2.2 Investment support

Similar to the subsidy programme for promoting energy efficiency, investments and projects can also be supported by tax exemptions, grants, subsidy loans, guarantees, exemptions from liability and participation.

Since these subsidies and their terms are very diverse, a description of the general framework conditions is not possible at this point. In general, any application for funding should be drawn up on an individual basis. The funds must be applied for in all funding programmes before work on the project begins.

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[36] Cf. section 14 of the Pfandbrief Act (Pfandbriefgesetz, or PfandBG), 2005.
[37] Cf. Hagen, Der Pfandbrief – sichere Refinanzierung (auch) in Zeiten der Krise, 2005.

F Guidelines for investment in Germany

The purchase of real estate and real estate portfolios offers a multitude of opportunities, but at the same time it brings exposure to risk. In addition to general investment risks, real estate transactions carry additional property-specific risks, such as market, location, development, asset and exploitation risks. For this reason, a detailed, systematic analysis of qualitative and quantitative information and data should be carried out before an investment. This allows the potential risks of the planned transaction to be identified in advance and the opportunities to be exploited in a systematic and targeted manner.

The following section gives an example of the steps taken to carefully analyse, examine and evaluate a transaction opportunity in Germany. A distinction is made between an asset deal and a share deal. An asset deal is a direct transfer of ownership of individual properties or portfolios, whereas in a share deal the shares of a property-holding special purpose vehicle (SPV) are transferred or sold.[38]

1 Asset deal versus share deal

1.1 Asset deal

In the case of an asset deal in Germany, the individual assets of a company without its legal entity are transferred to an investor. This can include a transfer of ownership of the land, buildings and structures as well as, if necessary, the associated interior or the associated equipment. After a suitable investment is identified, the investor should carry out a comprehensive due diligence process in preparation for such a transaction.

The following list provides an overview of the topics that should be examined in the course of a due diligence process as part of an asset deal in Germany:

1. **Land registry**
   eg, a land register extract, easement register
2. **Acquisition contract**
   eg, land purchase contract, hereditary building contract
3. **Fractional ownership**
   eg, distribution declaration
4. **Contaminated sites and environmental risks**
   eg, excerpt from the officially published list of contaminated sites
5. **Construction and construction documentation, public contracts**
   eg, development plan, monument protection
6. **Construction measures and project developments**
   Implemented, actual and planned measures
7. **Technical documents**
   eg, floor plan, area calculation, certificate of fire code compliance
8. **Leases**
   eg, tenancy and lease contracts, supplements, annexes, tenant lists
9. **Agreements**
   eg, object-related contracts (property management, water, electricity, facility management, asset management), property-related insurance policies
10. **Management costs**
    eg, the overview of recoverable and non-recoverable operating costs
11. **Object-related taxes**
    eg, property tax assessment notice, additional tax-related charges

[38] See Saemann, P., Schlüter, C., Immobilientransaktionen, 2007, p. 73.

1.2 Share deal

In the case of a share deal, the individual assets (land, property, interior) are not transferred separately but as shares in the SPV, which is the owner of the property. The reason for choosing a share deal structure for a real estate transaction in Germany is often tax-related.

In addition to the topics listed above, the following criteria should be examined for a share deal:

1. **Corporate information**
   eg, commercial register extract, shareholders and their capital shares
2. **Group structure and legal conditions**
   eg, representation of the participatory relationships, economic connections within the group, information about the received and/or applied subsidies (eg, EU, national), investment aid and special depreciation rules
3. **Organisation, management, personnel**
   eg, responsibilities, personnel statistics and salary structure
4. **Economic foundations and conditions**
   eg, description of economic risks, in particular the risk of rental loss
5. **Financials and financial position**
   eg, annual reports and financial statements for the last five years
6. **Principles of accounting**
   eg, system of financial accounting and cost accounting
7. **Financial position of the company**
   eg, detailed management accounts, cash flow statement, loans, credit lines and guarantees
8. **Company's assets**
   Accounts receivable, cash and cash equivalents, equity and borrowed capital, profitability and distributions, liabilities
9. **Taxes**
   Tax declarations (corporation tax, value-added tax), intercompany settlements and transfer pricing, tax effectiveness of foreign interests
10. **Earnings**
    Analysis of the earnings situation, in particular analytical verifications and plausibility analyses

2 Relevant due diligence areas

Before a real estate investment in Germany is considered, due diligence should be performed in accordance with the above criteria. If the German real estate market, the German legal situation and the German tax regime are adequately known, this can be carried out by the investor. Otherwise it is strongly recommended to outsource such analysis to a third party with appropriate expert knowledge and market experience. It should be noted in particular that a due diligence analysis can only reduce the risk of an investment if it is carried out properly, that is, independently and robustly.

Depending on whether the planned transaction is to be implemented in the form of an asset or share deal, it is advisable to focus on different aspects of due diligence.

2.1 Asset deal – real estate due diligence and valuation

The following analyses are recommended for real estate due diligence and valuation in the course of an asset deal:

Due diligence

1. Analysis of the net profit

The current income and expenditure situation of the property (or properties) should be analysed in detail and the actual net profit achieved should be reliably derived. In particular, a comprehensive examination of the following items is useful:

- Analysis of rental income, including revenue reductions due to vacancy and outstanding payments (rental analysis)
- Assessment of the cost of management based on the current contractual situation and examination of the additional cost statements
- Maintenance and repair costs
- Key real estate figures (eg, vacancy rates, average rent, maintenance costs and operating costs per square meter)
- Re-letting (re-letting periods, rental incentives and rent-free periods and their effects on cash flow)
- Normalisation of one-time effects (exceptional or one-time income, special expenses and/or non-operating costs)
- Analysis of existing main contracts (eg, management agreements, maintenance contracts) with regard to their potential risks and their financial implications

2. Analysis of rental accounting

Spot checks of the previous revenue and expenditure on the basis of the tenant's rent book and rent accounting and confirmation of their correctness on the basis of excerpts from tenant and bank accounts

3. Inspection of the rent roll

Examination of the rent roll based on the rental contract regulations (including index clauses, leasing expired dates, etc)

4. Analysis of commercial anchor tenant

eg, company profiles, creditworthiness, creditworthiness check

Valuation

1. Valuation of the property

Through nationally and internationally recognised and valid assessment methods such as the White Book (International Valuation Standards Council), the Red Book (Royal Institution of Chartered Surveyors), the Blue Book (The European Group of Valuers' Associations) or the generally accepted German valuation standards (ImmoWertV)

2. Value driver and sensitivity analysis

Identification of value drivers, sensitivity analysis to assess critical value points

3. Portfolios

Valuation as sum of the parts or as total portfolio, assessment of special premium for the valuation

4. Hidden reserves/value potential

Identification of potential value uplift or hidden reserves, recommendation on actions to take to release reserves

2.2 Share deal – real estate due diligence

Due diligence

1. Analysis of the earnings situation
eg, historical analysis of business results, result normalisation
2. Analysis of the assets
eg, analysis of net financial liabilities, working capital, debt-like items, off-balance-sheet items
3. Analysis of the cash flow statement

Valuation

1. Set-up or review of integrated business plan
(Cash flow statement/profit and loss balance sheet)
2. Definition of peer group and allocation of cost of capital
Consideration of special accounting or tax issues within the course of the valutation
3. Business enterprise valuation
Indicative or full scope

G Conclusion

Deep knowledge of the local conditions is the key to successful real estate investments

The German real estate market still offers foreign investors very attractive conditions for a successful real estate investment. Particularly in the current market environment, there are promising opportunities driven by the underlying trends, including strong economic growth, urbanisation and international migration.

Due to Germany's federal structure, the country's real estate market is much more decentralised than in other major European countries. The resulting geographic diversification potentials for real estate investments are just as important as the overall value stability of German real estate as well as the low ownership quota of residential real estate.

German real estate law is extensive and offers investors the highest degree of legal certainty. Even if foreign investors are faced with complex fiscal conditions, they nevertheless have the opportunity to optimise their tax structure. A comprehensive and in-depth knowledge of legal and tax legislation in Germany is, however, a prerequisite for a successful real estate investment.

For small and private investments, it is therefore useful to hire a notary, and possibly also a broker, for advice throughout the entire acquisition process. For larger transactions, it is important to ensure the interdisciplinary assessment and coordination of all aspects related to the investment. In addition to doing financial due diligence, it may be prudent to run legal environment and technical due diligence as well. This is the only way to recognise all potential risks at an early stage and to seize all opportunities – with the goal of achieving a secure and successful real estate investment. An independent valuation of the single asset, the portfolios or the business enterprise will help to minimise investment risk while also providing support for tax and accounting tasks.

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