OAK INVESTMENT MANAGEMENT GROUP

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The German Real Estate Market

Investing in commercial real estate assets in Germany is alluring. Its economy is by far the largest in Europe. It is an exporter of high value goods to the rest of the world. It is a stable and mature democracy maintaining a calibrated well balanced bureaucracy.

Yet strong fundamental economic indicators do not always translate into *alpha* in terms of investing in underlying real estate. Conceptually, it is quite possible to invest into a country or an area that is so pro-business, pro-exporters that this is at expense of all other forms of capital allocation even their own real estate. Empirically, businesses in Germany have often had economic benefit at the expense of their landlords. This is expressed as static rents (in real or relative terms), structural vacancy, an ease / willingness to build new on virgin land as well as a lack of a concentrated centre not just nationally but also within cities themselves.

This means that tackling German real estate has to be done with dexterity as well as a sure understanding on the information on the ground. This is not helped by the fact that historically the investment or occupational market has not very transparent. This changed somewhat with the first proper foreign influx money (largely CMBS-origined) into the country's commercial real estate between 2002 and 2007 – but still has some way to go until the investment or occupational market is as transparent as the US, the UK or France.

Germany is dominated by specialised production facilities, the value of which are very hard to judge. Like any other evaluation the value has to be related to the value of the underlying productivity. For example, the value of a Volkswagen plant in Wolfsburg is linked to the presumed success of that model in production. The value of the property is tied up in the equipment and re-tooling involved in moving to another location. This requires deeper understanding of automotive industry than say an insurance building in central Paris or a banking building in London.

The German market lacks the concentration of the UK, France or even Russia. As a federated state the country has a patchwork of major cities but no outstanding mega-polis that dominates like London, Paris or Moscow their countries' respective real estate markets. By size there are so called A list and B list cities, but on a macro-basis these do not command the pull and therefore the rents, on a micro-basis their outskirts often compete with the historic cores because of ease of driving to and from work. The investment consequence of all of these attributes is that there is a great deal less volatility than other national markets in Europe. With the exception of Berlin – which in the recent past has had supply rush ahead of demand only for demand to then outstrip supply – all of the other A list German cities can be categorised as having reached 'steady state'. This presents both opportunities from a risk adjusted basis as well as pitfalls for investment returns.

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