PHOTO: PRESSE- UND INFORMATIONSAMT STADT FRANKFURT AM MAIN/TANJA SCHÄFER

Most banks in Germany have their headquarters in Frankfurt/Main.

How to Finance in Germany?

FINANCING I ■ Before entering the German property market, foreign investors should familiarise themselves with the variety of commercial property financers. And with the state of the financing market in this country – which presents itself as more stable than you would think.

By Francesco Fedele

Despite transparency initiatives such as the study on the "German Debt Project" by the International Real Estate Business School (IREBS), which was first published at Expo Real 2013, the market for commercial property financing in Germany is and remains very heterogeneous. And it is often very difficult to understand for foreign investors who invest and finance less frequently in Germany.

The federal and polycentric structure predominating in Germany also contributes to this, as does the banking sector with its three "columns" (private, public and mutual sectors).

In turn, there are several contact points for property finance in each of the three columns:

- Specialist mortgage banks where the focus of business is property finance and that refinance themselves with Pfandbriefe (German covered bonds);
- Large universal banks (including the leading banks in the public and mutual sectors) where property finance or the mortgage bank business is one of several business fields;
- Regional and special banks

In addition, there are institutional investors, such as insurance companies and pension funds, which, from a supervisory law viewpoint, are currently better positioned for certain forms of financing than the banking sector. Insurance companies will probably lose this competitive advantage under the stricter regulations of Solvency II, however, and have also not been able to convert this advantage into any decisive gains in market share to date.

Domestic property finance strengthened despite bank restructuring

In comparison with previous years, 2013 was characterised by growth and an increased tendency towards new business across all groups of institutions relevant to commercial property financing. After the difficult year for credit in 2012, this concerns a normalisation of circumstances rather than a boom, however.

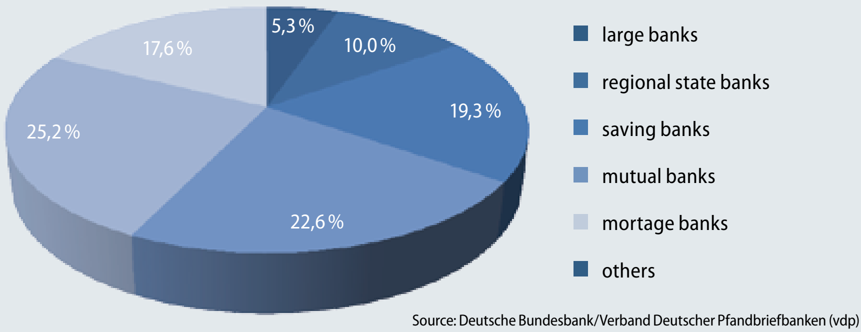
In a comparison over several years, it can be seen that neither the cessation of new business of the large market participants Eurohypo and Westdeutsche Immobilienbank nor the restrictions on other important property financers – primarily Deutsche Pfandbriefbank, formerly Hypo Real Estate, as well as several regional state banks – through restructuring processes and state aid legal constraints imposed by the EU, have led to a collapse in the financer market. A fundamental shift of the finance market to foreign banks or to alternative financers such as debt funds also has not happened.

On the contrary: as part of the large bank restructuring processes the focus has mostly been on reducing foreign activities and capital market portfolios (so-called "credit substitution business"). In contrast, the domestic property finance business has been assigned to the core business of the restructuring banks in both the private and commercial area and has thus been somewhat strengthened.

In B or C locations finance is frequently realised through banks with a regional focus, for example from the public or mutual sector. In this respect, the public sector is particularly interesting because there is no standard lead institution but several regional state banks. Although each of these banks has a regional focal point, they also compete with each other nationally.

The public sector (savings banks) also has a larger financing capacity than the mutual sector (Volksbanken (people's

Market share of commercial property finance in Germany



Source: Deutsche Bundesbank/Verband Deutscher Pfandbriefbanken (vdp)

banks)) among the regional institutions. This is because the savings banks are larger on average than the people's banks and because in the savings banks sector in particular there is a great readiness to realise larger finance volumes through consortium finance with other savings banks. The spread is significantly greater here for both margins and loan-to-value ratios than in A locations. In our consulting practice, we are currently seeing margins in the non-core area of mostly between 120 to 170 basis points.

According to the type of property, the focus of property financers is on residential, office and retail in particular. The situation in hotels/tourism is much more difficult. Here as well the individual case is decisive and involving regional finance partners mostly makes sense.

Up to now, the capacity of the German banking sector has been sufficient to ensure international debt funds play a minor role in the German property market as before, especially in the senior area. And in the stretched or junior area as well, debt funds have only been able to finance very selectively up to now.

Yields in equity area will diverge

In terms of conditions, we expect a stronger divergence according to the risk category in the equity area in the upcoming months and years. While strongly undifferentiated yields of 20 per cent and more are frequently still expected at the moment, we assume that in future low-risk and/or highly competitive project finance will also be able to realise a yield of between 10 and 15 per cent. This will be the case in particular if ongoing cash flows (for example, interim rents or rental income up to the final letting of the property) can be collected or if the equity investor can secure preferred access to the finished project (a so-called "forward deal").

Francesco Fedele is the CEO of BF.direkt AG, Stuttgart.