Press release

Irebs "German Debt Project Study": More competition, more business, more risk, slimmer margins

- New business growth up +20 %, significantly higher than expected by survey respondents last year
- High growth continued during the first half of 2016
- Specialised real estate, project financing and financing beyond the top A cities experienced the strongest growth
- Pressure on margins remains high and amber alert for LTVs

Eltville, 8 September 2016. For the fourth time, the "German Debt Project" study of the International Real Estate Business School (Irebs) – with the support of the association of German mortgage credit banks, the Verband deutscher Pfandbriefbanken (vdp) and nine highly reputable representatives of the real estate industry – presents detailed information on the commercial real estate financing market in Germany.

The new business growth rate for last year, at 20 %, was more than double that in 2014 and significantly above the original expectations of the participating banks. In the previous year's study, those questioned had expected "only" around 9 % growth for 2015. During the first half of 2016, new business once again rose by around 20 %, whereas the institutions, according to the interviews, only expected on average 6 % for the whole of 2016; two-figure growth once again seems more probable. The transaction volume in the commercial real estate market however in Q2 lagged behind the corresponding quarter in the previous year – the extent to which this trend will stabilise is currently difficult to see.

"Business is becoming ever more complex", remarked Prof. Dr. Tobias Just, head of scientific research of the Irebs Immobilienakademie, and added: "What is noticeable is the strong growth in the financing of operator real estate, properties outside of the top cities and in project financing – in some cases these can be attractive prospects, but this depends on investors and financiers being able to weigh up the specifics of these asset classes properly." Plain vanilla deals continue to be highly sought after, but are becoming increasingly hard to find on attractive terms. With ever more sophisticated bank portfolios, the risks rise. The growth spurt in new business has been given a greater than expected boost by purely commercial property financing (+37 %), whereas the volume of loans in the sphere of institutionally invested housing has paused, falling 8 %. All commercial subsectors have experienced substantial, two-figure growth. The frontrunner has been the trading subsector (+47 %), followed by specialist real estate (+43 %) with offices just behind at +26 %. The regional distribution indicates that during 2015 things once more levelled out – with 57 % new business growth outside of the TOP-7 cities. A series of institutions however are also considering the extension of their overseas activities; Brexit has therefore represented a stumbling block for some banks.

"Germany is building". Between 2011 and 2013 the growth in project financing was still significantly below the financing volume for existing properties. In 2014 and 2015, project financing was still a step ahead (2015: 24 % by comparison with 19 % growth in financing of existing properties).

Amber alert for loan-to-value ratios. At 68.2 % Loan-to-values (LTVs) are, for the portfolio analysed by us in 2015, only slightly above the previous year's level (67.8%). Here there are three aspects of note: firstly the development of the "V" (value), i.e. rising prices in the real estate sector, is curbing the debt component. Secondly, the mix of property types – as described above – is becoming more sophisticated. Thirdly the proportion of large institutional clients seeking low debt components is increasing. If the average LTVs continue to rise slightly nevertheless, there must also be more offers with more aggressive loan-to-value ratios; in the event of a cooling of the market, this conflicting trend exacerbates the problems in particular for such aggressive market players.

Shrinking margins with continuing downswing: For the portfolio in question, for 2015 a decline in the nett margin of 11.5 basis points to 118.1 basis points is apparent – similar to that predicted by the institutions a year ago. This means that the sector, within two years, has fallen to the margin level of 2010. For the current year 2016 the banks are now awaiting a further reduction of 10 basis points based on an entire year's perspective; the downswing has been virtually unchecked due to the competition situation, in the current year. In the interviews, hope has once more been expressed that, looking forward to 2017, a plateau might be gradually reached. The pressure of competition which has been high up to recently, runs counter to this hope.

Are the margins still risk-congruent? Declining margins, rising LTVs and pressure on the financing structures together with regulatory uncertainties – this scenario assumes that the real estate market will continue to boom. Author Markus Hesse, CEO of Irebs International Real Estate Business School, assesses the situation as follows: “Operating margins are only risk-congruent if the real estate market risks persist at their current level and the need for risk provisioning thereby remains low – and regulation does not continue to intensify, although this is a clear probability”. All the more important is increased transparency. This year the banks have made available even more detailed data on their portfolios. Simon Mallinson, Executive, and Managing Director at RCA, notes: “The German real estate market remains strong. Even with an expansion outside of the TOP-7 cities, however, there is a need for a higher degree of transparency among banks and investors; it should be seen as positive that the banks are open in this regard and are making further progress”.

Is the following campaign activity pattern in keeping with the perception of risk in real estate financing as described above? Currently the majority of full-service banks are allocating increasing resources to real estate financing, in consideration of the opportunities and the risks. Real estate financing has been one of the most profitable areas for some broader based full-service banks. Earning power in the profit and loss calculations, by comparison with full-service banks, indicates, at least, as an example, a higher and more stable operating earning power (interest and commission surplus after provision for risks) of the commercial real estate financing business segment. Investors too still see German real estate investments and financing as a “safe haven”. The good employment situation and finally increasing rents in some commercial real estate segments also indicate this. “The German property market is considered internationally to be a safe haven and, in particular during difficult times, has proven to be a stronghold of stability. Investors looking for a secure investment appreciate the constant growth of the German market as well as relatively low price fluctuations” explains Dr. Georg Reutter, board member at ZIA Zentraler Immobilien Ausschuss e.V. and chairman of the Verband deutscher Pfandbriefbanken (vdp).

Risk-averse investors such as insurance companies, pension funds and schemes are increasing their commitment in the German market for real estate debt and equity. The opportunity/risk assessment of some stakeholders with alternative business segments is apparently still very positively in favour of commercial real estate financing and they underpin this with their allocation decisions. Either real estate financing has become more attractive at least comparatively, with regard to its opportunities and risks, or the risk assessment of the aforementioned market stakeholders is incorrect – or economic hardship threatens rather from other financial and investment markets from which the banks and investors redeploy moneys into the real estate market. Risk is, after all, also a relative consideration.

We assume that it is a mixture of all these reasons and that the greatest risk for the real estate markets and real estate financing markets currently lies outside of commercial real estate financing itself.

On the German Debt Project study

The German Debt Project study was initiated by the market research and consultancy company Real Capital Analytics. 23 German financial institutions took part in the survey. The credit volume analysed in the context of the study was € 183 billion and therefore represents almost half of the commercial real estate financing market. The objective of the study is to increase transparency for the German market in commercial real-estate financing and to enable meaningful comparisons, in particular in risk analysis. The study was carried out for the first time in 2013.

Co-Sponsors of the project are: bf.direkt, bulwiengesa, Commercial Real Estate Finance Council Europe (CREFC), Cushman & Wakefield, ENA, INREV, JLL and the central real estate committee Zentrale Immobilien Ausschuss (ZIA). The scientific research manager for the study was Prof. Dr. Tobias Just of Irebs and the study has been written by him, together with Markus Hesse. The Verband deutscher Pfandbriefbanken (vdp) supported the survey.

German Debt Project website (www.german-debt-project.de)

The study can be purchased for € 450 exclusive of VAT from the www.german-debt-project.de website. You will find in it a collection of studies and commentaries of Irebs Immobilienakademie and its sponsors and supporters on the subject of commercial real estate financing. Other current issues relating to the subject of commercial real estate financing are also highlighted.

About the Irebs International Real Estate Business School at the University of Regensburg

Irebs has ten legal and economic research chairs and professorships as well as 15 honorary and guest professorships. University research and teaching is provided at the Regensburg University campus. Irebs continues to provide dedicated study facilities at Frankfurt, Eltville, Berlin, Munich and Hamburg for the further education of young managers and specialist staff. With its broad-ranging services, Irebs International Real Estate Business School is one of the top international university institutions in the sphere of real estate financing.

Further information on the Irebs International Real Estate Business School can be found at www.irebs.de.

About the Irebs Immobilienakademie

Irebs Immobilienakademie is the Irebs advanced training academy. Irebs Immobilienakademie offers professional development courses for management, junior management and specialist staff. In addition to real estate, construction and financial management companies, our clients include industrial, commercial and service companies and the public sector. In the 2012 university rankings, *Immobilien Zeitung* ranked Irebs Immobilienakademie first out of more than 21 further education institutes. In the category "overall learning experience", this academy of further education was assessed as being "very good". Irebs Immobilienakademie is certified to ISO 29990 as provider of education and further education. This certificate guarantees students that its services are designed on the basis of employment market requirements and are continuously being improved.

Further information can be found at www.irebs-immobilienakademie.de.

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