Press release

Increased equity at rising prices leads to a drop in borrowed capital quotas

- The growth in new business in commercial real estate finance in 2016 was half as high as it had been in the previous year, albeit at 10%, and looks set to be halved to 5% in 2017.
- There is ever greater variety in the mix of property types; for the first time in our survey, the proportion of other types was higher than the finance for retail real estate.
- Net margins have remained under pressure and could fall below 100 base points in 2017.
- LTVs are in decline due to the high availability of equity and sharp rises in prices, on average at least.

Eltville, 28 June 2017. The "German Debt Project" study conducted by the International Real Estate Business School (Irebs) is publishing detailed information about the market for commercial real estate finance in Germany for the fifth time with the support of the Verband deutscher Pfandbriefbanken (vdp) – and six renowned representatives from the real estate sector.

Faced with sharp falls in margins, the institutions surveyed are still intent on keeping their existing finance portfolio high in order to preserve their earning capacity. In 2016, the portfolio rose by almost 6%, similar to the previous year, with a 10% rise in new business. This year the growth rate is due to decline to a mid-single-digit figure. “There is no indication in this data of there being any credit-fuelled property bubble,” observed Dr. Rabe from ZIA, which supported the study.

A striking aspect of the risk assessment conducted by the institutions is the more cautious approach to finance of retail real estate and the more optimistic mood regarding logistics and hotels, as well as the more positive assessment of finance for the development of projects. The shares of other commercial real estate finance (19.9% of new business compared to 19.5% in the previous year) other than offices and shops remained at a high level, while there was a discernible rise in finance for project developments (26% of new business, previous year 23%).

In order to sidestep the high competitive pressure in the A-cities, the possible solution is to expand further into the regions and/or to take on more foreign business.

The share of the new business portfolio accounted for by non-A-cities virtually stagnated in 2016. The lot sizes are quickly becoming too small for the larger institutions; this will primarily remain the domain of savings banks and cooperative banks. Some banks had been more intent on looking for business outside the country, although this was thwarted by Brexit; according to the vdp, commitments to business abroad only rose by 1% in 2016 whereas new business on the domestic market was up around 10%. Simon Mallinson from Real Capital Analytics remarked that "German real estate lenders are still active in the UK, but post-Brexit, overall real estate investment volumes are down by around 40% from their peak at the end of 2015." Neither the move into provincial Germany nor the expansion abroad have left much scope as a valve for less intensity in domestic competition in the core business.

Consequently, the margins will remain under pressure. In terms of net margins, we are moving towards the psychological 100 base point mark on average in 2017. This still stood at 134 in 2013 but had come down to 108 in 2016 and looks set to lose a further 5 to 10 basis points in 2017.

While the average LTVs were still around 68% in 2015, the people surveyed had expected to see a rise of 2% to a figure of around 70% in the 2016 study. However, the LTVs dropped by two percentage points due to the "flood of equity". The expectation for 2017 is for the situation to stabilise with the possibility of a slight increase from this level. Co-author Markus Hesse qualified this by adding that "people should not lose sight of the fact that we are talking about an average assessment here, however; while low-risk business is being financed with less borrowed capital, higher LTVs are to some extent also being sought for challenging properties or project developments in order to safeguard the equity provided by these investors."

The conclusion of the study has revealed three key points: Firstly and most notably, the high price rises in core properties are increasingly backed by equity; consequently, price risks remain with investors providing equity, with a greater buffer for borrowed capital. The flood of equity is so great that, even with rising competitive pressure, there has been a drop in outgoing borrowed capital, on average at least. Secondly, margins in new business are still extremely hard fought. There is little evidence of the situation easing because, faced by falling margins, the institutions are seeking to keep portfolio volumes high with adequate levels of new business in order to maintain the profitability of their activities. This leads to the third point, the earning capacity of the business. The earnings reported in the profit and loss accounts of the banks are still at a high level compared to other bank business activities, despite sliding margins. At the same time, the challenges arising from regulatory measures and digitisation are becoming ever greater; and it is early days for alternative sources at least, explained Achim Reif from the vdp. It is no wonder that we have seen further mergers among classical real estate finance providers.

Where do the actual risks lie now? "The greatest risks are currently in the special macro environment which has a very stimulating effect on the real estate economy, but which possesses latent instability. Furthermore, many investors have set their sights on niches within the real estate market with specific risks attached," commented co-author Prof. Dr. Tobias Just.

The German Debt Project study

The German Debt Project study was initiated by the market research and consultancy company Real Capital Analytics, and the Verband deutscher Pfandbriefbanken (vdp) has been supporting the study from the beginning. 25 German financial institutions took part in the survey. The credit volume analysed in the context of the study is € 202 billion, covering 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.

The originating lead sponsor is Real Capital Analytics, and the co-sponsors are bulwiengesa and JLL; the trade association sponsors who have supported us are Commercial Real Estate Finance Council Europe (CREFC), INREV and the central real estate committee, Zentrale Immobilien Ausschuss (ZIA. The research in the study is led by Markus Hesse and Prof. Dr. Tobias Just from Irebs; they are the co-authors of this study

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

The study can be purchased for € 450 exclusive of VAT from the www.german-debtproject.de website.

About the Irebs Real Estate Academy

The Irebs Real Estate Academy is the further training academy of the Irebs International Real Estate Business School and part of the Faculty of Economics of the University of Regensburg. The International Real Estate Business School comprises the Irebs Institute of Real Estate Economics and the Irebs Real Estate Academy. The Irebs Real Estate Academy 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.

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