



Mark Munro discusses the German real estate market

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It is widely acknowledged that over the past decade or so the UK property market has provided investors with excellent returns, be it in commercial property or residential. Indeed, such has been the increase in capital values that rental yields on much prime commercial property have fallen to as little as 4.5% pa, which is below the cost of borrowing.

This boom in property has been a global phenomenon, driven to a large extent by low interest rates and a plentiful supply of liquidity, combined with stable economic growth. Japan has been an exception due to the extremely overbought levels reached during the 1980's boom; another exception has been Germany.

The sudden and unexpected fall of the Berlin Wall and the subsequent reunification of East and West Germany in 1990 led to a period of tremendous optimism, and this, combined with substantial tax incentives, prompted significant investment in the former East German property market. However, the reunification process has proven far more difficult and costly than predicted, with estimates of annual transfers from West to East in excess of Euro 50 billion. In addition, the combined German economy was put under further pressure when the Deutschmark was converted into the Euro at what in hindsight was an uncompetitively high rate, impacting upon Germany's substantial and important export sector. Consequently the German economy has experienced little growth in the past ten years, with unemployment peaking at 12% and the budget deficit surpassing the EU defined 3% limit. Furthermore, the economy recently has had to cope with record high oil prices, Germany itself having little production of its own and importing over 2 million barrels per day.

Against this background it is perhaps not surprising that German property markets have stagnated for the past decade. Indeed many investors who bought property during the reunification euphoria are still suffering losses ten years later.

Could all of this be about to change? Unemployment has started to decline, the economy is beginning to grow and it must be remembered that Germany remains one of the world's largest exporters, easily surpassing Japan. A new government, led by Angela Merkel, is intent on introducing reforms and there

is much evidence that companies are already initiating change under pressure from shareholders. Witness for example the recent announcement by Siemens that they are de-merging their problematic telecoms business into a joint venture with Nokia with the loss of over 6,000 jobs. The Government is also making serious efforts at reducing the budget deficit and over the long term has expressed its desire to lower the taxation burden. There are also important changes underway in the financial services sector, whereby the mortgage market will become much less restrictive. An interesting point in this respect is that Germany (after Switzerland with 34%) has the lowest level of home ownership in the developed world at 43% compared for example with the UK at 69%. In summary the changes currently underway bear a resemblance to the transformation of the UK economy during the early days of Margaret Thatcher.

German residential property currently looks extremely cheap, with affordability at its best level for thirty years and yields of 7% easily obtainable with prices currently below their replacement cost. Similar yields are also obtainable on commercial property, with signs that vacancy rates are starting to decline as the economy improves. Eventually this should have a positive impact on capital values.

This undervalued market has not gone unnoticed in the international investment community. Numerous vehicles have been launched with the sole objective of investing in German residential and commercial real estate. Indeed billions of "foreign" Euros are currently in the process of being invested in assets as diverse as office buildings, retail centres and apartment blocks, on the basis that "dull" Germany could be the real estate bargain of the decade.

Should you wish to discuss any of the issues raised in this article, please contact Mark Munro, or alternatively, the director/manager with whom you normally deal.

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