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Navigating Germany's Top Markets

By Thornston Wolf, SIOR

The French eat croissants. The Germans eat rye bread. This is how a friend of mine described his perception of Germany in comparison with its European neighbor France.

This comparison can also be applied to the perception of Germany within the commercial real estate world. Other European countries are certainly more accessible. Take, for example, Italy, full of Gucci, Armani, and sleek interior design; or Great Britain, an English-speaking country full of history and a real royal family; and France, with its croissant and it's people who know that without good food, life is without meaning.

Today, Germany is the focus of international interest. The country's political decision-makers are playing a decisive role in the fate of the euro. In the troubled eurozone, it is considered a safe haven for investors, consistently outperforming its European neighbors. It's no surprise then that German real estate is oftentimes on the top of the savvy investor's shopping list. Like any international market however, there are a number of points of which you much have an essential understanding when looking to invest in the German commercial real estate market.

German Real Estate Topography

Hopefully the city names of Berlin and Munich should sound familiar—and maybe even the Hanseatic city of Hamburg, with one of the biggest European ports – but who are the others? In Germany there are 82 cities that have more than 100,000 inhabitants.

In *Exhibit A* you will find the population totals of all major inner-city areas. This is not including the entire metropolitan area of each city. If you apply other criteria and start taking the metropolitan area into the equation, Hamburg, for example, has a population of around four million people, roughly doubling its size.

But how does the city size or status (for example, being the nation's capital), enhance or detract from its appeal in the commercial real estate world? Taking a quick look over the German border to our food-loving French neighbors reveals no surprises. To put it simply: usually, if you want to open a business or advise your clients where to invest in France, your attention should always be directed towards the biggest city, and the capital city. For our French neighbors, this is Paris. Lyon may be trailing a bit behind, but in the end, it is now what it has always been—Paris, Paris, Paris!

In Germany, however, this is not applicable. Berlin is indeed both the capital and the biggest city, and certainly it has appeal as an opportunity for the investor with a healthy appetite for risk in a roller coaster market. Additionally, indicators in all segments are positive, although, for example, top rents in offices have already flattened out, and the current inventory of unrented office space is well over 2 million square meters, which is relatively high for a city with a yearly space take up of around 600.000 square meters (projection 2012).

Top 10 Largest German Cities

1. **Berlin;** 3.5 million inhabitants
2. **Hamburg;** 1.95 million;
3. **Munich;** 1.4 million;
4. **Cologne;** 1 million;
5. **Frankfurt;** 660,000
6. **Stuttgart;** 600,000;
7. **Dortmund;** 584,000;
8. **Dusseldorf;** 580,000;
9. **Essen;** 580,000;
10. **Bremen;** 548,000.

Exhibit A

Continued

Berlin is a great second choice. The statistics reveal that the top spot for U.S. Americans is, in fact, Frankfurt and the surrounding Rhine main area. Some 20,000 U.S. citizens live and work here and about 1,000 American companies have an office, a production facility, or some other corporate real estate space in the region.

One of the main reasons for this is the high passenger and cargo aircraft traffic to and from the United States. Frankfurt is home to Germany's largest airport, through which more than 340 aircraft fly to 25 U.S. destinations per week.

For those of you with Asian clients, Düsseldorf should be the first market you will want to investigate. In Düsseldorf there are more than 700 Asian companies, giving work to well over 40,000 people in the area, and making it a top spot to do business. This high influx of Asian capital and workforce dates back to 1955, when Mitsubishi opened its first subsidiary in Europe.

But as with any international transaction, you must be aware of the pitfalls and do your due diligence in regard to paperwork. Recent requirements state that all provisions of the lease have to be included in one document and that each page has to be signed by a competent representative from both the tenant and landlord, additionally, in order to comply with the written form requirements, the time between the offer and the acceptance must not exceed a certain number of days. And to make things even more complicated, if anything is agreed verbally, this is seen as an amendment to the written agreement, and it potentially entitles both parties to terminate the lease contract.

When entering the German real estate market, apart from choosing the right location and making sure you satisfy the written form requirements, another point needs to be carefully navigated.

Since 2006, all 16 German federal states now determine their rate of real estate transfer tax independently. Not surprisingly, given that the choice is theirs, the majority of the federal states have raised the taxes, particularly Brandenburg, Thüringen, and North Rhine-Westphalia, which have all increased the tax from 3.5 percent to 5 percent. The real estate transfer tax is similar to the U.K. stamp duty, triggered when the ownership is transferred to another person or legal entity.

And it is not just limited to the transfer of real estate. In a very drastic step to avoid tax, some schemes involve a third party when dealing with transfers. For example, if a company sold its only asset, a property, it is very possible that the RETT is applicable too.

If you or your clients are seeking to invest in commercial property, literally every German city in the top 10 will hold some value. As always, the international investor puts Berlin at the top of his shopping list, but this choice may not always be indicated.

One out of three € spent on commercial property in Germany comes from non-German investors. The transaction volume climbed well over one billion € in the first six months of 2012, championed by Munich with a volume of around 1.5 billion €. Germany's second biggest city, Hamburg, trails well behind with just under 0.8 billion €. In all three cities, office buildings returned to first place in the asset-class ranking, pushing off retail from the top spot for investments. Prime yields did not move in any of the German top 10 cities. As in previous years, Munich is the unbeaten champion. Office buildings are selling at a low net yield between 4.2 percent and 4.7 percent. Hamburg is lurking in its shadow with 4.8 percent in the most sought-after parts of the Hafen City. Berlin, unlike other capitals in Europe, falls behind its economically more powerful competitors, the Bavarian capital and the city-state Hamburg, with a net yield of just under 5 percent for office properties in the attractive Berlin heart.

Decision-makers are playing a decisive role in the fate of the euro. In the troubled euro zone, Germany is typically considered a safe haven for investors, consistently outperforming its European neighbors. It's no surprise then that German real estate is oftentimes on the top of the shopping list. Like any international market, there are a number of points, however, of which you must have an essential understanding when looking to invest in the German commercial real estate market.