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Private Equity Investment in Real Estate in the GSA Region

Germany, Switzerland and Austria – growing relevance to global real estate

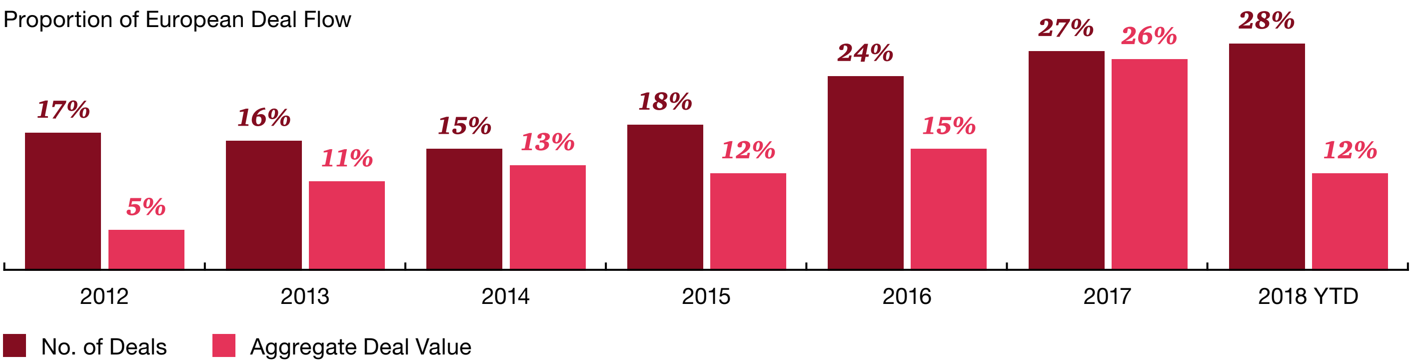
Since the inception of the European Union, the Eurozone has always been a key political and economic player in the global context. However, after major recent events such as the sovereign debt crisis, Brexit and the growing assertiveness in foreign affairs, the economic and political relevance as a grouping of the three German speaking countries of Germany, Switzerland and Austria ("GSA") has increased. The GSA countries, though not in any formal political or economic grouping, given their shared language, borders, economic strengths and size of investor pools, are increasingly viewed together as important real estate investment markets with an influential base of investors. Here we discuss two sides of this phenomena being (i) the emergence of GSA as an important global real estate investment market and (ii) the growing relevance of GSA real estate investors globally.

1 GSA's real estate markets are increasingly important

When the local real estate markets in southern Europe collapsed, investors rapidly refocused their investment activities on European "safe havens" such as Germany, Switzerland, Austria, France, and the United Kingdom. As the London and Paris markets have become exceedingly expensive from a comparative point of view, and with the UK market still volatile given the current Brexit negotiations, the number of investors seeking exposure to the GSA markets continue to increase.

GSA is now considered a serious global real estate investment market. Currently c. 30% of all European real estate transactions are transacted in GSA, significantly up from 15% in 2014 (see Figure 1), with this trend expected to continue given current market activity in the region. It is worth noting that within the GSA grouping, Germany is the largest driver of transactions with the country responsible for c. 94% of all GSA deals completed in 2017.

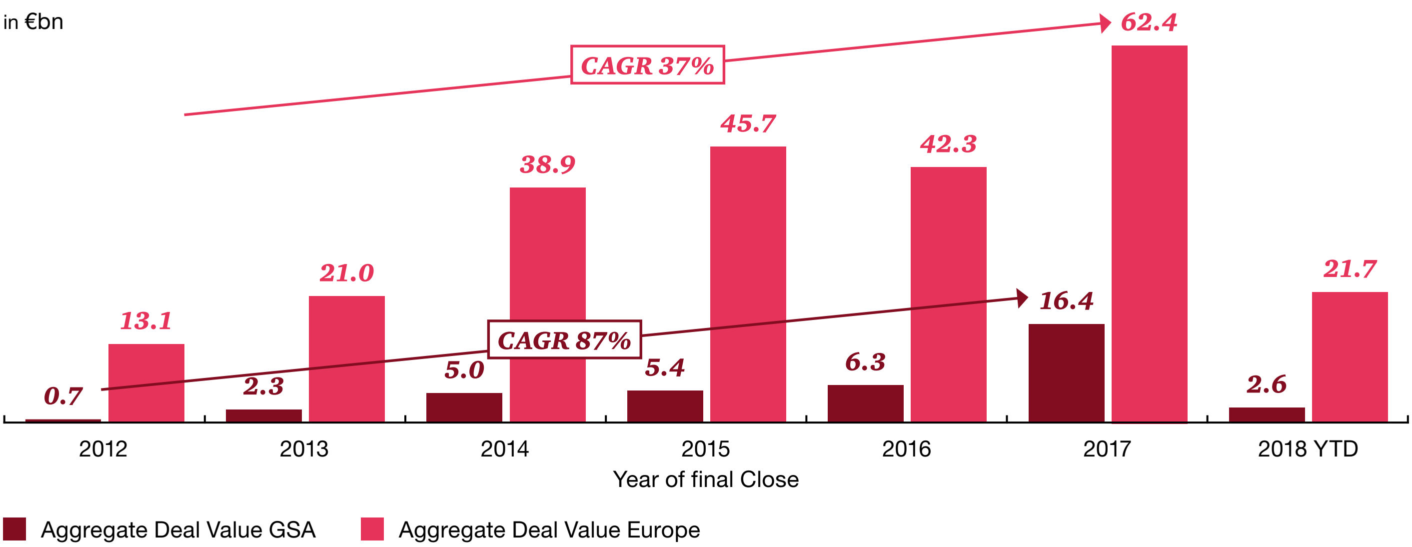
Fig. 1 GSA portion of total European Deal Flow



An important reason for GSA representing such a high portion of transactions in the European context is the comparably solid yield gap when compared to other major developed real estate markets. For example, there is a c. 3% spread currently between the German 10-year government bond yield versus prime office yields in major German cities.

Recent transaction data also demonstrates the continued interest in the GSA markets from real estate investors. The compound annual growth rate (CAGR) of the number of deals in Europe between 2012 and 2017 was c. 30% annually between 2012 and 2017. Over this same period, GSA's deals CAGR far exceeded the European growth rate, with an annual rate of c. 42%. When looking at the deal value, the increasing interest in GSA becomes even more apparent; Europe's aggregate deal value grew by c. 37% annually between 2012 and 2017, whereas the GSA aggregate deal value grew by c. 87% over the same period (see Figure 2).

Fig. 2 Development of aggregate deal value GSA vs. Europe 2012-2018 YTD

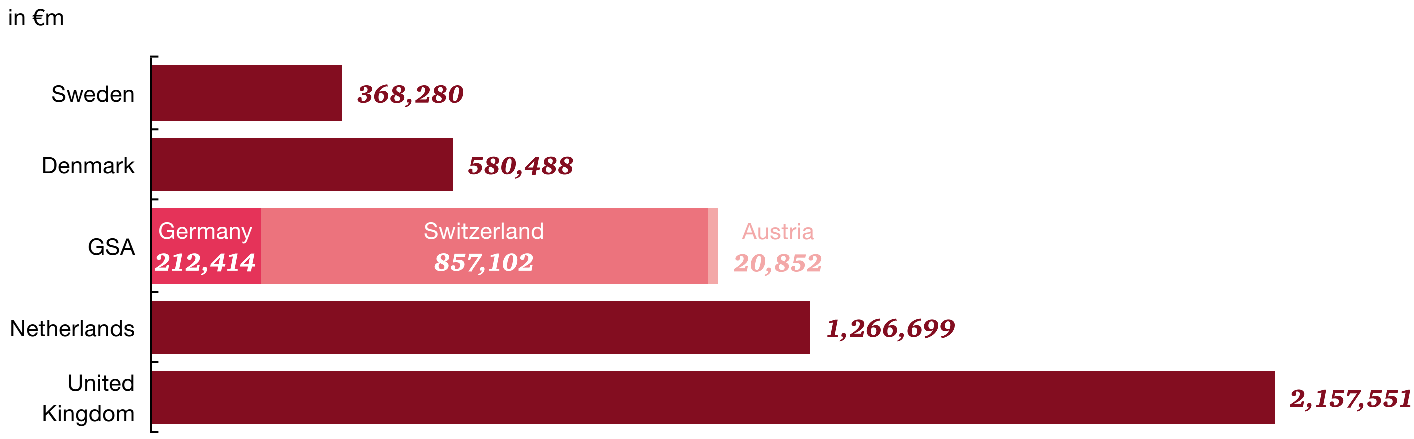


2 GSA is home to a significant and growing institutional investor base

The relevance to real estate markets of GSA as a block is also seen in the strength and "common" behaviour of institutional investors based in the GSA. While in 2015 there were 403 GSA-based institutional investors in Real Estate, the number has increased by 38% since then, with these investors numbering 557 in 2018. This relevance will continue to expand, as these investors continue to have significant inflows of capital, increasing their assets under management which in turn drives an increase in their allocations to real estate investments.

For example, pension funds of the GSA grouping have over €1,000bn in total assets under management, a number which will continue to grow.[1] (See Figure 3) A reason for this is the increasing importance of private retirement provisions as it becomes more and more unclear whether government entities will be able to provide sufficient pensions given the aging society. Given today's low interest rate environment, bank account savings are a diminishingly viable strategy for private individuals. Therefore, an increasing share of employees direct their retirement allocation to pension funds, a trend that will certainly continue and increase over the coming years.

Fig. 3 Top 5 European pension fund countries by assets under management



Source: OECD Pension Markets in Focus.

Diversification requirements increasing GSA investors' international relevance

GSA investors have a significant geographic European concentration in their real estate portfolios. In order to balance that exposure, GSA investors increasingly focus on geographic diversification to markets such as the United States and Asia-Pacific.

As a European-based manager noted in PwC's Emerging Trends in Real Estate survey *European investors have until recently remained largely focused on European assets, but are now starting to see Asia through a different lens*. The same holds true for the US real estate markets in which German investors invested c. US$6bn in the 12 months ended March 2018, a remarkable amount considering the aggregate deal volume in local GSA markets was c. €16.4bn in 2017. Recent conversations with larger German real estate funds confirm that trend with indications that they need to reduce their European exposure from currently c. 80% to around c. 33% in the medium term.

We believe this diversification trend will continue in the GSA, increasing the relevance of GSA based investors in international real estate markets.

[1] OECD Pension Markets in Focus.

Being a global investor is not straight-forward

The benefit of diversification comes with a set of challenges faced by GSA investors when establishing their international investment strategies. For example, some conservative GSA investors such as insurance companies and pension funds face the hurdle of mandatory currency hedging requirements, the cost of which significantly impact return profiles in today's low interest rate environment. In addition to hedging, investments need to be compliant with local regulatory and reporting frameworks for GSA investors which can be overly burdensome for some international managers. These hurdles require patience and education to overcome, in particular for some investors such as those located in Switzerland who have historically been pure domestic real estate investors.

GSA investors will continue to make strides in international real estate markets

Notwithstanding the challenges, it has been shown that these hurdles can be overcome. There are GSA investors who are market leaders with respect to successful implementation of a global real estate investment strategy. Two of which being well know German based investors, insurance group Allianz and pension fund Bayerische Versorgungskammer ("BVK"). An increasing number of institutional investors in GSA will follow the Allianz and BVK lead, learning from the experiences of their peers and increasing the visibility and relevance of GSA investors in the international real estate market.

Conclusion

To summarise, the GSA grouping has continued to gain relevance as both a direct real estate investment market and a base for a large number of institutional investors with significant real estate allocations. The number and size of transactions in GSA markets has been increasing faster than Europe as a whole and t the assets under management of institutional investors based in GSA continues to expand, with those investors increasingly looking for global diversification in their real estate allocations, making them now, more than ever, relevant global players.

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About PwC Real Estate Deals

PwC's Real Estate Deals Platform can support real estate investors and managers seeking to take advantage of these positive dynamics either through assisting with access to markets or investors and with the setup of investment strategies. With over 100 specialists in the GSA who have unique market insights and long standing relationships with key real estate players, and with offices in every major GSA real estate market, PwC is strategically placed to support. The GSA based teams offer a wide variety of real estate services including valuation and market analysis, M&A advisory, due diligence support, and capital raising services. More than additional 100 specialised tax and regulatory experts in GSA support the deal team.