Corporate Real Estate: Portfolio & Investment Structures

INTRODUCTION

The analytic series BEOS Survey has set itself the goal of enhancing the transparency of Germany's commercial real estate market. The focus is on corporate real estate whose four basic types (logistics, light manufacturing, transformation property, and business parks) were detailed in the last survey.

Survey no. 2 draws on the details of this previous account. The issue before you will focus on the analysis of corporate real estate as investment assets. To this end, it will study stock and investment structures, putting them in context with each other and with more established real asset classes in Germany.

MARKET VALUE AND TOTAL STOCK OF CORPORATE REAL ESTATE

By the end of 2010, the market value of German real estate not used for residential purposes totalled approx. 2,800 billion euros.[1] Taking office, retail, hospitality and recreational property as well as miscellaneous niche product (e. g. research and development) out of the equation will reduce the total value to 1,088 billion euros. In addition to corporate real estate, the remaining stock includes industrial real estate and a large number of smaller commercial properties, e. g. those occupied by the trades.[2] The corresponding market value equals approx. 1,107 billion euros at the moment.

The total stock of corporate real estate itself added up to approx. 520 billion euros in value and 922 million sqm in size in 2010. By the end of 2012, the value had risen by around 3.5 % to 538.3 billion euros. The usable area comes to a current total of around 932.2 million sqm (+1.1 %).[3]

This makes corporate real estate the dominant property class in German commercial real estate (industrial / logistics) as it accounts for nearly 49 % of its fair market value. Industrial real estate represents the second-largest share at just below 43 % (475.3 billion euros).[3] The trades, characterised by small-scale assets and focused on local markets, makes up a mere 8.3 % of the total volume at 93 billion euros.

In terms of floor area, corporate real estate accounts only for around 36 % of the total stock of commercial and industrial space in Germany. This implies that the value of corporate real estate must be rated as disproportionately high.

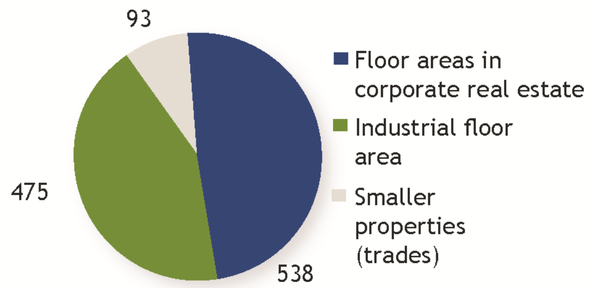

Fig. 1: Market value of commercial real estate (industrial / logistics) in 2012, in billion euros[3] (source: BulwienGesa AG 2013)

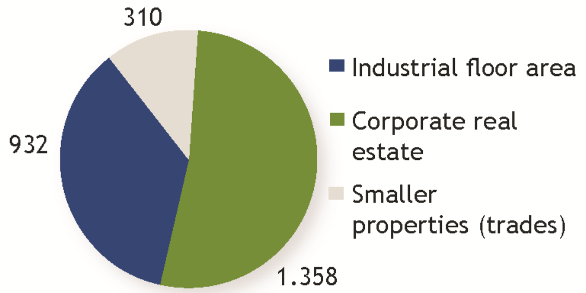

Fig. 2: Floor space volume of commercial real estate (industrial / logistics) in 2012, in million sqm (source: BulwienGesa AG 2013)

LIGHT MANUFACTURING THE LARGEST SUB-GROUP

Corporate real estate divides into four types (logistics, light manufacturing, transformation property, and business parks). In terms of property value, light manufacturing represents the largest sub-group (roughly 55 %). Vintage logistics properties account for nearly a quarter, whereas modern logistics properties for barely 12 %. Transformation property makes up 7.8 % of the volume, while business parks bring up the rear with a marginal share of 1.7 %.[3]

Key Figures / Property type	Floor space in million sqm		Share	Market value	Pro rata value	thereof investment-grade	
	2010	2012	in %	in bn euros	in %	in %	in bn euros
Transformation property	60.0	60.3	6.47%	42.2	7.84%	50%	21.1
Logistics (stock)	260.0	254.8	27.33%	127.4	23.67%	50%	63.7
Logistics (modern)	60.0	68.6	7.36%	61.7	11.47%	80%	49.4
Business Parks	5.0	6.6	0.71%	8.9	1.66%	90%	8.0
Light manufacturing	537.0	542.0	58.13%	298.1	55.37%	40%	119.2
Corporate real estate	922.0	932.3	100.00%	538.3	100.00%	49%	261

Fig. 3: Stock changes, 2010 through 2012, market value and investment-grade stock of corporate real estate in Germany, 2012[3] (source: BulwienGesa AG 2013)

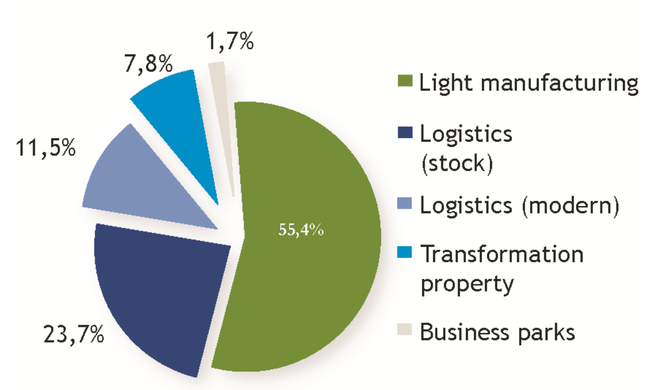

Fig. 4: Pro-rata market value of corporate real estate in Germany by type, 2012 (source: BulwienGesa AG 2013)

DOES “CORPORATE REAL ESTATE” SPELL “LOGISTICS”?

The term “corporate real estate” is relatively recent to Germany's real estate economy. Anglo-Saxon market players would probably refer to comparable assets as “light industrial” or “multi-let properties.” In reports on the German real estate market, by contrast, terms like “logistics” or “commercial / industrial” tend to front for corporate real estate. Definitions of these segments are generally hazy, and may comprise any kind of commercial real estate that fails to qualify for the categories of office, retail, or hospitality.[4]

The simplistic classification is explained by investors' growing interest in modern and large-volume logistics assets such as distribution centres. These have lately evolved into an acknowledged asset class in their own right in Germany. Indeed, many market players group them with the Core category.[4] Well aware of the trend, estate agencies have started to include key ratios for logistics properties alongside the figures for office and retail assets in their market reports for German commercial real estate. However, this delineation of the term logistics real estate is misleading because it often subsumes the entire spectrum of corporate, commercial and industrial real estate. The vague differentiation of this coverall category makes it harder to determine the market details of each of the subsumed property types.

LOW SHARE OF LOGISTICS IN INVESTMENT VOLUME

The asset class “logistics” as defined along the aforementioned lines received approx. 1.8 billion euros in investments in 2012. The last time this level was achieved dates back to 2008 (1.9 billion euros). Pro rata, however, the share of logistics has since declined (2012: 7.0 %, 2008: 9.9 %). The logistics has generally accounted for a pro-rata share between 5 % and 10 % of the total investment volume in commercial real estate in the years since 2007. Compared to the segments office (35 % to 53 %) or retail (20 % to 46 %), the logistics segment represented but a minor share of commercial real estate investments. Yet most market reports mention that keen investor demand for this products has gone unmet because of short supply.

Segment / Year	Office	Retail	Logistics / industrial[5]	Other
2007	53.1%	20.6%	6.7%	19.7%
2008	43.7%	34.0%	9.9%	12.4%
2009	46.5%	26.5%	9.6%	17.3%
2010	36.6%	46.3%	7.8%	9.3%
2011	35.0%	46.0%	4.9%	14.1%
2012	41.8%	30.5%	7.0%	20.7%

Fig. 5: Pro-rata share in the commercial investment volume in Germany, by segments and year3 (Source: BulwienGesa AG 2013)

Type / Criterion	Transformation property	Light manufacturing	Business parks	Logistics stock properties	Modern logistics properties
Top-level requirements	- multi-occupied capacity - reversibility of use - alternative use potential - advanced flexibility - regions of growing or stable economic power				
Location / pitch	- urban / integrated pitches - suburban pitches or pitches close to prospering regions	- pitch in conveniently accessed trading estates or close to long-distance modes of transportation	- pitch in trading estates or close to long-distance modes of transportation	- pitch in integrated trading estates close to regional and national modes of transportation	- pitches close to transport hubs - potential for expansion options - open to 24/7 operation - out-of-town or suburban location
Building quality / property quality	- historic building fabric - permitting flexible partitions - moderate refurbishment needs	- divisibility - moderate refurbishment needs	- sensible mix of buildings without excess office share - in good repair	- delivery access options - moderate refurbishment needs - general suitability for customisation and modernisations	- modern standard - standardised types of construction - high flexibility - minimum floor-to-ceiling height 10 m - generously sized delivery access - at least 1 gate per 1,000 sqm of warehouse space - ultimate load of floors at least 5t / sqm
Property size (usable area)	10,000 - 80,000	5,000 - 60,000	25,000 - 85,000	10,000 - 30,000	15,000 - 100,000
Accessibility	- great public transport access - great private transport access	- excellent public transport access - excellent private and heavy-goods transport access	- private vehicular transport access - close public transport access	- to some extent close public transport access - good to excellent private transport access	- excellent heavy goods transport access

Fig. 6: Investment criteria (selection) for corporate real estate types (source: BulwienGesa AG 2013)

The different property types included in the logistics asset class are not clearly distinguished, creating the impression that only modern large-scale logistics properties are grouped with this class. At 73 % of the investments in this asset class, the logistics property (distribution) building type was admittedly the property type that did experience the strongest demand in 2011. All other types of corporate real estate combined added up to a mere 21 %.[4]

It is, however, safe to assume that the distinctions made to differentiate between these property types have been less than accurate, and that a considerable number of transactions were not aggregated at all. As far as transformation property goes, there is reason to believe that these continue to be grouped either with office properties or with mixed use / commercial buildings.

GERMAN INVESTORS RETICENT IN THE LOGISTICS SEGMENT

Survey No. 1 showed that Anglo-Saxon investors keep a much higher share of “light industrial” or corporate real estate in their portfolios (United States 2011: 21 %). How do you explain the reticence among German investors?

For one thing, the bulk of German investors has not yet found an angle on this segment. German investors accounted for only 30 % of the commercial investment volume committed in Germany, the rest having been traded by foreign players.[4] This ratio underlines the high level of acceptance that logistics and commercial real estate meet with outside Germany. Particularly safety-conscious investors such as insurance companies and banks did not even enter into the picture – the biggest investors were asset managers and fund managers.[3]

One reason for the timid investment behaviour could be the comparatively low market transparency. A variety of surveys have greatly improved the transparency level in recent years, though.[2/6]

PROPERTY QUALITY AND PITCH DECISIVE FOR INVESTMENTS

Warren Buffet's maxim of investing only if you have truly understood the investment is perhaps being taken too serious here. After all, corporate real estate is hardly more complex than office real estate, for instance. Ahead of office acquisitions, extensive pre-acquisition audits are conducted to determine the level of exposure associable with the respective commitment.

Much the same goes for corporate real estate even if certain other deciding factors come into play as well. The most important factors are listed in Figure 6, above. The degree to which these factors are met is indicative of the quality of a given property and of its suitability as investment property.

In addition to high property quality, the location must be sustainably suitable. In the case of corporate real estate, this hinges definitively on occupier demand. Particularly eligible in this senses are economic growth regions that show a high per-capita gross domestic product (GDP) or else brisk GDP growth. In Figure 7, these regions are shaded in hues of blue.

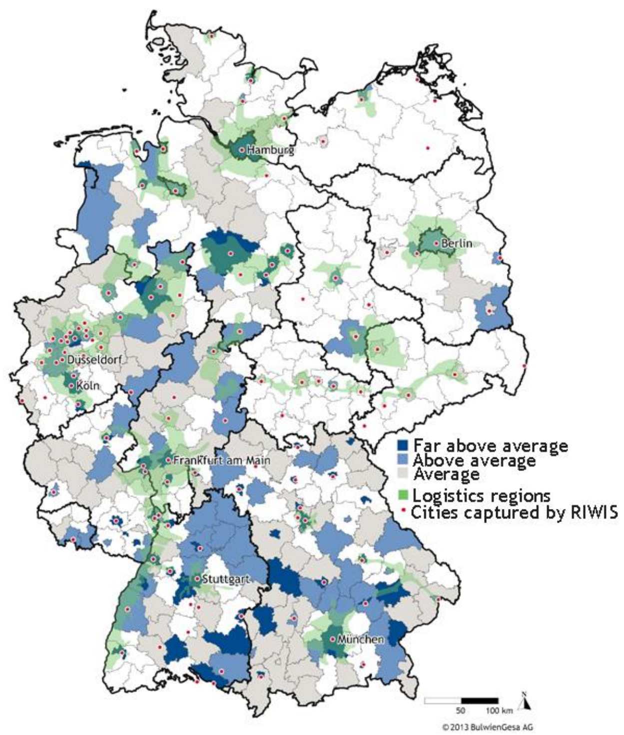

Fig. 7: Economic growth and logistics regions in Germany, 2012 (source: BulwienGesa AG 2013)

On top of that, logistics real estate depends on convenient transport connectivity. The logistics region shaded in green by BulwienGesa maps areas that are heavily frequented by logistics operators at the moment, because they represent optimal condition in terms of economic geography.[3]

HIGH INVESTMENT POTENTIAL IN EVIDENCE

Naturally, not every corporate property is of investment grade quality. Whether or not a given asset is worth investing in depends on its property type, with investment eligibility ranging from 40 % in the case of light manufacturing to 90 % in the case of business parks. All things considered, around 49 % of the corporate real estate in Germany can be rated as "investment-grade." This translates into an asset value total of approx. 261 billion euros (see Fig. 3) or around 457 million sqm of usable area. Just for the sake of the argument: At today's average annual investment volume in commercial and logistics properties of roughly 1.8 billion euros, there is enough investment-grade corporate real estate in Germany to last 145 years. Differently put, there is plenty of investment potential to go around. But there is simultaneously every reason to believe that the investment volume will increase in the future, and this for two reasons: One, companies are lowering their owner-occupation ratio, and will increasingly start renting. Secondly, corporate real estate will keep establishing itself as an investment class, and will therefore attract growing investor demand.

OUTLOOK

The so far largely untapped value potential of corporate real estate presents a wide spectrum of investment options for investors that have met with barely a response – due to a lack of information about its opportunities and benefits. BEOS Survey No. 3 will therefore focus on the: "Performance of Corporate Real Estate Investments." The next issue will be published in June 2013.

1) Institut der deutschen Wirtschaft Köln, 2010, Wirtschaftsfaktor Immobilien – Die Immobilienmärkte aus Gesamtwirtschaftlicher Sicht, www.diese.de/files/Vortrag_Dr._Michael_Voigtlaender.pdf
2) BulwienGesa AG et al., 2010, Gewerbe- und Industrieimmobilien in Deutschland, www.beos.net/sites/beos.net/html/media/pdfs/downloads/BulwienGesa_Gewerbe_Industrieimmobilien_2010-06-08.pdf
3) BulwienGesa AG, 2013, estimate based on its proprietary RIWIS real estate database
4) Jones Lang LaSalle, 2012: Logistikimmobilienreport 2012, http://www.joneslanglasalle.de/Germany/DE-DE/Pages/ResearchDetails. aspx?ItemID=8206
5) Includes all types of light industrial real estate
6) Fraunhofer-Arbeitsgruppe für Supply Chain Services SCS et al., 2011, Logistikimmobi-

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