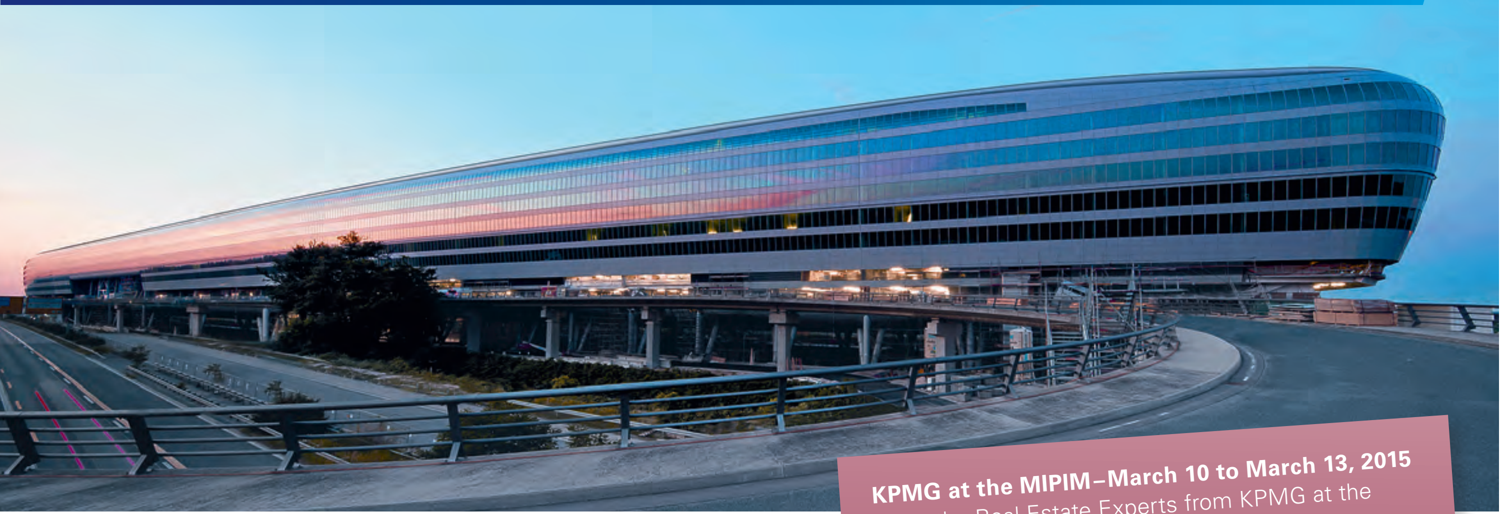

KPMG at the MIPIM – March 10 to March 13, 2015
Meet the Real Estate Experts from KPMG at the MIPIM in Cannes. You can find us in the **Palais des Festivals, hall Riviera 7, booth R7.G20.**

March 2015

Spotlight

The German real estate market is flourishing.

No other term can describe the current mood better. After a transaction volume of residential and commercial real estate of more than 50 billion Euros in 2014, the experts KPMG interviewed at the end of 2014 expect a further rise in 2015. Only in the boom years 2006 and 2007 did more German properties change owners.

Many reasons suggest the real estate boom is set to continue

The lack of yield potent investment alternatives on the securities market, the liquidity glut brought on by the central banks, the low interest rate level, the stable economic situation and not least also the lower Euro value fuel the high demand for German real estate. Germany is hailed as the ideal destination for international real estate investors after the United Kingdom. If these factors are already sufficient on their own to explain the current boom, it is even more reinforced by the entrance of new players. Insurance companies from China and Taiwan have as of recently been permitted to also invest in foreign properties, which continues increasing the pressure on the markets in Germany and the United Kingdom.

Braking factors ineffective up to now

Higher burdens with higher real estate transfer tax, the increasing of the real estate tax observed everywhere for the municipal budgets' financial recovery as well as the emerging rent control seem to influence the boom in no negative way. In addition, after the publication of the Luxemburg leaks the expected political reaction to putting a stop to any possible abuse of any international tax regulations and the planned measures of the OECD against the so called „Base Erosion and Profit Shifting (BEPS)", when viewed on their own, should have no longterm negative impact on transactions markets. KPMG is in pace with the times with all these topics and is at your disposal with a wide range of services along the value added chain of the asset class real estate in all relevant markets.

I wish you an informative and inspiring reading experience.

Yours
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Partner, Head of Real Estate

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Content

Enter the “IPMS”. Will the new floor area calculation standards lead to increased transparency and uniformity worldwide?

The recently published International Property Measurement Standard (IPMS) is the new standard for the floor area calculation in office buildings.

Currently differences worldwide

The answer to the question of the usable building space of an office building can vary considerably. It essentially depends on the country the property is situated in or according to which historical and cultural directives and recommendations the floor areas of buildings are measured.

In India, for example, attached parking areas can also be added on to the office floor area. In Spain leisure facilities are included. In some areas in the Middle East, even “theoretically existing” storeys are included in the calculation. In other regions, on the other hand, only air-conditioned spaces may be included, while the actual floor area is irrelevant. These different procedures result in substantial discrepancies in floor area calculations when comparing properties across international borders.

Often, owners of international property portfolios are therefore forced to adjust area calculations to ensure a comparability of the (usable) spaces in buildings and key property related metrics arising from this.

A uniform solution is due

As a result, the International Property Measurement Standard coalition was initiated during a meeting of the World Bank in 2013. Representatives from more than 50 international organisations joined and set their sights on developing a method for the uniform calculation of usable floor area. Among others the members include the Gesellschaft für immobilienwirtschaftliche Forschung e. V. (gif), the Royal Institution of Chartered Surveyors (RICS) and the HypZert GmbH.

At the end of 2014, the first IPMS for office spaces was published in English (www.ipmsc.org) and subsequently discussed in the German National Association of the RICS with experts of the property industry. The RICS aims to issue a guideline for the application of the IPMS in the course of this year.

Apart from the IPMS for office property, further standards are planned for residential (to be published in 2015), industrial and retail property.

Creating acceptance has priority

It is now the IPMS coalition’s primary goal to create acceptance for the new standard and on a global level. In the meantime, numerous international companies and organisations are committed to its introduction and are striving to be registered as IPMS partners.

From a present point of view, it can be assumed that the focus of the introduction of the IPMS standard will be on countries with no standardised method of floor area calculation. For example, Dubai has announced a compulsory introduction of the IPMS for office areas. This is a reaction to the growing number of international commercial property investors.

In countries already having a standardised method – for example in Germany where the DIN or the recommendations developed by the gif are used – the IPMS will probably be used in parallel or supplementarily for the time being. It remains to be said that there already is a very detailed set of regulations in Germany concerning the calculation of floor areas.

Outlook

It can be assumed that the IPMS is increasingly moving into the focus of internationally operating market players in the calculation of floor areas and key property related metrics. Ultimately, it is all about an internationally uniform method of measuring buildings, making floor area calculations comparable and thus reducing investment risks.

To what extent the new standard will establish itself on the German property market and supersede the prevailing national standards will be decided by the market.

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Recognition of the personal tax exemption status of pension schemes with foreign real estate investments

Tax avoidance strategies of multi-national groups have triggered a discussion about tax standardisation. However tax exemptions themselves are less in the spotlight – with consequences for the equal tax treatment of pension schemes.

The current planning of measures against Base Erosion and Profit Shifting (BEPS) intends a uniform taxation of multi-nationally operating companies in order to thus avoid base erosion and profit shifting in "tax oases". However, the question comes up what is in return happening with the uniform tax exemption.

Only German pension schemes are exempted from tax in Germany

In Germany for example, pension schemes are exempt from trade tax and corporate income tax. There is an exception for income which is subject to withholding tax. If a German pension scheme for example receives dividends from a real estate company, thus these are subject to the (reduced) capital gains tax and are basically satisfied by the withholding of the tax.

If, on the other hand, foreign pension schemes or similar institutions receive domestic income from real estate investments, thus they basically are subject to the limited tax liability in Germany. Despite tax exemption in their home country, their rental income in Germany – other than with domestic pension schemes – is taxed. A satisfying effect likewise merely arises for the withholding tax on dividends from intermediary real estate companies.

No equal tax treatment abroad

It is a similar case with investments by German pension schemes abroad. Depending on foreign tax law, institutions tax exempted in Germany can be subject to foreign income taxes, even though there comparable domestic pension schemes are exempt from tax. In the case of a real estate investment abroad, this leads to a definite tax burden of German pension schemes. Against this background, comparable foreign institutions in these countries ought to likewise be exempted from tax if an exemption is granted to locals.

Partial tax exemption abroad

In the Netherlands for example, Dutch pension funds can profit from tax exemption just like pension funds located in the EU with real estate held via special funds. Experience has shown that in individual cases in Great Britain, tax exemptions of German pension schemes who invest via special funds in real estate situated there are also accepted. In Finland, a first instance judgement has already been delivered about the comparability of a German special fund with a tax exempted Finnish investment fund. Thus according to that, the tax exemption for Finnish investment funds is also applicable to German fund assets.

Also beyond Europe's borders, the equal treatment of domestic and foreign tax exempted institutions can be seen. If pension schemes invest over a holding or a fund in Mexican real estate, the income deriving from leasing and sale of the premises can be tax exempted in the relation in which pension schemes and similar tax exempted institutions participate. This regulation applies to a participation quota of the pension schemes of at least 90 percent and can, if all the shareholders consist of tax exempted institutions, lead to the total exemption of this income from tax. Similar tax exempted investments can ensue for pension schemes via the participation in a US-REIT. If the respective participation in the REIT is under 10 percent, the distributed dividends are exempted from withholding tax due to which an almost tax free income of the pension schemes is generated.

Ergo: uniform tax exemption

In some countries tax exemptions are already being uniformly applied to domestic and overseas institutions. Apart from a uniform taxation in the course of the BEPS measures, consequently also a uniform tax exemption should be attained. This equal treatment would correspond to the basic idea of the BEPS plan and could lead to a "smoothing" of the location attractiveness from a taxation point of view for investors such as pension schemes.

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Challenges for property managers due to rules of investment law

The German Capital Investment Code obliges fund management companies to extensive supervision of their outsourcing partners. This obligation has a grave impact on involved property managers and facility managers.

The challenge

On 22nd July 2013 in the course of the implementation of the Directive for Alternative Investment Fund Managers (AIFMD) in Germany, the German Capital Investment Code (KAGB) replaced the former investment law. The new regulation concerns the managers of open-end funds and closed-end funds.

A great number of formerly unregulated financial market players has been confronted with the implementation of new legal requirements since then. According to the provisions of the KAGB, an Alternative Investment Fund Manager (AIFM) is obliged to make an extensive supervision of functions it has outsourced. In so doing, it has the responsibility to ensure that the service provider is in the position to fulfil the tasks taken over in proper form.

The quality requirements of the processes concerning the insourcing company and its documentation are the same as the ones KAGB stipulates for the processes of the AIFM.

In order to meet these new requirements, the AIFMs draw up inspection plans by which they supervise the quality of the processes of their service providers. Among other things, these plans are to be implemented within the scope of the internal audit. Based on these proceedings, the AIFMs then actively review the internal processes of the service providers and decide by means of the results if it is necessary to withdraw the contract from the respective service provider, for example if insufficient control mechanisms exist.

Property managers/facility managers

For many service providers in the real estate sector, especially property managers and facility managers, this requirement is new. Ultimately, all operative processes of a service provider have to be documented and illustrated in handbooks observing the regulatory requirements. Then in practice, the staff is to implement the precisely documented work steps and abide by them. In turn, the service provider has to check this internally on a regular basis. If necessary, the process descriptions have to be adjusted.

Insofar as a service provider has not yet implemented his organisation documentation and design in this form, extensive preparations are necessary so that the provisions of the internal revision of an AIFM can be fulfilled.

In so doing, the focus of the AIFM internal audit is on the checking of the respective processes and their documentation. In addition, service providers who work for several AIFMs have to repeatedly run through these checks.

Certification makes for security

In order to avoid this, it is recommendable to attain a certification of the internal control system (ICS) via the auditing standard (PS) 951 of the Institute of Public Auditors (IDW). It relates to the processes of the service provider work and is based on the process documentation. Beyond this, the processes are checked for adequateness and functional capability.

The certification is suitable as proof of functionality of the relevant ICS and, therefore, can – also repeatedly – be presented as expressive source of information, if information is demanded about the internal organisation. Further, the future documentation and auditing workload are kept lower due to an early certification of process quality.

The basic revision and documentation of the individual process steps which ensue preceding a certification according to IDW PS 951 demand respective commitment. As a result, liability risks of the company and of the managing directors are revealed, and efficiency effects are achieved in many cases.

Our experts are delighted to accompany you towards certification according to IDW PS 951. Here essential action fields are:

- Support in the definition of the relevant organisational and procedural requirements on basis of the present service contract with an AIFM
- Cooperation in the execution of a gap analysis and the definition of action fields
- Accompaniment of the process documentation among other things via coaching and review services
- Pointing out well proven approaches from our extensive project experiences.

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Even more regulation of leasing of residential properties

The Federal Government has reacted to the rent rise in sought-after residential areas with an amendment to rental laws. However, experts see the rent control it provides as controversial and recommend instead lending state support to residential construction.

High demand in residential property market in densely populated areas

A number of market studies at the moment note that there are housing shortages in many regions in Germany, which, in turn, can lead to numerous problems in the affected areas, in particular densely populated, prosperous areas but also in attractive medium-sized towns and popular university locations. Here, one can see an above-average increase in rent with the re-letting of existing flats with some exceeding the average comparative rent to a significant degree.

Rental regulation by introduction of rent control

The aim of the intended Tenancy Law Amendment Act (Mietnovellierungsgesetz – MietNovG) is to curb rent increases with the re-letting of existing flats in tight housing markets, according to the draft bill of 10th November 2014. For this reason, the draft bill provides for the introduction of a so-called rent control which means that when flats are rented in the future, the rent will not be permitted to exceed the average local comparative rent by more than ten percent. The state governments are to be authorised to designate areas with tight housing markets, and rent control is to apply only in these designated areas. New buildings from 1st October 2014 on are to be exempt from rent control, likewise flats that are rented for the first time after undergoing extensive renovations. Also to be taken into consideration is that for the starting rents for index-linked rental agreements, the general regulations for the permitted amount of rent are to be applied according to the new draft bill. Only the subsequent rent increases that are due to adjustments to the index development are not to be subject to checking any more, according to the planned provisions for rent limitation. This in contrast to graduated rental agreements, in which each grading agreed upon is to be controlled again at the time it is due as to whether it is permissible regarding the amount. A grandfathering regulation in the draft bill includes the provision that the landlord can carry on demanding a permissibly agreed-upon rent also in re-letting, even if the rent which the previous tenant last paid is higher than the rent permitted in accordance with the new regulations. When calculating the pre-rental payment, however, rent reductions and rent increases which were enacted within the last year before the previous rental contract was terminated, are not included.

Regulation versus new building

Many experts, however, have their doubts as to whether the intended benefits of the changes in the law – in particular the avoidance of an above-average rise in rents in densely populated, prosperous areas and the creation of affordable living space in sought-after locations – will in fact be realised, and ask whether these changes can help resolve the pressures on the current housing rental market.

In addition to the introduction of rent control under the category of "affordable living", the coalition agreement between CDU, CSU and SPD specifies that the allocation of modernisation costs should be limited to at the most ten percent and should last only up to an amortisation of the costs. This means that existing regulations on rent increases linked to renovations will be changed, and proven framework conditions will be abolished. The implementation of the planned regulations will thus make renovations a less attractive option for home-owners and will likely lead to a decline in the number of renovations made. As a result of this, the standard of existing housing on the total housing rental market is expected to deteriorate noticeably.

Regulatory measures like the introduction of rent control and capping limits, as well as the lowering and limiting of modernisation fees, are understandably being evaluated extremely critically. In contrast, state measures to promote residential construction in the affected areas seem to be by far the more expedient option.

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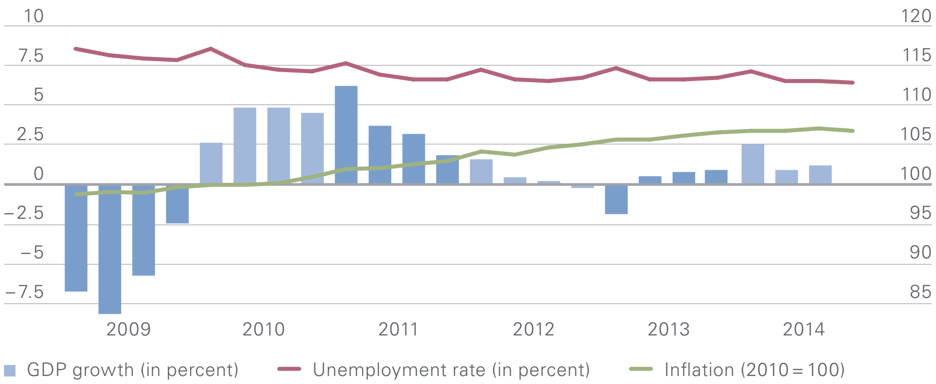
The buoyancy of the German real estate market – a never ending story?

Following top turnovers in the investment market for commercial property in 2013, it is still a success tale in 2014. The rents are rising, the premium yields are also falling in Class B locations. How long will this trend last?

Figure 1
Economic fundamentals
Source: Destatis



Economic-political general conditions

Following a surprisingly good start off in the first quarter of 2014, the German economic situation has clearly dampened in the course of the year. In the third quarter of 2014, the German economy only just scraped past a recession. The reasons for this were above all the uncertainties caused by the geopolitical crises as well as weakening in important sales markets. Thus for example the sanctions against Russia in the course of the Russian-Ukrainian conflict resulted in a considerable slump in German exports to Russia.

On the whole, the real gross domestic product (GDP) rose by 1.5 percent in 2014 compared with the previous year. For 2015 the Deutsche Bank assumes an economic growth amounting to 1 percent, the German Institute for Economic Research (DIW) predicts a GDP growth of + 1.4 percent (Figure 1).

The principal growth driver in 2015 will also be the domestic economy, aided by a robust employment market. On the other hand, foreign trade is to make a low(er) contribution. The population looks extremely optimistically into 2015, according to the Allensbach Institute.

The building and real estate sector appears unaffected by the geopolitical unrests and crises abroad. (Foreign) investors above all still look upon Germany particularly in periods of crisis as safe “real estate haven”, even though the Real Estate Climate Index published by the Deutsche Hypothekenbank fell in 2014 by 3.0 percent to a year-end value of 125.2.

Office estate

The highest rents in the office sector also followed the positive trend of the past years in 2014. With a rise by around 6.2 percent to 34.50 Euros per square metre compared to the previous year (32.50 Euros), in Munich not only the highest rise in rent of the top 5 office locations could be attained, but in addition it was the highest level attained in the state capital for ten years.

Also a rise in the highest rents could be observed in Berlin, Dusseldorf and Frankfurt/Main. Only in Hamburg the rents stagnated, as already in the two previous years, on a level of 24.50 Euros per square metre. The highest rents of all top 5 office locations were over the pre-crisis level 2008/2009 again for the first time in 2014 (Figure 2).

The office space take-up in the top 5 locations in the first three quarters of 2014 amounted up to around 1.7 million square metres – this corresponds to a slight decrease by 2.3 percent compared to the same period of the previous year. In Dusseldorf (– 17.6 percent) and Frankfurt/Main (– 21.6 percent), clear decreases in the space take-up were registered which above all resulted from the lack of large scale rentals. Also in Munich, space take-

Figure 2
Prime office rent (in EUR/m²/month)
Source: Thomas Daily Archiv

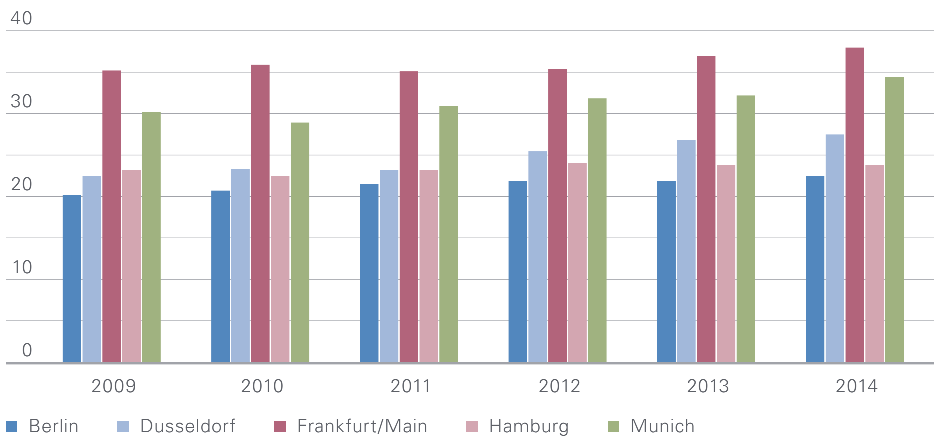
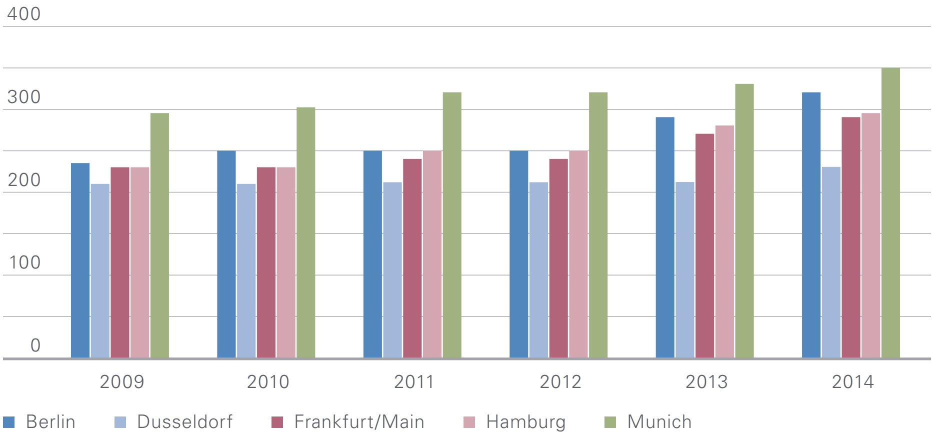


Figure 3
Prime retail rent (in EUR/m²/month)
Source: Brockhoff



up was lower compared to the same period of the previous year (–6.9 percent). In Hamburg and Berlin on the other hand, the space take-up went up clearly with 20.2 percent respectively 17.0 percent. Hamburg was even able to top Frankfurt/Main with around 372,000 square metres of space take-up.

Compared to the same quarter of the previous year, the premium yields for office estate in the third quarter of 2014 again fell in all top 5 office locations. The decrease shows up very distinctly in Berlin and Munich with minus 25 basis points to 4.65 percent respectively minus 30 basis points to 4.45 percent. In Dusseldorf and Frankfurt/Main the premium yields are 4.7 percent, in Hamburg 4.55 percent.

Due to the excess demand, investors increasingly fall back on good office estate in Class B locations.

Up to the end of the third quarter in 2014, barely 13 billion Euros were invested in office estate (+52 percent compared to the same period of the previous year). This corresponds to a share of around 51 percent in the total investment volume.

Retail real estate

Also the highest rents in retail increased in all top 5 locations in 2014, foremost Berlin with a rise in rent of 10.3 percent compared to the previous year. Hamburg showed the least rise in rent with around 5.4 percent (Figure 3).

Due to the limited space available, the premium yields continued to fall in the first half of 2014. The premium yields for business premises reduced by 10 basis points to 4.2 percent.

Also shopping centres in prime locations, shopping precincts as well as supermarkets and speciality markets showed a premium yield reduced by 0.1 percentage points.

The tight supply of core-properties in the top 5 locations and the very good climate in the retail trade sector lead to the investors becoming increasingly interested also in well positioned properties in Class B cities as well in properties with value increase potential. Due to the continuingly high investment pressure in the core segment, top brokerage firms assume a stabilisation up to a slight decrease in premium yields. Also a reduced level of yield is expected in the non-core sector.

Logistics properties

As already in the previous year, the highest rents for logistics properties stagnated on a high level up to the third quarter 2014. Alone in Dusseldorf, there was a rise of 5.10 Euros to 5.30 Euros per square metre. The highest rents of the other four top locations were between 4.70 Euros in Berlin and 6.50 Euros in Munich in 2014 (Figure 4).

Up to the end of the third quarter 2014, there was a take-up of around 3.8 million square metres of warehouse and logistics space throughout Germany (+2 percent compared with the previous year). Hence the space take-up in Germany is already clearly over 3.0 square metres for the fifth year running. In the top 5 locations, there was a take-up of around 1.3 million square metres of logistics space up to the third quarter of 2014 (–6.5 percent compared with the same period of the previous year). While in Berlin, Hamburg and Munich increases in take-up could be generated of up to 8.2 percent, Dusseldorf and Frankfurt/Main had to make do with –18.8 percent respectively –16.0 percent clear declines in turnover.

The transaction market for logistics properties achieved a record result of 3.3 billion Euros in 2014 (+54 percent compared to the previous year). Thus logistics properties are continuing to become established as an attractive investment class next to office and retail real estate.

Consequently the premium yield decreased by 0.25 percentage points to 6.25 percent for the third quarter of 2014. Leading brokerage firms also assume a flourishing investment dynamics in 2015.

Figure 4
Prime logistics rent (in EUR/m²/month)
Source: BNP Paribas Real Estate

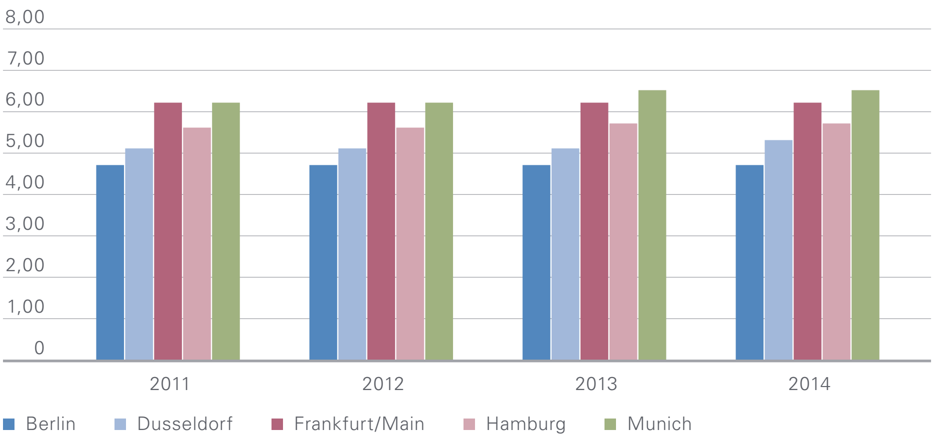


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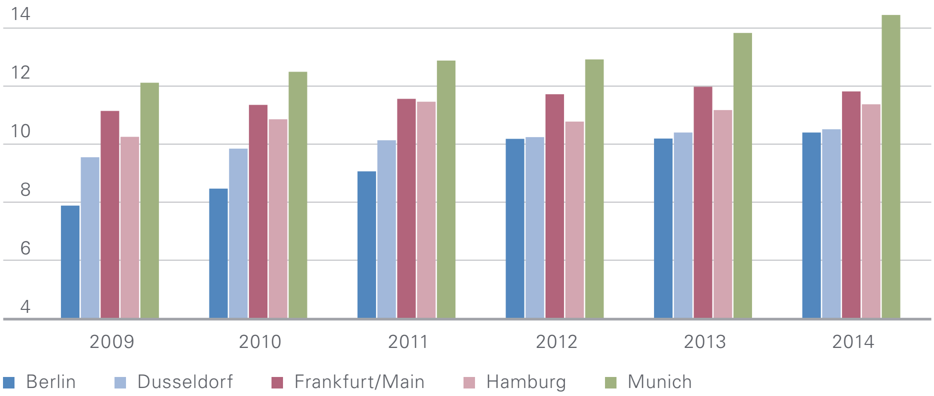
Figure 5
Median residential asking rent (in EUR/m²/month)
Source: empirica



Residential property

The real estate economy index for residential property of the Deutsche Hypothekenbank decreased in the course of the year by around 1.0 percent to 155.7 points. However, still clearly the most attractive segment is habitation.

The investment market for residential property was characterised by sales of large residential portfolios (+15 percent compared with the previous year), as for example in the sale of the DeWAG portfolio to the Deutsche Annington (11,500 housing units) for 970 million Euros or the sale of the DGAG portfolio (18.000 housing units) to the BUWOG Group for 892 million Euros. In addition, the fusion of the Deutsche Annington with the GAGFAH caused a sensation.

According to the price statistics of the German Real Estate Association (IVD), the new rental contracts have risen less dynamically nationwide in Germany in cities of all sizes than in the previous years. The rise in rent for existing apartments amounted to 2.1 percent according to IVD. The same development is also apparent with renting in first occupancy. In cities with over 500,000 inhabitants, the rents rose less strongly with 4.8 percent than in the previous year (5.9 percent). For cities with a lower population figure, the rents rose at 2.9 percent (3.9 percent in the previous year). Named as possible reason for this development is among other things the high demand for owner-occupied flats on the basis of favourable financing options. In 2014, the prices for home ownership have increased both in existing homes and new buildings (existing flats +4.5 percent, newly built flats +5.1 percent). In the large cities, there was an above average price increase with 9.3 percent for existing flats.

The highest rents per square metre are achieved in Munich with approximately 14.51 Euros (+5.1 percent). Berlin and Hamburg have 10.42 Euros (+2.7 percent) respectively 11.38 Euros (+1.9 percent) at the end of 2014 (Figure 5).

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