

SECOND OFF-MARKET STUDY

October 2019

Foreword by John Amram

Last autumn the first HPBA Off-Market Study, which we prepared in cooperation with bulwiengesa AG, prompted a lively debate in the real estate community. As the world's first academic study on the benefits and drawbacks of off-market transactions compared to conventional on-market models it provided statistical information on this market segment. Not only did the study reveal that off-market models are considerably more widespread on the institutional real estate investment markets than previously assumed, at the same time it also underlined the fact that numerous investors are prepared to accept a price delta for the higher degree of execution certainty and enhanced discretion.

These core results – and the considerable media interest they triggered – were the stimulus for us to survey this topic in greater detail this year. In this second HPBA Off-Market Study we are, for the first time ever, analysing the proportion of share deals in the off-market segment, the frequency of off-market transactions in the individual asset classes, as well as the market penetration compared to classical bidding processes. For me personally the most important insight which can be derived from the survey results is this: with off-market models it is possible to reach investor groups who do not participate in conventional on-market transactions.

The surprising aspect for me is that although we can fundamentally see a high degree of continuity in the survey results, compared to last year there have already been some changes. The number of respondents who believe that off-market transactions are less transparent has increased, for example. At the same time a significantly lower number of market players than last year regard off-market models as being inconsistent with their own corporate governance. The proportion of respondents who have completed

purchases and sales in the off-market segment on a regular basis – also in a comparison with on-market models – has likewise increased.

As was also the case last year, together with bulwiengesa we have anonymously surveyed a high-calibre panel of 700 participants from all areas of the professional real estate markets – from fund managers, through real estate joint stock companies, private equity investors, insurers and pension funds, project developers and family offices, to wealthy private investors. I am extremely grateful to all of them – for without their participation the important findings in the second HPBA Off-Market Study would never have come to light.

John Amram, founder and managing director of HPBA Off-Market-Solutions, October 2019



Summary

On the one hand the second HPBA Off-Market Study illuminates new aspects of the market, and on the other hand it points to the development of trends since the last study in 2018. The important finding is that off-market transactions quite obviously take place in diverse and widely differing segments of the German real estate market.

Characteristics of off-market transactions

1. The considerable degree of approval for off-market transactions – with, similarly to last year, **98 per cent** endorsing them – is joined this year by the almost equally striking figure of **29 per cent** for market players who do not participate in bidding processes or explicitly reject them.
2. The data on the price delta between the transaction styles also reveals a much more differentiated picture in the current study: there are some respondents (**15.2 per cent**) who actually believe a mark-down on off-market transactions of as much as **2.5 per cent** is justified, but with a view to the mean mark-up of approx. **five per cent** which had already been determined last year, the proportion of those who accept a mark-up has risen by **7.8 percentage points**. In total the proportion of those investors who accept price mark-ups of one to ten per cent with off-market deals has increased from **77 to 84.8 per cent** compared to the first Off-Market Study. In addition, the satisfaction with the prices attained is **17 percentage points** higher than with classical on-market processes.
3. The proportion of market players who have successfully completed off-market sales and purchases has increased significantly compared to the first HPBA Off-Market Study: **68 per cent** of the buyers and **75 per cent** of the sellers have successfully completed more than **50 per cent** of their transactions using off-market models. Thus the difference to the classical on-market models is more distinct than last year: among the buyers the proportion that has successfully completed transactions on a regular basis is **40 percentage points** higher, among the sellers it is **26 percentage points** higher.
4. Furthermore, compared to the first Off-Market Study there is a high degree of continuity regarding the stated benefits of off-market transactions (discretion, quality of the matching, probability of a transaction being concluded).

Market volume

1. Pursuant to a recent, comprehensive overall model for the German real estate market the transaction volume attained in 2018 through off-market models was more than **40 billion euros**.
2. A key finding from the newly-added questions is the fact that **31 per cent** of the surveyed investors conduct share deals instead of asset deals documented under land register legislation. With the specific panel for the study this figure is largely representative for the German institutional real estate investment market.

Introduction

“The second HPBA Off-Market Study reveals differentiated results on the characteristics of off-market transactions – for example on the question of the price delta to bidding processes – and confirms clear trends: that 98 per cent of the professional market actors regularly pursue off-market transactions and, conversely, that 29 per cent of the professional actors avoid and reject structured sales processes.”

Andreas Schulten, Executive Manager, bulwiengesa AG

The research into the German landscape for off-market real estate transactions – with the exclusion of the specialist audience to a large extent and away from the customary bidding processes and other conventional, usually structured on-market models, therefore – is entering its second round with this survey and adds greater depth to the results from last year's survey. The key findings of the first HPBA Off-Market Study, which met with criticism and with a wealth of comments from a number of market players, are in many cases considered in greater detail in this study. Furthermore, the catalogue of questions was expanded to take in additional aspects regarding the characteristics of off-market transactions.

Cooperation HPBA and bulwiengesa

The following second study was also made possible thanks to the intensive support provided by HPBA Off-Market Solutions in Berlin and the academic work of bulwiengesa. The surveyed panel of suitably experienced experts from the professional real estate market was compiled jointly by both companies, as was the questionnaire that was utilised in a slightly expanded form for this second study.

It was a matter of key importance for both companies that the following results be presented in order to initiate a specialist debate on this topic. It is important to conduct similar calculations and surveys in other projects so as to provide further detail and to improve the validity of the results in the future. In this respect international comparisons will also be helpful and necessary for future studies.

For whom are the results interesting?

The backgrounds to and volumes of the off-market transactions will again supplement the classical market data that is gathered regularly, and not only in the specialist world of institutional real estate investors. German urban development planners and business development agencies will also note with interest that the figures on the German real estate investment market available until now have not reflected all of the driving forces. Likewise, it seems obvious that financiers and credit institutions will devote greater attention to these figures. Ultimately the two available HPBA Off-Market Studies show that the market liquidity is significantly higher than assumed to date. Without attaching any emphasis to this in the synopsis of the study, off-market transactions are also of particular significance away from the metropolitan areas and are relevant across all locations.

Not least of all, the information is important for the current nationwide discussion of real estate share deals, the sale of companies with a significant proportion of their assets in the form of buildings and properties, therefore. To this end a key module for further analysis and research has been compiled in this study – on page 18 – which at least in the case of commercial properties and residential portfolios traded at economically attractive locations provides some guidance to the considerable scale of share deal transactions.

Definition and approach

“An off-market transaction in the real estate sector describes the trading of one or more properties in the form of a sale or swap deal, which – in contrast to structured bidding processes or marketing through brokerage platforms – is conducted behind closed doors. The trading takes place on the basis of specifically addressing a small group of investors or exclusive bilateral negotiations with just one potential buyer by the seller himself or through a specialist off-market mediator. In a non-formal process, the process can be structured flexibly with respect to transaction volume, contractual modalities and timeframe in line with the individual needs of the buyer and/or seller.”

It is difficult to develop a standard industry-wide definition for off-market real estate transactions, among other things as the boundaries for some aspects of off-market models are blurred and the basic approaches of off-market models can differ. With the definition on the left – one which is still applicable and utilised – the HPBA Off-Market Study 2018 delivered a solid basis for the first time ever.

With an off-market transaction the motives for the purchase and the reasons for the sale can remain confidential, therefore. An on-market transaction, in contrast, can, for example, be a bidding process, be facilitated through traditional brokerage activities or be offered on online brokerage platforms.

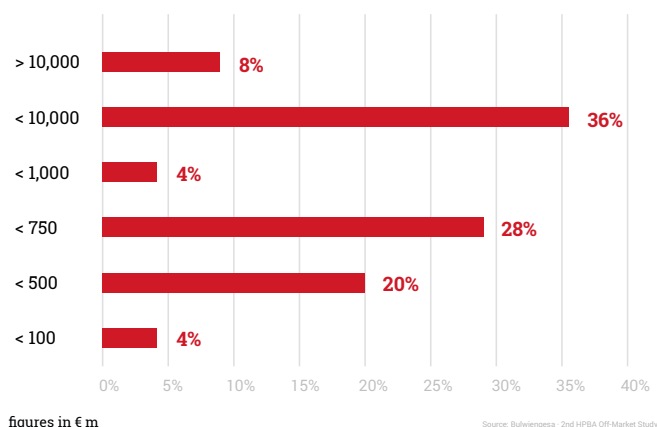
The second HPBA Off-Market Study also illuminates and measures the German market for off-market transactions. To this end a survey was conducted in the summer of 2019 which follows up the survey from 2017/2018, and is thus intended to serve as a basis for the “measurement of the off-market segment”.

The market will become more transparent with the aid of the survey. In the long term it may also create even better transaction conditions. The respondents were the most important players on the professional real estate markets. The highly-qualified panel is a specific selection comprising, among others, managers of classic institutional investor groups such as real estate funds, insurers, pension funds and pension schemes, as well as managers from family offices, private equity investors and other institutional investor groups.

The selection of the surveyed companies was conducted by bulwiengesa in consultation with HPBA. A total of some 700 persons were selected for the automated survey, whereby bulwiengesa and HPBA each contributed half of the contacts. Both companies specifically addressed additional market players to ensure that there was a representative spread regarding the question of assets under management. Depending on the specific question, the size N (valid answers) in the survey is between 59 and 25; on average it is 51. The overall response rate with 74 answers was ten per cent.

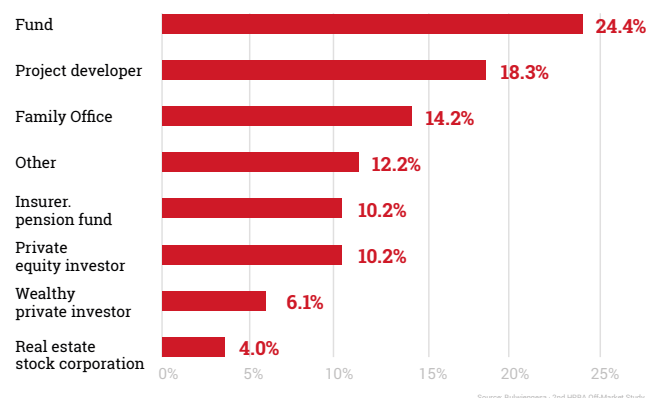


Representativeness



Assets under management

The majority of the surveyed investors have assets under management of between 100 million and 750 million euros.



Investor profile

The panel of surveyed investors primarily comprises funds and institutional investors, project developers, family offices, insurers and other investor profiles not described in more detail.

Representativeness

The high degree of representativeness of the surveyed companies for the German real estate market is a result of the assets under management (managed real estate assets, AuM), on which data was gathered in the first study, and the investor type, which has been surveyed for the first time.

In total the surveyed companies account for real estate assets of approx. 100 billion euros – with a large range of assets from less than 100 million euros through to ten billion euros. The majority of the respondents manage assets of less than one billion euros, followed by asset managers with assets in the region of less than ten billion euros.

In the second off-market survey data was additionally gathered on the managed assets of the investor type, which now – likewise representative for the professional, investment-oriented real estate market – ranges from real estate funds (24.4 per cent), through project developers (18.3 per cent) and family offices (14.2 per cent), to publicly-listed real estate joint stock companies (4.0 per cent).

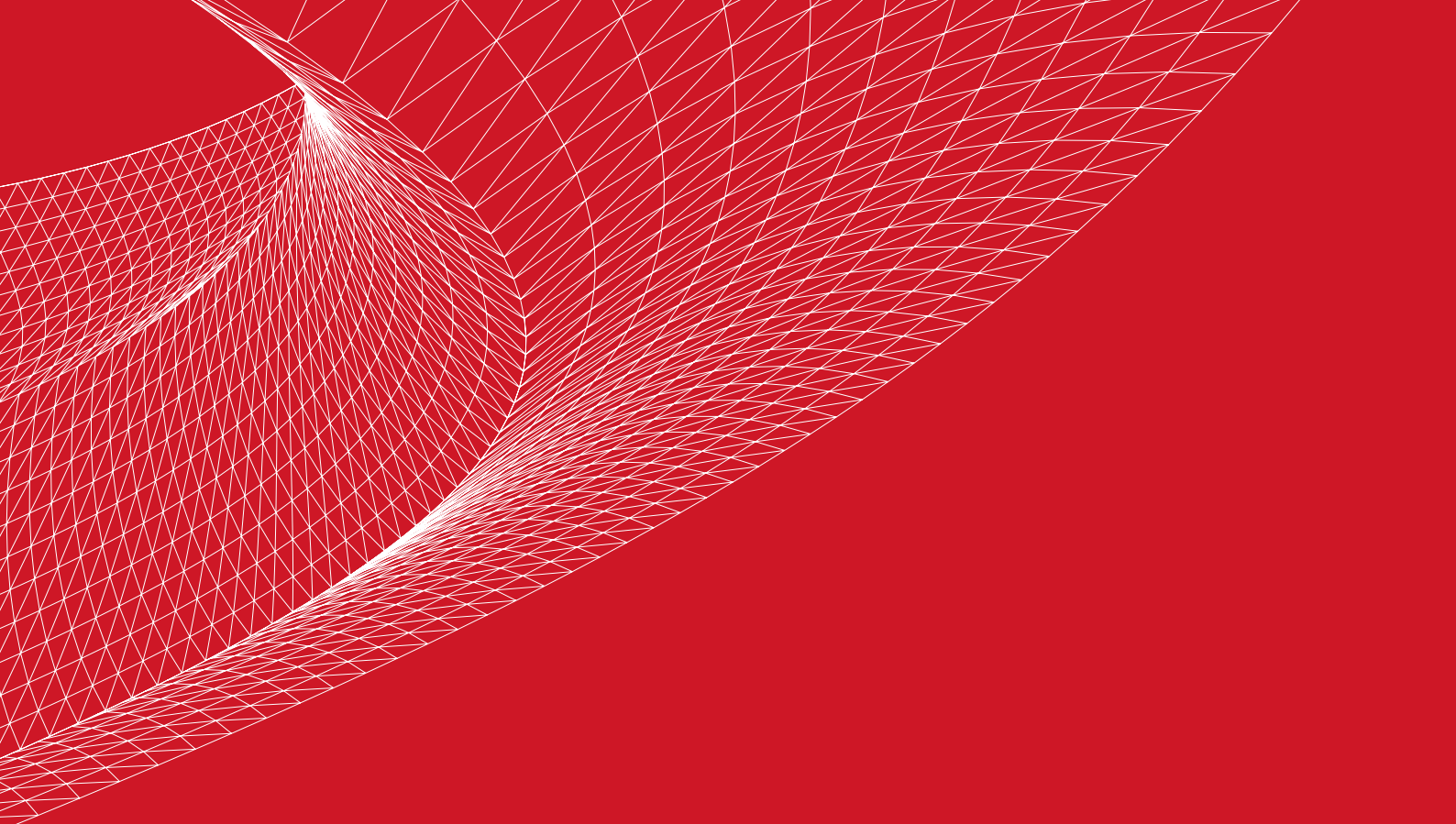
A questionnaire was prepared prior to the survey comprising closed-end as well as open-ended questions. The respondents had the possibility to quantify their answers precisely in the framework of a scaling system.

So as to expand the scope of the target group the questionnaire was prepared in both German and English.

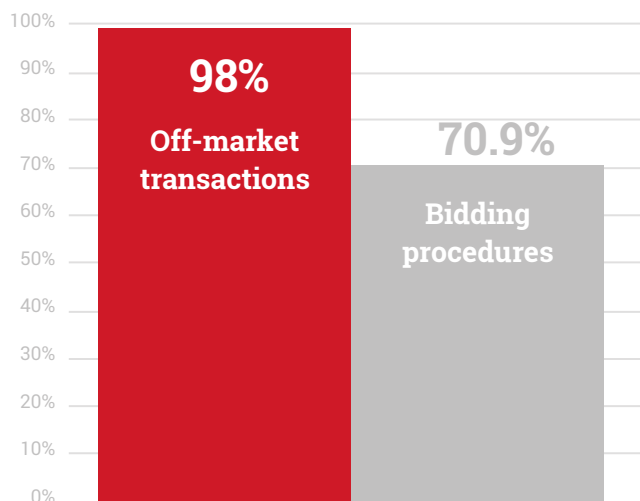
As discretion is of extraordinarily great significance with the surveyed topic the survey was conducted anonymously.

The questionnaire was drawn up with the aid of a tool developed by bulwiengesa, "Survey Desk", an online survey tool. Following the initial invitation two reminders were sent to the selected companies and various companies were contacted directly so as to ensure a representative panel (AuM, asset classes, investor type etc.). The survey was conducted over a period of four months and gathered data on the 2018 financial year.

The survey is to be conducted once a year in the future. The results from the set of questions will be summarised in a report which specifically looks at the development of the off-market segment in Germany and will be supplemented by topical issues of relevance.



Results



Positive responses in per cent.

Source: Bulwiengesa - 2nd HPBA Off-Market Study

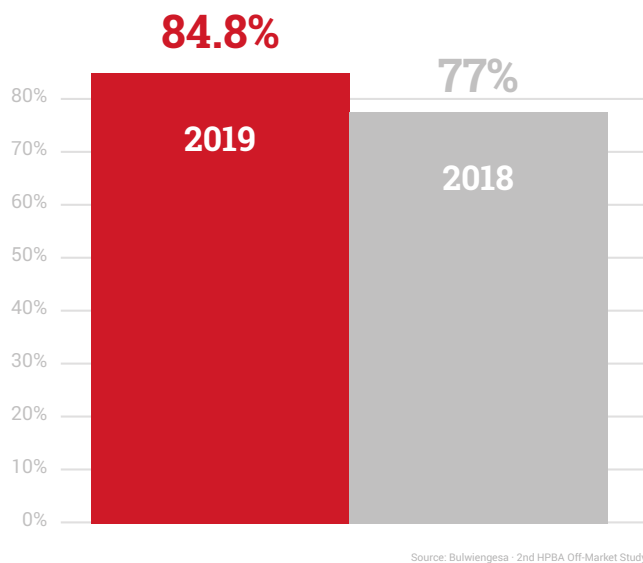
Number of actors who participate in off-market transactions rises slightly to 98 per cent

The surprising finding from the first Off-Market Study – that virtually all the real estate actors at least in part make use of off-market transactions in their dealings – was confirmed in a valid manner in the second survey. The proportion actually increased slightly, from 96 to 98 per cent.

Conversely, merely about 71 per cent participated in bidding processes, which indicates that a correspondingly high proportion of actors are exclusively operating in the off-market sector.

Participants

In the past twelve months virtually all the market players (98 per cent) have participated in off-market transactions. 70.9 per cent have participated in bidding procedures.

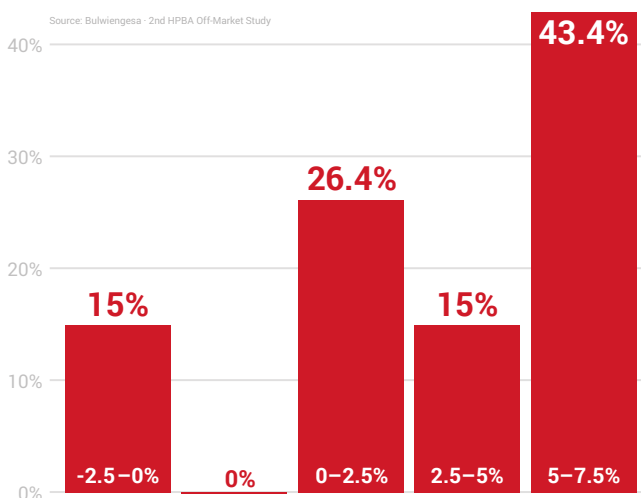


Price delta of 5 per cent has remained stable

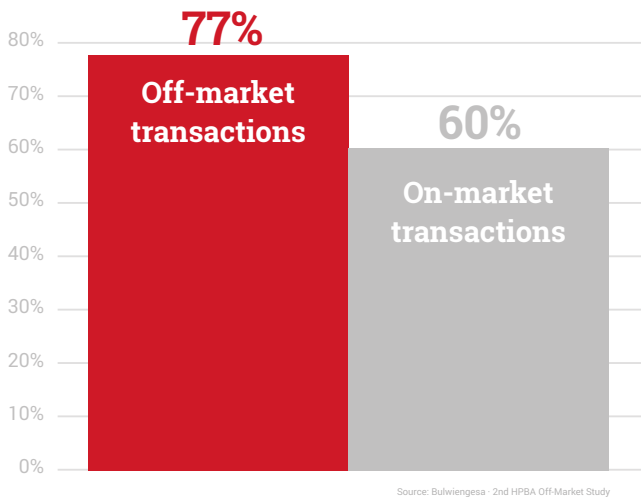
According to the second HPBA Off-Market Study 84.8 per cent of all respondents are prepared to pay a higher purchase price with an off-market transaction. The remaining respondents are of the opinion that price mark-downs of as much as 2.5 per cent are appropriate. In a comparison with the first HPBA Off-Market Study the proportion of market players prepared to pay higher prices has thus increased by 7.8 percentage points. In the view of these respondents, compared to the first Off-Market Study the price delta at which an off-market transaction may legitimately be more expensive than a structured selling process with several bidders has been confirmed at a level of about five per cent. More than 43 per cent of the respondents regard a price delta of between five and 7.5 per cent as legitimate. This minor change is probably indicative of a slight trend towards the endorsement of off-market transactions.

Selling prices

84.8 per cent of all investors are prepared to pay a higher purchase price for off-market transactions. For these the average price delta is five per cent.



Price delta 2.23%; basis: all responses in the range from -2.5 to 7.5%
 Price delta 5.0%; basis: all responses in the range from 0 to 7.5%

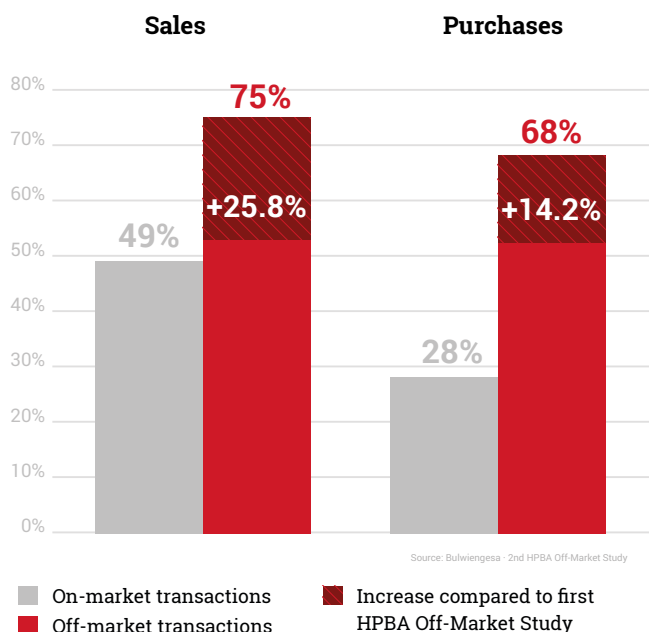


77 per cent of the respondents are satisfied with off-market prices

An additional aspect which was included in the second off-market survey in the context of the price issue is the question regarding satisfaction with the prices attained with successful transactions. The general trend to be adduced from the result is that there is satisfaction with both transaction forms. But nevertheless the difference between 77 per cent satisfaction in the case of off-market transactions and merely 60 per cent price satisfaction with structured and conventional transaction forms (on-market transactions) is considerable.

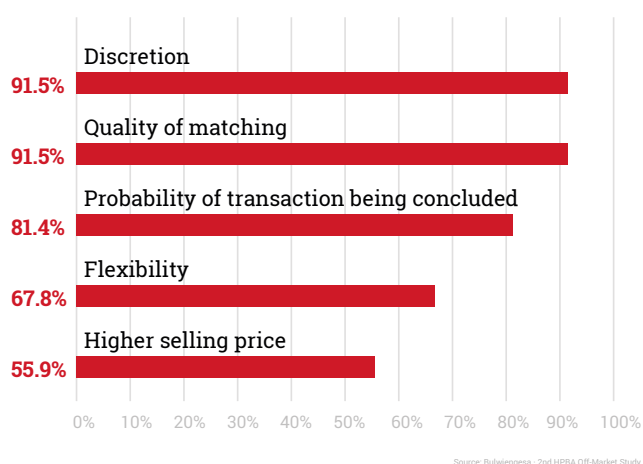
Satisfaction with prices attained

Higher satisfaction ratio with the prices for off-market transactions



Success Rate

Compared with on-market models the proportion of buyers who have successfully completed sales in the off-market segment is 40 percentage points higher. For sellers this figure is 26 percentage points.



Benefits

Discretion, improved matching and greater probability of a transaction being concluded are regarded as the most important benefits of off-market transactions.

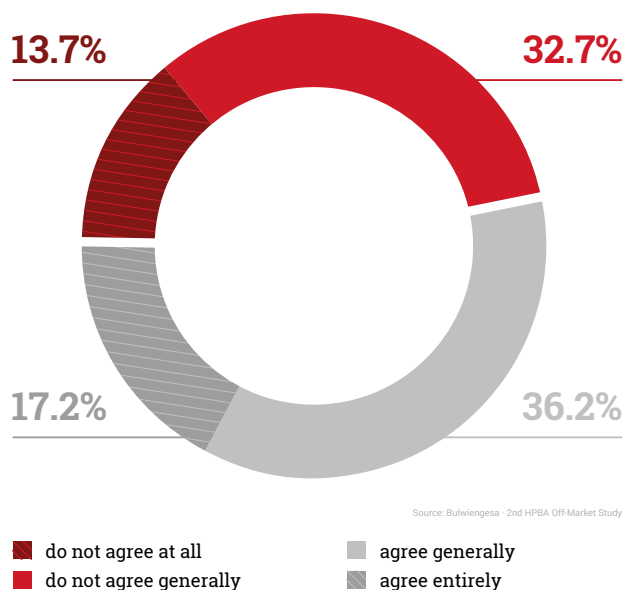
Proportion of completed sales for off-market transactions increases considerably

In a comparison with on-market transactions the proportion of respondents who have successfully completed off-market transactions is significantly higher than in the first off-market study, both for buyers (up 40 percentage points) and sellers (up 26 percentage points). The recent result, as well as the increase over the previous study, is not surprising for the buyers. The only thing that is recognisable is the even more considerable improvement in the proportion of completed transactions in the off-market segment compared to processes in the on-market segment. Here the time and effort involved for buyers with the customary bidding processes, as well as the inflexibility of such processes, have made themselves much more noticeable than they did last year.

What is surprising in the current off-market study, in contrast, is the significantly higher proportion of completed transactions with sales in the off-market style. Sales are generally easier to attain in the current market situation shaped by excess demand. But the leap of 26 percentage points over the previous survey is also a clear illustration on the seller side of a valid benefit of the off-market style so as to ultimately bring about a successful conclusion to a transaction. This suggests that it is merely the more complex on-market process which tends to hinder a successful conclusion to a transaction for both parties.

Benefits of off-market transactions remain unchanged

The prime benefits of an off-market transaction have not changed appreciably compared to the previous survey. Merely the higher selling price is stated in the current survey as a benefit by 56 per cent of the respondents – compared to 33 per cent in the past survey. This is a valid result worth mentioning, and it correlates with the above explanations on satisfaction and the proportion of completed sales. Otherwise the benefits have remained in virtually the same order.

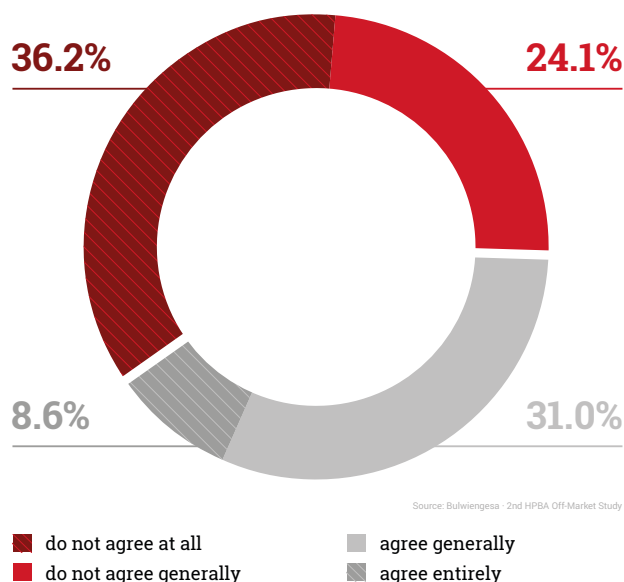


54 per cent see a lack of transparency

Reciprocally and in contrast to the previous survey is the assessment that a lack of transparency with off-market transactions is one of the discernible drawbacks. Whereas in the previous survey 53 per cent of the respondents did not see any inadequacy in terms of transparency, in the most recent survey this figure is only 46 per cent. While this is nevertheless still nearly half of the professional real estate actors, it is an indication that with more complex portfolios or buildings requiring some explanation that a lower level of transparency ranks among the factors that are detrimental for the off-market segment – and especially in market phases in which the pressure on returns and sustainable value development leaves very little room for manoeuvre.

Transparency

More than half of the investors see drawbacks in terms of transparency with off-market transactions.



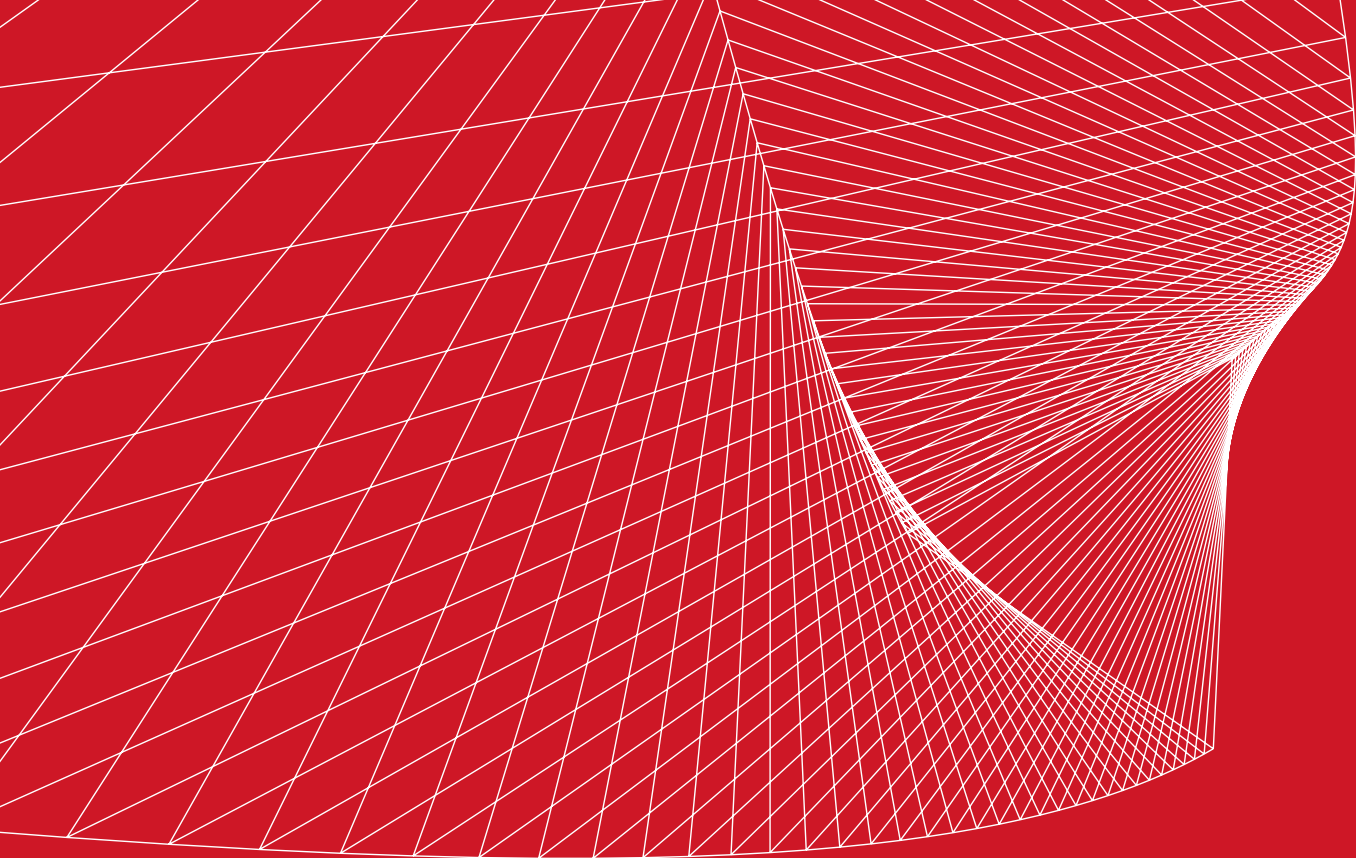
60 per cent regard governance as consistent with off-market transactions

One topic which had revealed the limits of off-market transactions for numerous actors from the professional real estate market in the first survey was the issue of compliance and governance. Rules for an ethical approach can necessitate an obligation to ensure audit requirements compliance and the best-possible price comparability. For some actors this can lead to their own compliance regulations dictating the use of bidding processes.

In response to the conflict created by the constraints regarding satisfaction and the proportion of completed sales as described above, compared to the previous survey there seems to have been some more detailed specification with respect to the treatment of the corresponding rules. For 52 per cent of the respondents in the previous study and 60 per cent in the most recent study compliance and governance are not at odds with one another when transactions are conducted in the off-market style.

Compliance

For more than 60 per cent of the respondents off-market processes are still consistent with their own compliance rules.

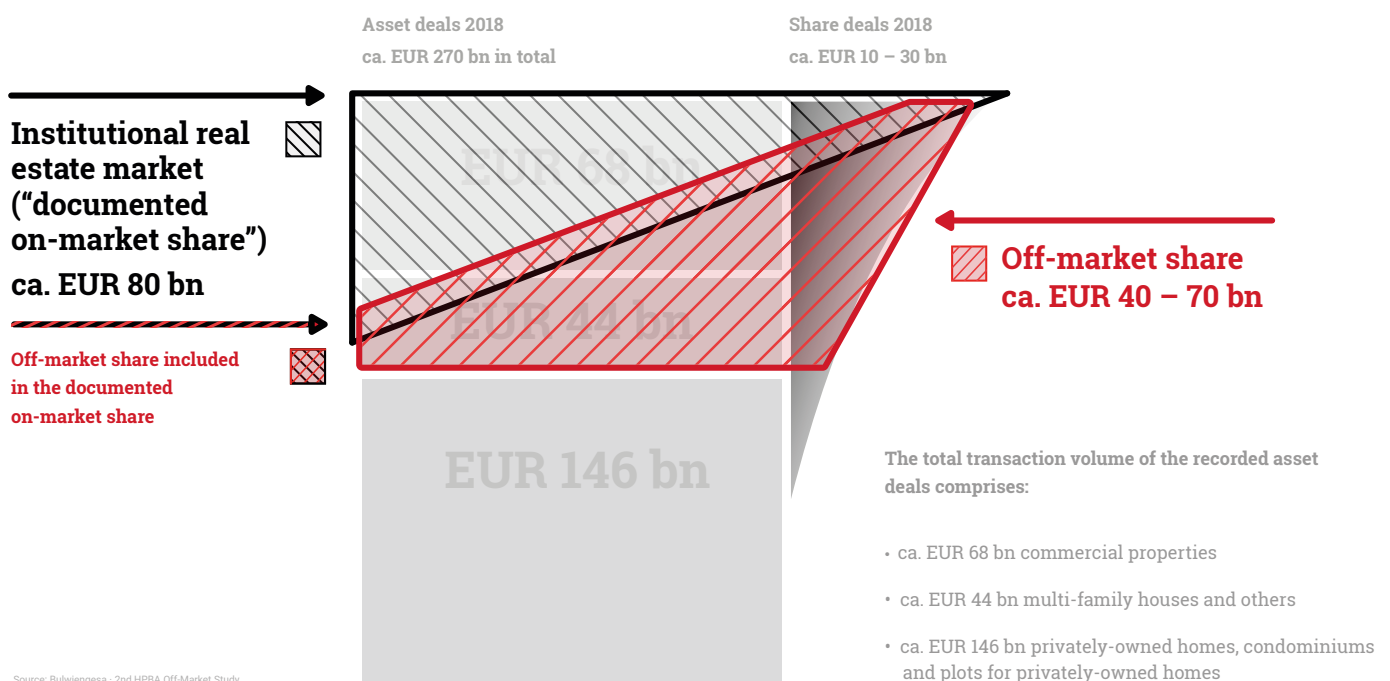


Market volume

**Off-market volume of 40 billion euros p.a.
– if not more**

Upon the publication of the first HPBA Off-Market Study the high volume of approx. 40 billion euros in the years 2016/2017 was discussed by many market players with astonishment – and in some cases questioned and criticised. The differentiation and explanations in this respect in the current study are the logical continuation of the joint research work. Above all the proportion of share deals plays a key role – as already noted in the first study. In this second study with data for 2018 a model has now been developed which – on the basis of updated data and calculations – presents and compares the bigger picture for the German real estate market and in this context estimates unidentified factors.

The result: the volume attained for commercial properties through off-market transactions in 2018 was between 40 and 70 billion euros.



Derivation of the off-market volume

The starting point for the calculation of the volumes on the German real estate investment market is formed by the two key transaction forms:

– **asset deal**

with certification of the entry in the land register by a notary public and documentation by local expert committees for land valuation. Valid data on such deals are published every two years by Arbeitskreis der Oberen Gutachterausschüsse (AK OGA), the Working Group of Senior Valuation Expert Committees, in its real estate market report for Germany. The official statistics on the income from land transfer tax provide support for this data framework of the expert committees as a consequence of the association with the land register. Initial statements on the total volume of the market in 2018 are in the region of 270 billion euros.

– **share deal**

as the sale of shares in a company which is defined to a high degree by its real estate assets. There is only very little valid data on the volume of share deals, meaning that estimates by owners and brokers can only provide a rough indication. There is considerable evidence that share deals are more common with commercial properties and large residential portfolios than with small-scale private business with residential properties.

A further parameter in the model is formed by the transaction volumes of the institutional real estate market for 2018, which are published annually by brokers, analysts and mortgage banks in addition to relevant transactions that have come to light (in part belatedly). Accordingly

- commercial properties with a value of ca. 61 billion euros were traded – as asset or share deals,
- residential real estate (usually portfolios and project developments) with a value of ca. 19 billion euros was traded – as asset or share deals,
- this volume totalling 80 billion euros includes off-market transactions as asset and share deals without there being any indication (to date) as to the concrete size and structural features of the respective percentages.

31 per cent share deal proportion among professional real estate investors

In the model the share deal volume for commercial properties is assumed to be approx. 20 billion euros and some five billion euros for multi-family houses and other real estate such as industry, infrastructure etc. This assumption is supported by the new question in the second survey regarding the proportion of share deals (cf. p. 18), according to which, on average, 31 per cent of professional investors practice share deals.

Nevertheless the volume is only stated cautiously with a very wide range of just ten to 30 billion euros for 2018 because this proportion – which has been determined in a valid manner across all actors – cannot yet be applied to individual asset size ranges. To this end further research into the real estate types and with various orders of magnitude for transaction volumes is required to ensure greater precision. In contrast, a clear structure, which is also a valid data set in its sub-segments, is offered by the Real Estate Market Report 2019 which will be published by AK OGA in December 2019. The total value of 270 billion euros has already been announced in advance. The structuring in sub-segments was conducted for the second HPBA Off-Market Study on the basis of the proportions from the 2016 report.

Off-market volume of 18 billion euros with commercial properties

The direct contrast of a volume of approx. 61 billion euros with professional investments and approx. 68 billion euros in asset deals (AK OGA) with commercial properties (projected from the proportion from 2016) indicates initial underreporting of the transactions in the publicly documented professional investment market to the tune of seven billion euros. In addition, the proportion of share deals has to be included, however: with office real estate alone this leads – with a ratio of nearly 20 billion euros in asset deals (projected, see above) to nearly 29 billion euros for documented total transactions from the professional sector (obviously including share deals) – to a higher numeric proportion of share deals of 45 per cent. The situation is reversed in the retail sector with a ratio of about 25 billion euros to eleven billion euros, which may be explained by a relatively high proportion of operators nationwide at all German locations.

On the basis of all these relatively valid data the new structural model allocates the off-market – with its overlapping areas compared to the market documented by brokers and analysts – a volume of some 18 billion euros. Here too, however, there is undoubtedly a large range, which will have to be gradually narrowed down in the future.

Off-market volume of 36 billion euros with multi-family houses and other real estate

The multi-family houses and “other real estate” category encompasses the heterogeneous market segment at the transition between the purely private residential market and the market for commercial properties (office, retail trade, industry/logistics, hotel etc.). It includes larger residential portfolios, which are in part treated as share deals, as well as mixed-use buildings and quarters (and also their project developments), in addition to infrastructure facilities such as railway stations and power plants.

Of the 44 billion euros in asset deals in these two segments (projected, see above), a rough estimate of eight billion euros, which in most cases are likely to be covered as share deals in the documented market, are stated as belonging to the off-market segment. The large-volume market defined in this manner poses the risk of a certain lack of precision by definition because the many multi-family houses which are also traded away from the metropolitan regions that are important to the institutional investment market are in part traded on real estate-specific online platforms which have a restricted user base. For this reason a wide range is advisable when it comes to finally determining this off-market proportion.

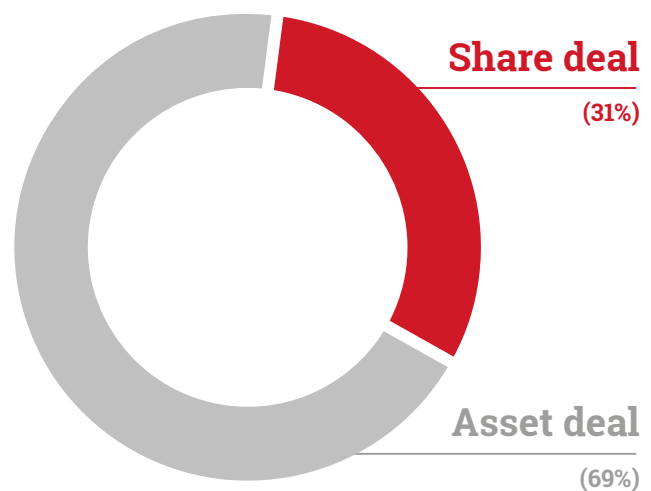
31 per cent share deals

One explicitly new question for the second Off-Market Study was the question regarding the significance of share deals. Despite the long and ongoing political discussion on this issue, there are no statistical sources which reveal the relevance of this form of company sale with underlying real estate assets compared to the registration of sales of real estate pursuant to land register legislation. In this respect the second HPBA-Off-Market Study can now contribute valid findings:

On average nearly one third of all off-market transactions were processed in the form of a share deal in 2018. A large proportion of the actors – 41 per cent – do not utilise this possibility or only to a very limited degree. But 59 per cent of the surveyed actors from the institutional sector and the family offices use this form of transaction at least occasionally or frequently.

In the statistical average of the representative random sample 31 per cent of the actors utilise share deals for their transactions.

This statement is also relevant so as to gain a better grasp of the volume of the entire German real estate market. The valid sources on this question, the official statistics on the income from real estate transfer tax and Arbeitsgemeinschaft der Oberen Gutachterausschüsse (AK OGA), merely state asset deals as being in the region of 269 billion euros, those transactions, therefore, which are identifiable on the basis of a change in the land register. The share deal volume can, therefore, still imprecisely, be stated as having a volume of 10 to 30 billion euros per year. For more accurate calculations in the future the unknown elements in both the commercial properties segment as well as in the segment for multi-family houses and other real estate has to be clarified in more detail. It is to be presumed that sources such as Deutsche Industrie- und Handelstag, the Federation of German Chambers of Commerce and Industry, will also be of great relevance here, as ultimately all company sales have a share deal proportion for their respective properties.



Source: Bulwiengesa - 2nd HPBA Off-Market Study

Share deal

Nearly one third of all off-market transactions were processed as a share deal.



Glossary

On-market

In this study the expression on-market transactions is used to describe transactions that are not off-market transactions. They are primarily documented in the institutional and professional market by analysts, brokers and banks.

Institutional investors

Institutional investors is an expression used to describe funds, asset managers and direct investors who invest in real estate with the primary intention on investing monies on behalf of third parties. Above all these include insurers, pension funds and real estate funds.

Professional investors

The expression professional investors is used in this study to set apart actors such as family offices or wealthy private investors from the extremely fragmented private real estate market with privately owned homes and individual condominiums. Professional investors also encompass institutional investors.

Asset deal

An asset deal describes a real estate transaction which is documented directly with a corresponding contract pursuant to land register legislation. As a rule this contract is certified by a notary public and is included in the collection of purchase prices managed by the respective local Expert Committees for Land Valuation.

Share deal

A share deal describes a real estate transaction which involves the sale of shares in a company, which in the context of this study encompasses appreciable real estate assets. In terms of land register legislation this transaction style is not associated with a change of owner. Accordingly, these transactions are included in the actual asset deals in the course of a year.

Arbeitsgemeinschaft der Oberen Gutachterausschüsse (AK OGA)

Arbeitsgemeinschaft der Oberen Gutachterausschüsse, the Working Group of Senior Valuation Expert Committees, compiles all the local data from the Expert Committees for Land Valuation in the Real Estate Market Report Germany to form an overall picture every two years. This data source is the most comprehensive and most valid source on real estate transactions in Germany. The next report with data for 2018 is due for publication in December 2019.

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