



The rise of distress in Europe’s biggest market is expected to bring with it a larger proportion of off-market deals as investors turn to discreet fire sales

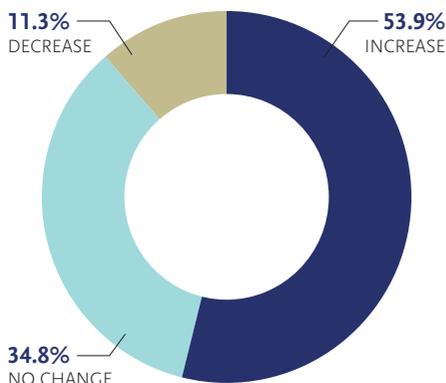
BY **ROBIN MARRIOTT**

**F**or a moment in 2018, John Amram found himself at the centre of controversy in German real estate.

An inaugural study published by his Berlin-based firm, HPBA, together with consultant Bulwiengesa, had ruffled feathers at some of the big international investment brokers.

### Off-market transactions

Will the volume of real estate transactions change in the coming 12 months?



SOURCE: BULWIENGESA – 3RD HPBA OFF-MARKET STUDY

HPBA and Bulwiengesa’s First Off Market Study suggested there had been €110 bn of professional real estate deals in Germany in 2016/17. And while that may not sound controversial for Europe’s largest property market, the figure was a jaw-dropping €40 bn more than the brokers had stated. The reason for the difference? The investment brokers calculated €70 bn of total deal volume, but had not reckoned with ‘off-market’ transactions, the specialist area of HPBA, which itself advised on €1 bn of trades in 2017 alone.

#### GROUNDBREAKING RESEARCH

Looking back, Amram says: ‘These are the numbers everyone is looking for – €70 bn – but imagine everyone waiting for this figure which people have got used to, and then our study comes out saying we have another market here, called “off-market” – and we have identified another €40 bn. ‘It made quite a lot of waves in the German market, mainly because we attempted to put a number to the size of the “off-market” market, so it made headlines, and there were some surprising results which are still being discussed today.’



‘Discretion is not the only reason for off-market deals. It is one of the main ones, but the other is that such deals offer more security and a higher success rate’

JOHN AMRAM, HPBA

Now with the Third Off Market Study published a few weeks ago, HPBA and Bulwiengesa are back with their latest findings. Amram says there are still critics of the study out there, but the dust has settled on the €40 bn figure stated in the inaugural report.

The follow-up Second Study, looking at German real estate volume in 2018, saw some important refinements to the data calculation. Most notably, the study took into account 'share' transactions which had previously been overlooked. This meant the volume of off-market deals for 2018 was stated at between €40 bn and €70 bn.

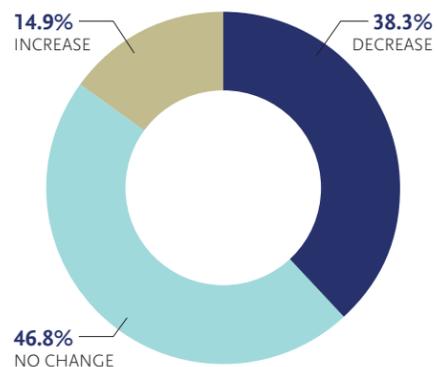
Amram says of the 2018 study: 'We had to consider share deals, which are not picked up by the German registry, and some off-market deals that would be part of the official figure from the international brokers. Originally, the figure we came up with sparked debate, with some people saying it was just not possible. But by the second study where we started going into more detail it was getting accepted.'

Bulwiengesa, also based in Berlin, is a data, analysis and consultancy firm founded by Hartmut Bulwien in 1983. Bulwien, incidentally, is also a co-founder of the annual Expo Real trade fair in Munich. Bulwien and Gesa merged to form Bulwiengesa in 2004.

Andreas Schulten, chief representative

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of Bulwiengesa, recalls how the firm first got involved. 'We were very happy when John came to us to ask us about the issue of off-market transactions. You know, a lot of people say, "We have done a really good deal" and of course it was off-market, but nobody knows what off-market actually is. Does it mean transactions that were not reported to the public? Are they ones without a bidder process? So, we defined it three years ago. And for the last two years, we have tried to define "how big" the off-market market actually is.'

## NATIONAL LAND REGISTRY

In Germany, there is a deal registration system that other countries do not have. It operates a 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 the Arbeitskreis der Oberen Gutachterausschüsse, the Working Group of Senior Valuation Expert Committees, in its real estate market report for Germany.

Says Schulten: 'It is a good system and one that other countries do not have. It gives us a view on how big the real estate market is in total in a particular year. Then we look at what the large international property agents say were total real estate transactions in that year.'

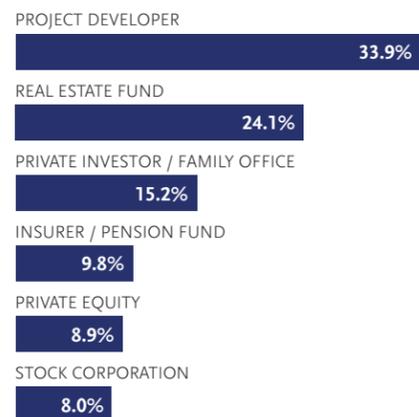
The difference between the value of deals with the notaries and the figure given by the agents provides the value of off-market deals. 'It has been a little like a puzzle where we say: this is the total market from the registry, and this is what we believe the size of the share deal market could be,' explains Schulten. 'We try to put these puzzle pieces together to say it is at least €40 bn in the off-market range and could also be even €70 bn.'

## OFF-MARKET DEFINITION

The definition settled upon is as follows: '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

## Participant type in off-market transactions

Were you involved in off-market transactions in the past 12 months?



SOURCE: BULWIENGESA – 3RD HPBA OFF-MARKET STUDY

ed 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.' Amram of HPBA says the advantages to off-market deals are discretion, less risk of losing face, greater certainty of deal completion, and perhaps most controversially, that the seller can command a premium or 'price delta' because the buyer is willing to pay more for an off-market as opposed to on-market deal.

These beliefs drove Amram to studying the market in the first place. 'We felt we needed to prove it and put some numbers on it,' he says.

## PRICE DELTA

Not only did HPBA and Bulwiengesa establish the volume of annual off-market deals, but using surveys among a large number of investment firms, they gained data on the attitude and approach to them among investors.

Those polled were asked to what extent they believed a buyer should pay a premium to get an off-market deal. In the First Study, it seemed respondents were saying

the 'price delta' (premium) was 5%.

In the Second Study, more than 43% regarded a price delta of between 5 and 7.5% as being legitimate. The authors took this minor change as indicative of a slight trend towards the endorsement of off-market transactions. At any rate, they felt they had proved there was an advantage to sellers in using the off-market route because they will get 5-7.5% more on a sale.

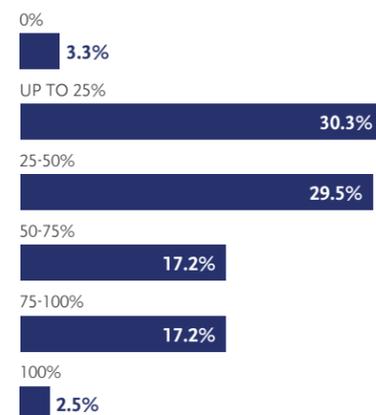
In the Third Study just published, there seems to be an even split of opinion about what should happen in the next 12 months. Nearly 40% (39.8%) of respondents said they felt a price mark-up was justified, against 33.8% who said it would not be. The remaining 26.3% said there should be no mark-up or mark-down.

## SIZE MATTERS

The data in the Third Study also shows an interesting link between deal volume a firm might do and the percentage of off-market deals. For example, for a firm that transacts more than €1 bn annually, only 0.7% was off-market. For a firm with a volume up to €500 mln, 2.2% was off-market; for €200 mln-€500 mln the percentage increases to 8.8%, rising to 9.6% for €100 mln-€200 mln, all the way to 23.5% for up to €10 mln.

## Percentage share of off-market transactions

How high was your proportion of off-market purchases in the past 12 months (in %)?



SOURCE: BULWIENGESA – 3RD HPBA OFF-MARKET STUDY

About 24% of all respondents stated they had a 100% success rate with the off-market transactions in which they were involved. The Third Study was conducted over a period of 15 days in May 2020 and sought assessments of 2019 transactions among the firms as well as current appraisals of the coronavirus recession.

Some 1,140 firms representing around €450-€500 bn of assets took part, and 149 of them completed detailed questionnaires.

## DISTRESS = MORE OFF-MARKET DEALS

More than two-thirds of all survey respondents expect a moderate to large downturn in the German real estate transaction market. But within that smaller market, the off-market segment will see growth: nearly 54% of respondents expect to see a moderate to large increase in off-market transactions. In the case of on-market models, on the other hand, only about 15% believe there will be growth.

'This is because off-market is more discreet, and we think there have been more emergency sales,' say the authors.

Some 67% of the survey sample predict distressed transactions will carry over into 2021. Says Amram: 'Discretion is not the only reason for off-market deals. It is one of the main reasons for sure, but the other one which we have established in the study, is that off-market deals are proven to offer more security and a higher success rate, which is very important in this market where investor behaviour changes and is less reliable.'

It is not just the investors that are being less reliable but also the financing banks, he points out. 'We have seen some firms wanted to do a deal, but the banks were not the most reliable partners. This is where off-market done in the right way offers advantages. For example, there is very little damage done if something does not work out, and the higher success rate is what people are seeking.'

When the researchers first introduced their study, there were some who said it was just for private equity firms and properties that cannot or do not really fit into a normal professional structure. 'But we could via sampling prove that this is just normal. Every-



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body buys off-market,' says Amram. The authors believe that it is mostly the office and residential sectors which see the most off-market transactions and that the volumes are very much driven by domestic German developers and funds.

'It is dominated by domestic players,' affirms Amram. 'There was a feeling that Anglo-Saxon money was dominating the market but it's not the case.'

Schulten adds: 'It was quite surprising it is mainly domestic. But we now have it empirically proven that a large segment of the market is only pursuing off market-deals.' Should this finding upset the international brokers?

'Our studies suggest about a third of firms categorically decline to take part in on-market bidding processes,' says Schulten. 'That is something the big broker houses would not like as it seems to be critical. But we say, if 29% are not pursuing open-market deals, one actually has the ability to act for a broader spectrum of potential investors.' ■