Guest commentary: 2023 a good year-in-waiting for German family offices

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Profile

John Amram, founder and CEO HPBA Off Market Solutions, reckons now could be a 'ripe time' for wealthy family offices to invest in real estate given their high affinity for direct ownership.

By John Amram

'From the successful founder of a tech company, through a centuries-old dynasty of entrepreneurs, to multinational mergers – the families behind the family offices active in Germany are just as diverse as their financial goals. There is scarcely any other group of investors that differs so widely in terms of size, investment style and approach. They have, however, one remarkable common feature: according to various studies by Engel + Völkers and Catella, the average real estate quota of family offices is considerably higher than that of institutional investors, whereby the precise figures fluctuate greatly.

The Engel + Völkers study also comes to the conclusion that the emphasis of many family offices is placed on value-add investments and residential real estate to a greater extent, with the focus still clearly on Germany. A survey by the consulting company Ebner Stolz at the end of 2022 confirmed that 97% of German family offices continue to set store by real estate, and in doing so above all by the inherent protection against inflation that rising rents offer.

As many family offices take a long-term approach, there is very little to indicate that these fundamental preferences will be called into question in the future. On the contrary: in view of current market developments, family offices could set the tone on the German real estate investment markets in the first six months of 2023 – above all as buyers, but possibly also as sellers.
2022 was a "wait-and-see" year.

In 2022 numerous family offices tended to take a cautious attitude towards the investment markets – just like the majority of the institutional market players. According to figures released by real estate market analysts at BNP Paribas, the share of family offices in the officially reported transaction volume of all market players was 3.2 per cent. This reticence is not surprising as a large number of family offices – in contrast to many other investors – are not driven by investment pressure (or the interests of third parties) as a rule, and accordingly can simply sit out a period of uncertainty.

In 2022 this uncertainty was shaped above all by the historically high degree of interest rate dynamics, whereby pricing became much more difficult for buyers and sellers. Potential buyers faced the challenge that interest rates could in part fluctuate greatly between the due diligence and the signing, and that business plans would therefore sometimes have to be amended several times. By contrast, a large number of sellers persevered at the price levels from 2020 and 2021 – an unrealistic expectation in many cases given the shift in interest rates.

The picture is changing with prices falling and interest rate dynamics subsiding.

In the meantime, however, some changes can be seen looming on the horizon. Among these is the fact that real estate prices are decreasing noticeably. Markdowns of six to ten times the annual net rent have become the reality for residential properties in metropolitan regions in the meantime – although there are still very few example transactions. After years of exaggerated market prices, real estate is now coming on to the market at very favourable prices, above all against the background of ever-increasing rents in many locations for both residential and commercial real estate.

Furthermore, the announcements by the US central bank, the Fed, and the ECB in December 2022 – namely that they would increase interest rates further but lower the rate hikes from 75 to 50 basis points and where necessary skip individual rate moves – have led to interest rate dynamics abating. This has resulted in a general tendency towards greater planning certainty. The challenges remain considerable, however, as underlined by the hikes by the Fed (0.25%) and the ECB (0.5%) at the beginning of February.

Equity capital key factor in 2023

A major challenge for the market, however, is the major degree of scepticism on the part of German financers. The quarterly sentiment index BF.Quartalsbarometer, which is prepared by the research firm Bulwiengesa, is currently at a record low of -18.21 points. By way of comparison: during the “coronavirus shock” in the second quarter of 2020 this figure was -15.24 points. According to the analysts we are facing a credit crunch, in which loans are being extended extremely selectively and with risk departments being given a far greater voting weight than the front office or the new business unit.

The combination of a very restrictive financing situation and the possibility to acquire real estate at favourable conditions now offers an extra opportunity for family offices with strong equity positions. With a correspondingly long holding period there is the possibility to invest anticyclically and profit from a later recovery on the investment market. At the same time, for many family offices a large proportion of the customary competition on the market has disappeared: among these are professional investors with high volumes of borrowed capital and conservative institutional actors, such as insurers and foundations, who are waiting for greater audit security with regard to pricing.

Heavily regulated investors have also been hit by the fact that the arithmetical real estate quota in 2022 is now considerably greater as the devaluation for stocks, shares and bonds has been much larger than that for direct real estate investments and real estate funds. This can also lead to restrictions being placed on the available options. In the meantime some market experts believe that the limits imposed by the statutory regulated real estate quota could be one of the most important factors for these actors to purchase much less often in the coming months.

The time could now be ripe for family offices to purchase property – above all given the high affinity to direct ownership of real estate in conjunction with what is often less stringent regulation. In particular those actors who have made fewer purchases in the past 15 years, and who speculate on value appreciation rather than merely on value retention, can now make their move and position themselves ahead of the market. This could possibly be an important indicator for other investors.

In this manner they would have the necessary example transactions which can, in turn, form a basis for future calculations. In this respect it is also important that family offices are guided in their decision-making by the tougher provisions imposed under the Buildings Energy Act (GEG) and the EU Taxonomy Regulation, and accordingly purchase sustainable properties. For although family offices are less heavily regulated, these ESG-related factors have a large impact on the resale value of properties.

Sales?

This does not mean, however, that family offices will probably only be found acting as buyers. A number of factors currently also indicate that family offices could increasingly rank among the sellers in the first six months of 2023.

Firstly, real estate prices are still significantly higher than they were at the beginning of the 2010s. An investment could be liquidated with a considerable profit after a holding period of ten or as much as twenty years, even if the ideal point in time for a sale has passed in the meantime.

The resulting liquidity could in turn be used as equity for new transactions. Secondly, family offices without their own developer competence could dispose of those properties which no longer suit their sustainability aspirations or which are at risk of becoming a “stranded asset” in a number of years. While bodies of rules such as the EU Taxonomy Regulation do not apply directly to family offices, future marketability to regulated investor groups does impact on pricing, however. Thirdly, the volume of inherited wealth in Germany is ultimately at an all-time high. With a change of generation there is undoubtedly the possibility of an adjustment to the investment strategy and some of the inherited real assets and properties could be – or even need to be – liquidated.

While many family offices utilise both classic bidding processes and off-market transactions for their purchases, they are more discrete when it comes to a sale, however. Ultimately, a number of well-known families attach particular importance to safeguarding their privacy. For this reason it is highly likely that a certain proportion of the transactions will take place in the form of discrete sales, which even remain concealed from the eyes of experts in this field. For the other market players there thus tends to be less potential for insights being gained from example transactions than would be the case with acquisitions.

The complexity of current market developments makes it difficult to offer any prognosis regarding the timeframe and dynamism of the re-opening on the markets. Accordingly it is not possible to forecast with any certainty whether family offices will actually dominate market activity in the first six months of 2023. Nevertheless, numerous factors point to this being the case – and the other market players should prepare for this in good time.'