GERMAN REITS

A View From the U.S.

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STEVEN A. WECHSLER, NAREIT **With the establishment of the G-REIT, the German government and investment community have created a truly modern investment vehicle capable of giving German investors access to the benefits of real estate investment – diversification and continuing income – in a form that also provides the liquidity and transparency of a publicly traded security, as well as superior risk-adjusted performance. Very importantly, it is an investment vehicle that will be successful in attracting global capital to Germany's property sector.**

NAREIT has watched the development of the G-REIT very closely and, over the course of its development, we have shared with Germany's legislative and regulatory officials what we have learned in developing and refining the U.S. REIT over the past half a century. Despite being created in 1960, the U.S. REIT remains a work in progress. And I believe the German REIT will be a continuous work in progress as well.

Not everything about the G-REIT today is as efficient as it could be. For example, we believe the exclusion from G-REIT portfolios of residential properties built before Jan. 1, 2007 is not efficient.

If the motive for this exclusion was to keep residential properties out of the hands of large corporations to ensure the affordability of rents…well, to use a common American saying, "that ship has already sailed." Of the 15 largest stocks in the DIMAX in terms of market capitalization, nine of them already focus exclusively on residential real estate or hold large residential property portfolios.

Almost all of the REIT regimes in countries around the world permit residential properties in REITs' portfolios. In the United States, residential REITs comprise about 15 percent of the industry's equity market capitalization. Depriving German REITs of the ability to own residential properties will only slow the development of the German REIT industry.

It also will hinder the flow of capital into the multi-unit residential marketplace – capital that could be used for the development and improvement of multi-unit housing facilities. Additionally, building these kinds of inefficiencies into legal and regulatory codes often drives companies to get around the obstacles by establishing foreign holding structures and listing on foreign exchanges.

The inefficiencies that do exist in the German REIT industry, though, are likely to be corrected over time, as the inefficiencies in the U.S. industry have been. Far more important is the fact that so much about the German REIT is right – and very efficient, indeed.

The G-REIT's structure closely compares to the latest evolution of the U.S. REIT, and to the U.K. REIT, which also was introduced last year. Like those REITs, and unlike the J-REIT, which was introduced seven years ago, the German REIT is internally managed, so it can be run as an efficient corporation for the benefit of its shareholders.

Also like the U.S. and U.K. REITs, German REITs will be allowed to invest outside Germany, so they can put their capital to work wherever it will produce the best returns. The J-REIT, by comparison, is limited to domestic investment, although Japanese authorities now are considering lifting that restriction. The German government also wisely gave G-REITs the ability to create taxable REIT subsidiaries. This will give the REITs the ability to provide services that will make their properties more appealing and generate additional revenues.

Beyond these modern structural elements, G-REITs have the same basic financial tests and requirements as U.S. REITs, U.K. REITs and many other modern REITs around the globe. These are the requirements that 75% of assets and income be from qualifying real estate sources, and that 90% of income be distributed as dividends. These structural and financial commonalities are vitally important, because they allow the G-REIT to fit the model of what is rapidly becoming a global REIT brand.

Brands, as we all know, are important to making commerce work efficiently on a mass scale. That's because a given brand represents a specific user experience that consumers can count on. This is true in the world of consumer goods, and in the world of financial products, as well.

When you buy a Vanguard fund, for example, you know it will give you basic exposure to an index at one of the industry's lowest cost structures. The uniform quality and attributes of branded products lead us to choose those products over others, giving them an advantage in the marketplace. The advantages are very much the same for REITs.

The REIT is coming to be recognized around the world as an investment that delivers the diversification and income of the real estate asset class in a securitized form that provides ready liquidity; measurable, indexable performance; and the transparency of a publicly traded stock.

The uniformity and growing understanding of this brand is what is driving institutions around the world to put REIT allocations into their portfolios. This brand is what is convincing more and more mutual fund providers to construct and launch REIT funds – especially global funds. And this REIT brand is what will foster a new generation of derivative products based on securitized real estate. Germany's decision to create G-REITs based on this brand model positions them to enjoy all of these advantages, which will allow them to attract capital from investors around the globe.

NAREIT is looking forward to helping the new G-REITs attract this global investor interest. We would very much like to introduce G-REITs to the U.S. investment community at our REITWeek® institutional investor forum – the largest event of its kind for REITs – which we host in New York each June. We also are planning investment community events in Germany, including our REIT Day investor conference in Frankfurt on April 10.

Germany's commercial property market is the world's third largest, with an estimated value of $1.3 trillion. But only about two percent of that value is in securitized real estate. By comparison, the average level of securitization globally is approximately 11%. We believe the G-REIT will be the trigger that will accelerate the securitization of the German property market.

Given the market's size, just increasing the securitization level to the 11% global average would produce a listed marketplace with a market capitalization of $140 billion. This would be a market that would satisfy global requirements for depth and liquidity…a market that would attract the largest institutional investors. I believe we will see that market develop within the next several years.

The 1990s – the decade of the Modern REIT Era – saw the transformation of the U.S. REIT industry into a publicly traded marketplace of companies with real institutional depth. The first half of this decade saw the explosive growth of the Asian REIT marketplace. With the launch of REITs in Germany, the U.K. and Italy, I believe the next five years will be the European REIT Era – an era of growth for Europe's securitized property market that will be spearheaded by the German REIT.