Boom-Era Debt Sparking German Apartment Sales: Mortgages

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Germany's multi-family housing market is set to have the most deals in five years as investors including private-equity firms are forced to sell almost 100,000 apartments to pay debt amassed in last decade's buyout boom.

There were 2.9 billion euros ($3.7 billion) of apartment property transactions in the first quarter alone, more than three times the amount a year earlier, and the total this year may exceed 6 billion euros, the most since 2007, according to estimates by London-based real-estate broker Savills Plc.

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Fortress Investment Group LLC (FIG) and Guy Hands's Terra Firma Capital Partners Ltd. are among private-equity firms facing debt maturities after buying thousands of German properties with the easy credit available in the years before the financial crisis hit in 2008. Loans for the deals were typically packaged and sold as commercial mortgage-backed securities. A total of 10 billion euros of German multifamily CMBS is now set to mature by the end of 2014, according to data compiled by Bloomberg.

"The main issue facing the larger players is purely refinancing risk on maturity due to the size of their outstanding debt," said Nassar Hussain, founder of London-based real-estate debt adviser Brookland Partners LLP.

Concern about the scale of refinancing required has depressed the values of senior German multi-family CMBS, providing opportunities to bet on the outcome. Debt sold by German Residential Asset Note Distributor Plc, backed by Deutsche Annington Immobilien AG's loans, trade at 92.1 cents on the euro, according to data compiled by Bloomberg.

JPMorgan Trades

One active buyer of senior German multi-family CMBS has been JPMorgan Chase & Co. (JPM)'s $360 billion Chief Investment Office, according to two people with knowledge of the matter, who declined to be identified because the information is private. The New York-based bank last week disclosed the CIO had a $2 billion trading loss on synthetic credit derivatives. JPMorgan spokesman Holger Ullrich declined to comment on the CMBS investment.

Refinancing debt in Germany has become more challenging as banks scale back lending as a result of stricter capital standards, the sovereign-debt crisis and the continuing stagnation of Europe's CMBS market. Buyout firms and companies that bought during the real-estate boom are being forced to weigh alternatives including selling assets or pursuing an initial public offering.

Gagfah Selling Apartments

Gagfah SA (GFJ), controlled by New York-based Fortress, said earlier this month it may sell 38,000 apartments because 3.3 billion euros of mortgages backed by the properties are due to mature next year. The company, Germany's largest publicly traded residential landlord with nearly 150,000 apartments, hired investment bank Leonardo & Co. to advise on the sale of its properties in Dresden, which account for about a quarter of its real estate.

Deutsche Annington, owned by funds managed by Terra Firma, needs to refinance 4.46 billion euros of debt coming due in July 2013. The Bochum-based company owns and manages 215,000 homes across Germany.

Vitus Immobilien Sarl, owner of 30,000 German homes, has five loans maturing later this year. They totaled 580 million euros at the end of 2011, according to notices to CMBS holders. Vitus is owned by a group of funds managed by Blackstone Group LP (BX), Round Hill Capital LLC, Deutsche Bank AG and Aviva Plc. (AV/)

The companies and their owners either declined to comment or weren't immediately available to comment on their refinancing plans.

Limited Capacity

While there is some willingness among lenders and investors to refinance the loans, banks and debt markets "cannot absorb the level of capital needed," Brookland's Hussain said.

The success of buyout firms' refinancing efforts depends on how much debt financed their acquisitions and what they bought. Some investor groups overpaid for inferior properties in eastern Germany or depressed industrial regions. Others are struggling to generate enough rental income to meet debts and some firms face having to refinance substantial borrowings, according to real-estate advisers.

"In the heady days of 2005 to 2007, particularly, international private equity paid increasingly large multiples for German multi-family housing portfolios," said Robin Priest, a senior adviser with turnaround firm Alvarez & Marsal's European real-estate advisory unit.

Some firms' leveraged bets were based on unrealistic expectations about rental growth, valuations and operating costs, according to Priest.

Surprised Germans

"The assumptions and capital structures that were deployed served to turn a formerly mundane asset class into something rather more exciting," Priest said. "Germans looked on in surprise and many of those same Germans are now looking to buy back in at rather more comfortable multiples."

The best properties in cities like Berlin, Hamburg and Frankfurt generate gross rental income equivalent to about 5 percent of the purchase price, while a 10-year German government bond yields a record-low 1.41 percent. Apartment-block values, which investors gauge by multiples of annual net rental income, vary from 19 times in Munich, the most desirable investment location, to as low as 8.5 times in Gelsenkirchen, a former coal-mining city in the Ruhr area, Savills said.

Property companies and real-estate funds are among those looking to take advantage of the latest opportunities to invest in German multi-family housing, according to Rolf Elgeti, chief executive officer of TAG Immobilien AG (TEG), which in March agreed to buy DKB Immobilien AG from Bayerische Landesbank for 960 million euros including debt, more than doubling its portfolio to about 56,000 homes.

'Real Money'

"People are going to look back at 2012 and say this was the year that real money came back to invest in the big residential portfolios in Germany," Elgeti said in an interview, referring to opportunity funds, pension funds, insurance companies and public companies.

Cerberus Capital Management LP, the U.S. private-equity firm led by Stephen Feinberg, agreed to buy 22,000 housing units in a 985 million-euro debt restructuring from the liquidator of Speymill Deutsche Immobilien Co., or SDIC, the New York-based firm said in a May 16 statement. Benson Elliot Capital Management LP in March acquired 3,000 apartments and commercial units formerly owned by SDIC, which had defaulted on a 187 million-euro loan packaged into CMBS.

Since September, Blackstone Group has acquired about two-thirds of the 21,000 apartments and 700 commercial properties owned by Level One, which was placed in insolvency administration in August 2008 owing creditors 1.5 billion euros. Blackstone paid a total of around 450 million euros for the assets.

Buyers Reconsidering

"Prices on smaller lots have gone up, but in the bigger portfolios prices are not overheated," said Thomas Zinnoecker, chief executive officer of GSW Immobilien AG (GIB), which raised about 190 million euros earlier this month to buy properties. "People who bought five to eight years ago are now asking themselves 'Do I still want to be here?'"

Borrowers will probably find it easier to refinance if debt is less than two-thirds of the value of the real estate, Conor O'Toole, a London-based asset-backed securities analyst atDeutsche Bank AG (DBK), said in an interview. Smaller U.S. buyout firms or borrowers with little expertise in the German residential market will have more difficulty, he said.

Accelerating asset sales "will be one of the key strategies for mitigating refinancing risk," O'Toole said in a note to investors in March.

Preparing for IPO

GSW Immobilien refinanced more than 890 million euros of CMBS in February 2011. The deal and cost cutting cleared the way for Cerberus and funds managed by Goldman Sachs Group Inc. (GS) to complete a 468 million-euro IPO of GSW in April 2011.

Deutsche Annington may be preparing for an IPO by incorporating into a common-stock company to facilitate the share sale. Chief Executive Officer Wijnand Donkers said in an interview with Immobilien Zeitung this month that it was close to completing its refinancing of some of its CMBS debt.

The amount of residential real estate on the market is complicating buyout firms' efforts to sell assets bought during the boom. Germany's government is looking to sell TLG Wohnen GmbH and Bayerische Landesbank plans to dispose of GBW Immobilien. Together, they own about 44,000 apartments. There are also residential assets for sale owned by companies that have defaulted or are insolvent.

Competing Bidders

Barclays Plc (BARC) is trying to sell its Baubecon Immobilien GmbH unit, which it values at 1 billion pounds ($1.6 billion). GSW and Goldman Sachs-managed Whitehall Street Real Estate fund have made an offer to acquire Baubecon, which has 21,000 housing units. Deutsche Wohnen (DWNI) is also competing for Baubecon.

Deutsche Wohnen has about 400 million euros to invest and"could be eyeing larger portfolios that would require more equity," JPMorgan said in a note to investors today.

"There could be a refinancing 'crunch'" because of the amount of CMBS maturing through 2014, Neil Green, an analyst at the investment bank, said in the note. "Although Deutsche Wohnen has no debt to refinance until 2015, we don't think a wave of forced restructuring would be positive for the overall market."

Patrizia Immobilien AG (P1Z) led a group of investors that acquired 21,000-unit LBBW Immobilien GmbH for 1.4 billion euros in February from Landesbank Baden-Wuerttemberg, Germany's biggest state-owned lender.

"The time for pure private-equity investment that we had five or six years ago is over because investors simply cannot get the leverage and returns they did before," Klaus Schmitt, the Augsburg-based real-estate company's chief operating officer, said in an interview.