IVG Research LAB 9/2012

Trends and opportunities at the Austrian investment market

Passion for Real Assets

Dear Readers,

If the opinions and expressions of interest by international investors meant actual purchasing activity, the Republic of Austria would have been well ahead among the target countries being invested in for two years now. But opinions and announcements are not the same thing as deeds. However – and this is where it gets interesting – in the wake of the general risk aversion, combined with enduringly stable expectations, Austria is finding itself on the radar of plenty of European property investors. The first, isolated investments can now be documented. One conspicuous aspect is that the investor community, which has been highly Austrian to date, is being mixed up by foreign investors. To put this in figures and take a sober look at the data, straight away numerous investors are vying for a market volume of around €23 billion. Compared to Germany or the Netherlands, the market is more monocentralised and compartmentalised. In other words, the capital city of Vienna alone accounts for around 80% of all commercial investments. The average annual investment volume here is around €1.2 billion. But what made it seem unattractive to most investors and ultimately led to it being considered a way station en route to the countries of Central and Eastern Europe a few years ago is today considered an advantage. The market is becoming more transparent. Following rational investor logic, the systematic market risk of Austria is therefore also gradually being reduced. This is what makes the "new" stereotypes that apply to an investment almost classic: stability and security with a clear trend towards "green properties".

Our latest Research LAB begins precisely in this almost textbook starting situation. While ten years ago Austrian investors heading out to Europe invested mainly in the UK, Germany and a range of countries in Central, Eastern and Southeast Europe, this trend is now reversing. The Austrian office and retail property markets are getting a great deal of attention from outside. So the following questions quickly come up:

- What market structures are investors seeing?
- Which investment segments offer the most promising opportunities for investors?
- Which exit possibilities are there for investors in a compartmentalised market?
- What shape is the market for "green buildings" currently in?

We will verify all of this in our usual way with numbers, data and facts while providing appropriate commentary. To give away one finding and to issue a warning at the same time: Without local expertise an international investor will face more difficulty on this market than in the hyper transaction-dominated London – both on the way in and on the way out in a few years.

1 The role of institutional investors on the property investment market

The last survey of the property assets of private Austrian households, carried out by Österreichische Nationalbank (ÖNB) in 2008, revealed **residential property assets in Austria** totalling **€880 billion**. The biggest share of these assets is held by private households in the form of owner-occupied residential property. The home ownership rate – depending on source and definition – is given as 50% (ÖNB) to 57% (Statistik Austria). The rest of housing therefore falls under the category of commercial residential use. Nonetheless, only a small share of commercial residential property assets is actually traded on the market.

Institutional investors focus mainly on capital investments in commercial property. Experience shows that the ratio of commercial property to total property assets in Western European states such as France or Germany is one fifth. Accordingly, **total property assets in Austria** would add up to around

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€1,100 billion. Almost **€100 billion** of this volume relates to **office and retail property**, the segments preferred by institutional investors for property.

Institutional investors are by definition capital investors, who invest the capital entrusted to them by their clients in the individual asset classes on the market, particularly insurance companies, pension funds, investment funds, REITs, foundations and banks. As institutional investors invest highly extensive amounts, their actions greatly influence activity on the markets for the individual asset classes. Institutional investors can invest in property both directly and indirectly – through property funds, for example.

Given the fact that the structures on the Austrian property market more closely resemble those of Switzerland and Germany than, for example, the UK or the Netherlands, **the volume of property assets in Austria managed by institutional investors is roughly estimated at between €45 and €50 billion.** This corresponds to just 4% to 4.5% of the country's total property assets. In connection with Austria, Investment Property Databank (IPD) speaks of property assets of around €22.8 billion which are managed by the most important market participants as part of their active portfolio management. So who are the most important market participants among Austria's institutional investors?

In its quarterly reports on the asset development of Austria's **insurance industry**, the Austrian Financial Market Authority (FMA) reports a property share of 6.7%, corresponding to property assets of around €6.4 billion, trend rising. The most significant insurance groups with notable property holdings in Austria are Vienna Insurance Group VIG (Wiener Städtische Versicherung), UNIQA Versicherungen AG, Generali Austria Holding, the Allianz Group and the AXA Group. Austrian **pension funds** manage property assets of around €542 million, corresponding to a property share of 3.5%. The country's biggest pension funds include VBV, Valida, APK, BAWAG/Allianz, Bonus, Victoria and BPK. Austria's **occupational pension schemes** have a relatively low share of property at 1.5% to 2.5% (absolute value: €50 to €105 million).

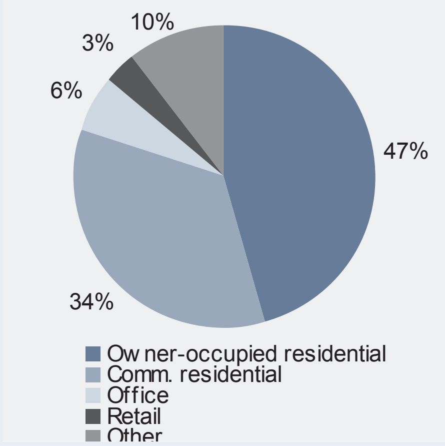
It is difficult to estimate the property share in the **banking** sector. Generally, however, banks concentrate on their core business, not least on account of the more stringent equity requirements under Basel III, and are reducing their own property holdings to the bare minimum. But as issuers of open-ended funds, they are still key players on the investment market for commercial property through their investment companies.

Generally, the property ratios of these institutional investors do not provide any insight into the property assets actually held in Austria. As Austria's big insurance companies in particular operate widely in CEE nations, their property assets there are included in their balance sheets alongside their properties for own use. Information on investment assets actually held in the form of property broken down by country is rarely provided. Beyond this, an analysis by different asset classes and their issuers is reasonable for further differentiating the key institutional market participants in Austria.

Property funds – highly significant as an indirect investment form

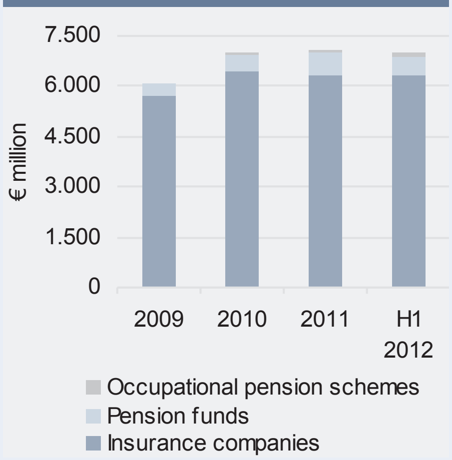
As many indirect property investment instruments such as property funds only appeared in Austria relatively late – from 2004 – many domestic investors have opted to go through Germany to invest in property in Austria. There are very few domestic providers in the closed-end property fund and special fund segment. In total, the members of the German Association of Closed-end Funds (VGF) have launched 40 **closed-end Austria funds** with property assets under management (gross, i.e. property assets reported in the balance sheet including borrowed capital, not including cash and cash equivalents) of **€2.65 billion**. This investment vehicle experienced a boom in 2004 and 2005, when five and six new Austria funds were placed respectively with total volumes of €555 million and €805 million. Eleven further funds were placed

Distribution of property assets



Source: IVG Research based on ÖNB, BulwienGesa etc

Institutional property assets



Source: FMA

in the next six years, albeit with a greatly reduced volume. Thus, after 2006 only roughly €100 million was placed per year; in 2011 this figure was just €22 million. With a total of 22 closed-end Austria funds and a property value of €1.37 billion, the most active fund initiators include KGAL, Sachsenfonds, Wölbern Invest and the Austrian Signa Group.

Out of 42 **German open-ended public funds** with total fund assets of €83 billion, only 13 were invested in Austria in mid-2012. Above all, the preferred asset class of open-ended public funds in Austria is Viennese trophy buildings and major property complexes, while office and retail property accounts for more than 80% of the capital invested there. The Austrian property portfolio acquired by these funds has a total value of around **€1.4 billion** (recognised net property assets in Austria including borrowed capital). This corresponds to 2.85% of the fund volume of these 13 public funds. The heavyweights in this group include the fund DEKA Immobilien Europa with €427 million, UniImmo Europa with €445 million, Commerzreal hausinvest with €173 million and AXA Immoselect with €140 million. Furthermore, WestInvest also has a presence in Austria with two funds (total volume of €170 million), as does RREEF in "grundbesitz global" (€115 million). The closure of the funds of SEB, AXA Real Estate and Credit Suisse relates to a property portfolio in Austria across all types of use of around €270 million.

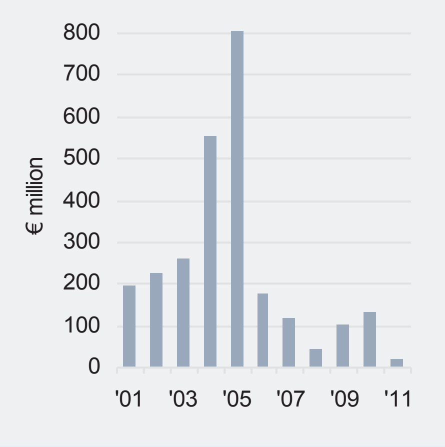
In addition to the open-ended public funds, **German so called „Spezialfonds"** are in demand among domestic institutional investors for property investments in Austria. Aside from IVG Austria, there is hardly any native supply for this investment vehicle, which means that German special fund providers such as Warburg-Henderson and Invesco are among the most important market participants in this segment. The property assets managed by Spezialfonds in Austria can only be roughly estimated and – depending on Austria's assumed share of total investment assets in German Spezialfonds (€32 billion) – amounts to between €600 million (1.8%) and €1.2 billion (3.4%). If one assumes that Austrians hold around 2.9%, as is the case for German open-ended public funds, Austria has property assets managed by German Spezialfonds of €1 billion. Generally, however, there is greater interest among the Austrian institutional investors of Spezialfonds fund providers in foreign real estate.

Austria has also been issuing **open-ended public funds** since 2004. Issuers include Semper Real Estate and above all the fund companies of the four biggest banks in the country, Unicredit/Bank Austria (Real Invest Austria, Real Invest Europe), Erste Bank (Erste Immobilienfonds), Volksbank (Immobilienfonds 1) and Raiffeisen Zentral Bank (Raiffeisen Immobilienfonds). The industry's flagship is Real Invest Austria from Bank Austria with a fund volume of €2.05 billion (09/2012), which corresponds to a share of 62.6% of the total volume of Austrian open-ended public funds worth €3.3 billion. The gross property assets of the five Austrian open-ended funds – regardless of the liquid funds available – presently amounts to **€2.9 billion**, 77% of which is invested in Austria and only Raiffeisen Immobilienfonds and Immofonds 1 are fully or majority invested outside Austria. The share of the commercial property portfolio of the two biggest open-ended funds (Real Invest Austria, Erste Immobilienfonds) in the total volume of €2.05 billion is currently just 37%, while all the other funds invest exclusively in commercial property. The residential property share for the Austrian portfolio of these five funds totals 58%.

Property stock corporations, REITs and developers: central importance for development business and as operators of retail property

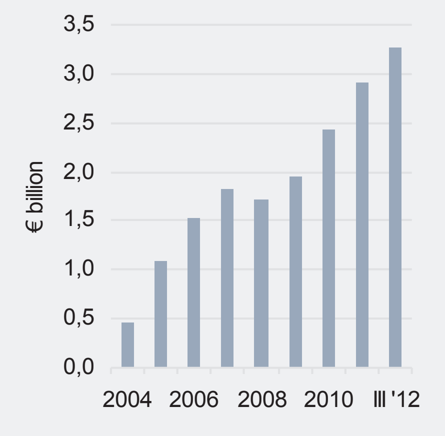
At present, five domestic **property stock corporations** are listed in the Austrian Real Estate Index IATX, of which warimpex AG invests exclusively in Central and Eastern Europe outside Austria. The other four property stock corporations together manage gross property assets totalling €19.3 billion, of which only **€6.2 billion (32%) is invested in Austria**. The biggest of these is

Closed-end funds: Austria funds



Source: IVG Research, gross reported property assets of investment companies with Austria funds or property in Austria

Austrian open-ended funds: assets



Source: FMA

Immofinanz AG with a property portfolio of almost €9.4 billion (Austria share: 39%), followed by CA Immo AG with property worth €5.3 billion in its portfolio. At 14%, it has the lowest Austrian share in its portfolio of all the domestic property stock corporations. The situation is reversed at Conwert Immobilien Invest SE, where 47% of its total portfolio is invested in Austria (€2.7 billion). S Immo AG roughly hits the Austrian average with an Austria share of 30% (absolute volume: €562 billion). The big property stock corporations focus their investments in different areas: While Immofinanz AG has invested over two thirds of its Austrian property portfolio in residential property, the portfolio of CA Immo AG is dominated by office property (78% share). Overall, rented accommodation is the most important asset class in the domestic portfolios of the four property stock corporations, with a share of 44%, followed by office (36%) and retail property (14%). One noticeable aspect at all property stock corporations is that they operate not just as asset managers but as project developers as well (e.g. Immofinanz AG is very active in residential construction, as is CA Immo AG in the office sector).

The project development market in **retail** is led by Spar European Shopping Centers GmbH (SES), a subsidiary of the Austrian Spar Group. In addition, the German shopping centre developer ECE was active in Vienna in recent years at Bahnhofcity West and the Vienna central station. Also worth mentioning as the third big player is the Franco-Dutch REIT Unibail-Rodamco, which has acquired the two biggest shopping centres in the country (Shopping City Süd, Donau Zentrum).

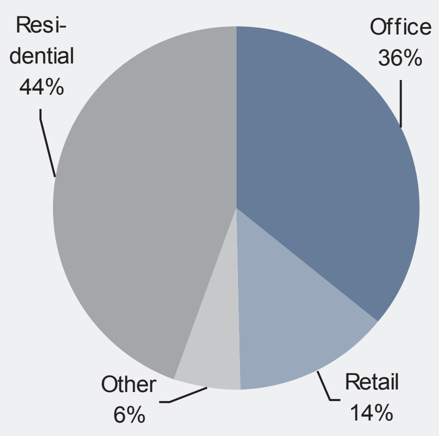
The most important **shopping centre operators** in the country are SES with twelve centres and total space under management of 380,000 sqm, Interspar GmbH with twelve centres and 290,200 sqm and Ekazent Immobilien Management GmbH with seven centres and 205,300 sqm of space. These are followed by Unibail-Rodamco (two centres, 192,000 sqm), Shopping Center Management GmbH (two centres, 101,000 sqm) and ECE (three centres, around 81,000 sqm). These companies control the ten biggest shopping centres with the highest sales in the country, which are in the direct catchment areas of the biggest state capitals. They account for not just over 31% of total shopping centre space, but also more than 40% of shopping centre sales in Austria. According to the Austrian Council of Shopping Centers (ACSC), surface area productivity of the major centres > 10,000 sqm averages at approximately €3,320/sqm. In total, the five shopping centre operators named manage over 63% of total shopping centre space in Austria, hence new competitors face difficulty establishing a foothold in the already saturated shopping centre segment.

Taken together, the institutional investors and developers listed above account almost entirely for the professionally managed property portfolio reported by IPD of €22.8 billion. Nonetheless, the market is also still highly atomised and characterised by regional investors and participants.

2. Development of the Austrian property investment market

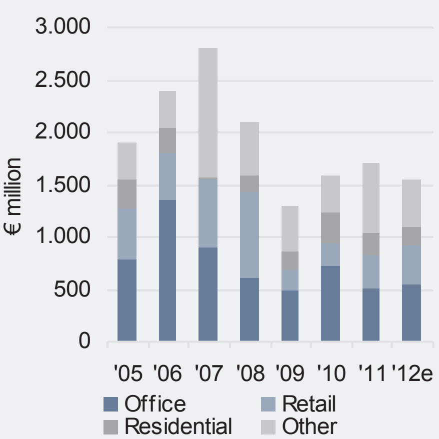
Like everywhere in Europe, the Austrian investment market for commercial property peaked with an investment volume of €2.8 billion € in 2007 before the bankruptcy of Lehman Brothers, when opportunistic international investors also invested heavily here. After the start of the crisis, the transaction volume dropped markedly; it reached a low of €1.3 billion in the crisis year of 2009. The subsequent recovery phase seems to be losing momentum this year, unless a few more big transactions take place before the end of the year. Vienna was and is by far the most important investment destination for domestic and international investors in Austria with an average annual transaction volume of €1.2 billion. In the last three years, Vienna's share of the total sales volume has been between 70% and 80%.

Property stock corporations: assets by sector



Source: IVG Research, property assets held only in Austria

Investment volume by asset type



Source: CBRE, IVG Research forecast

Over the long-term average (2005 – Q3 2012), domestic investors were by far the most important investor group with a share of 62% of sales volumes. This figure swelled from 70% to 80% during the crisis when almost all international investors withdrew from the market. Otherwise, German players have been among the most faithful investors in Austria with an average share of sales of 23% in recent years. Even during the crisis, German investments did not fall below the €200 million line. Investments by international investors from countries other than Germany reached their zenith of €672 million in 2008 before falling off sharply in the wake of the economic crisis. However, demand has picked up again significantly since 2011: These investors made purchases worth €323 million in 2011 and have invested €150 million in the first half of this year. Despite this, their share of the total sales volume is still considerably less than before the crisis.

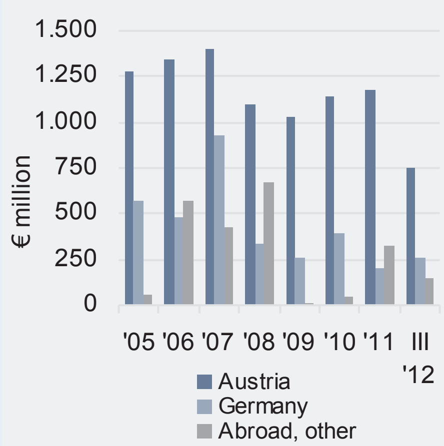
There was a clear breakdown of investor preferences up until 2010: While Austrian investors invested in both office and retail property in addition to the commercial residential construction segment, most German investment vehicles – above all the open-ended and closed-end property funds – focused on acquiring high-quality, newly built office properties at the edge of the city centre (e.g. the Vienna properties TownTown, City Point Vienna, Skyline, Solaris, Marximum, Catamaran). The open-ended public funds invested above all in large-scale properties with a purchase price upwards of €50 million, while the closed-end funds and Spezialfonds have preferred properties in a price range of between €10 million and €60 million since the crisis broke out. By contrast, international investors such as equity funds and REITs invested heavily in retail properties, such as the Australian property investment group APN/UKA in Shopping Center Nord (Vienna-Floridsdorf, 56,000 sqm) in 2006 and Unibail-Rodamco in the Shopping City Süd (Vösendorf, 131,000 sqm) in 2007.

The Austrian office investment market

Compared to the period before the financial crisis, interest in office property has lessened significantly. A three-year comparison of the periods immediately before and after 2008 shows a decline in transaction volumes from an average of €950 million p.a. before the crisis when credits were cheap by two fifths to €577 million p.a. thereafter. In light of the greater difficulty in obtaining borrowed capital, only few investors with good equity reserves can still manage large-scale transactions. Furthermore, investors can be seen to be clearly fixated on core properties. The focus of many investors in Vienna has currently shrunk almost exclusively to its 1st district and the belt (2nd to 9th districts). Investments outside these office locations are only considered if the location has good underground or road connections, the property meets the latest green building standards and it has long-term leases with tenants of good credit standing. Flexibility of space is also a prerequisite, as are low and transparent additional costs. Additional benefits such as a good infrastructure of nearby facilities (cafeteria, kindergarten, doctors' surgeries or shopping) in the surrounding area favour the acquisition process. The recent acquisition of the Euro Plaza 4 office complex (48,500 sqm GFA) at the Wienerberg location by the German open-ended public funds UniImmo Europa for €150 million is an example of this. The extreme focus on office and commercial buildings in central Vienna on the one hand and green buildings in good locations at the fringe of the city centre on the other is leading to a shortage of core properties. As a result, initial yields for prime office properties are tending towards 5%. Properties in good locations at the fringe with an underground connection, tenants of good credit standing and a green building standard generate initial yields of up to 5.65%, high-quality office properties in average locations yields upwards of 6.25%.

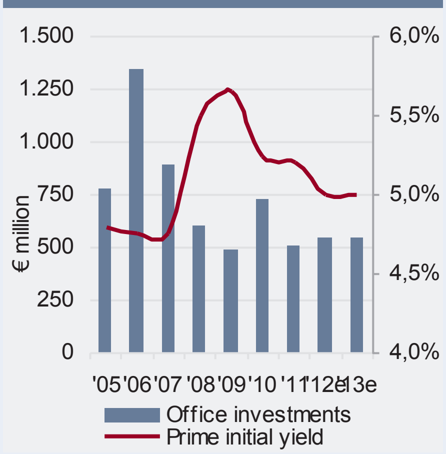
It is expected that the Austrian office investment market will see some movement in the medium term. Fund companies such as Wealth Cap and HCI have begun selling parts of their portfolios. Above all though, the Austria

Investment volume by origin



Source: IVG Research using CBRE data

The Austrian office investment market



Source: CBRE, IVG Research forecast

portfolios of the German open-ended public funds AXA and Credit Suisse are available for sale. The gap between initial yields for prime and non-core properties is expected to widen further. In particular, properties with high vacancies are currently only finding buyers if they have the potential for conversion for different use. Office properties that were once ‘Zinshäuser’ and that can be converted for residential or retail purposes before resale and office properties that can be converted into hotels are especially sought after.

The Austrian retail investment market

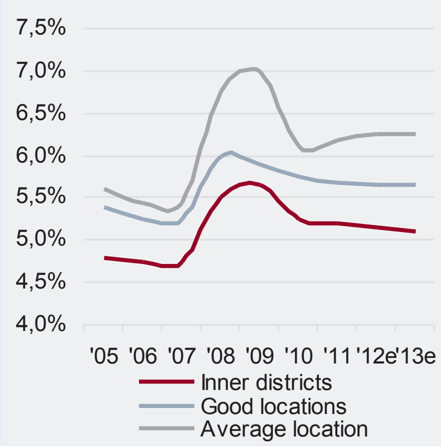
The investment market for retail property experienced its biggest boom in the years 2006 to 2008, when international investors in particular invested strongly in shopping centres, retail parks and retail warehouse portfolios. Sales amounted to well in excess of €600 million p.a. in the years 2007 and 2008. The market largely collapsed after the bankruptcy of Lehman Brothers. A renaissance has since begun. Above all, Warburg-Henderson KAG has been on a shopping spree for its Austria Spezialfonds since mid-2011 and in recent months has acquired three retail parks and one high street property. In the past two years Bank Austria has focused more on shopping centres and high street properties. ECE European Prime Shopping Centre Fund and the UK’s Curzon Capital Partners III Fund attracted attention in the third quarter of 2012 when they acquired a retail park and a shopping mall respectively. It can be assumed that centre operators such as Unibail-Rodamco and ECE will attempt to broaden their position in Austria.

Generally, investors are signalling interest in all three types of retail (high street, shopping centres, retail warehouse.) However, many potential investors are practicing caution in view of the high level of saturation on the market for shopping centres and retail warehouses.) Investors currently consider prospects to be most promising in the high street segment, as the supply in this segment can only increase a little owing to protected buildings and natural restrictions, and as there are also highly intriguing options for multiple use here on account of their excellent location. Prime initial yields for high street stores are currently at 4.3% upwards, from 5.4% for shopping centres and from 6.6% for retail parks, with the trend stable to declining slightly.

The Austrian „Zinshaus“ investment market

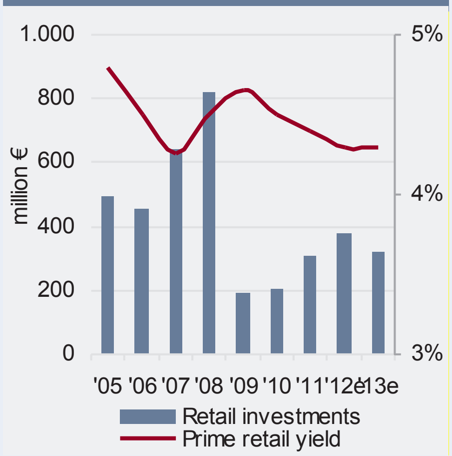
A highly desirable type of investment property in Austria is the so called „Zinshaus“. These are apartment buildings built during the „Gründerzeit“ between 1848 and 1918 in the wake of industrialisation to cope with the rural exodus and to create housing for Vienna’s new working class. A typical Zinshaus has a living floor area of between 800 sqm and 3,000 sqm, averaging at around 1,200 sqm. With 15,070 apartment blocks in total, these buildings from the Gründerzeit account for a share of more than 10% of Vienna’s total housing stock, with most of them located in the 15th to 18th and the 2nd and 3rd districts. According to Otto property, the total value of Vienna’s Zinshaus segment (built from 1848 to 1918) is estimated at around €30 billion, corresponding to a share of between 7% and 8% of commercial residential property assets in Austria. Depending on the area and district, rents for these classic apartment blocks are between €2 and €8/sqm per month (average: €4.50/sqm) and are stipulated by an official benchmark for each district. Old leases occasionally can be passed on to relatives. Moreover, Vienna’s strict tenancy laws make it almost impossible for owners to terminate leases. The prospects for increases in value are consequently very low. However, the price range for such a Zinshaus outside the 1st district is €400 to €2,500/sqm, corresponding to an initial yield of between 2.4% and 6.4%, trend falling. Peak prices of €3,350 to €5,480/sqm are even paid for Zinshäuser in the 1st district, resulting in an initial yield of 1.4% to 3.5%. This investment segment is therefore above all attractive for investors seeking a stable cash flow and with sufficient equity. Over 90% of all purchases are made with equity. Given the small investment volumes averaging at €1.8 to €2.1 million per transaction, this segment is mainly suited for private investors, especially as the

Vienna: office prime initial yields



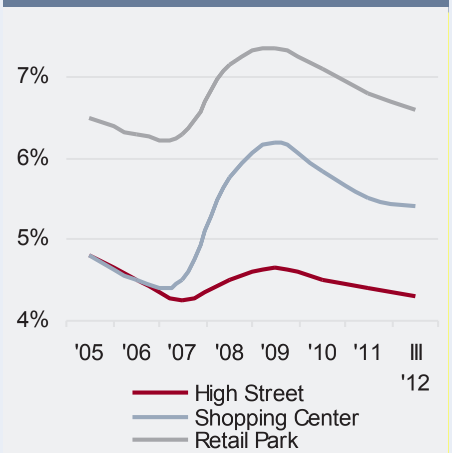
Source: CBRE, IVG Research forecast

The Austrian retail investment market



Source: CBRE, IVG Research forecast

Prime initial yields by type



Source: CBRE

acquisition of such a Zinshaus often also involves an emotional component. This is reflected in a 71% share of sales by private investors and developers.

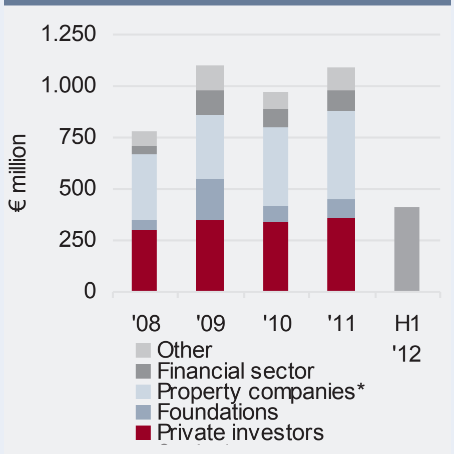
In spite of the low returns, the Zinshaus segment has been booming since the start of the economic crisis in 2008. The average transaction volume in the last three years has only been around 40% lower than the average commercial investment volume at around €1 billion. Given a lack of safe alternative investment options, in recent years more and more institutional investors (foundations) and financial sector investors have been parking their capital in the Zinshaus segment to preserve the value of their capital. A further indication of this is the rising volume of traded Zinshaus shares, which has risen since 2007 from 11% to recently 25.5% (2011) of the total realised Zinshaus investment volume. When acquiring Zinshaus shares, in contrast to general practice, it is normal to buy just a percentage share of one rather than an entire building. According to an analysis by Bank Austria, foundations accounted for more than 10% of volumes purchased in the period from 2008 to 2011 in Vienna (€3.94 billion), the financial sector for 9%. The flight to "concrete gold" drove down the prime initial yield for apartment blocks from 5% at the start of the millennium to now just 1.4%. The high recent sales momentum should also not conceal the fact that on average only 3.3% of the total Zinshaus stock have changed hands. The largest share of this portfolio is held by private investors and is not for sale.

3. Outlook: "Why should institutional investors invest in Austria?

The question of "why" can be answered with one word: stability! Apart from the crisis year of 2009, Austria has enjoyed economic growth in excess of the European average in recent years. Public debt is below average compared to the rest of Europe at 72.5% of gross domestic product (EU27: 82.5%), and the forecasts for 2013 – following a tangible downturn in growth momentum in 2012 – are assuming growth in economic output of 0.9% and 0.7% in employment. Thanks to the social partnership between companies and unions, as well as the broadly diversified, export-oriented economy with an internationally competitive level of SMEs, Austria has the lowest unemployment rate in the European Union at 4.4% (10/2012) and is well above the EU average for national gross value added per capita at €35,710. Furthermore, the high purchasing power of the Austrian people, together with €1.5 billion in influxes from neighbouring countries, contributes towards stable domestic demand. Confidence in the Austrian economy is confirmed by a property market survey conducted by Ernst & Young, in which 92% of the respondents rated Austria as attractive or very attractive. However, those surveyed were also aware of the fact that the market has lost steam as a result of the euro crisis and they therefore anticipate a significant decline in real estate activity.

The question of where institutional investors should invest in Austria is easily answered: Vienna. The capital city of Vienna is clearly the economic centre of Austria and, with 10.6 million sqm of office stock and around 2.4 million sqm of retail space, by far the country's biggest property market. The four major state capitals in Austria with more than 100,000 inhabitants (Graz, Linz, Salzburg, Innsbruck) have a combined population of only 42% of that in Vienna (Vienna: 1.72 million). Both purchasing power (Vienna purchasing power index: 105) and gross value added per inhabitant (€42,600 per capita) are well above the national average. In addition, there is Vienna's geopolitical position: As the "Gateway to the East", the Austrian capital is home to international organisations such as the UN, OPEC and the OSCE. While some companies have since begun relocating their Eastern European activities from Vienna to the corresponding countries, Vienna remains the Austrian or Eastern European base of operations of many national and international corporations.

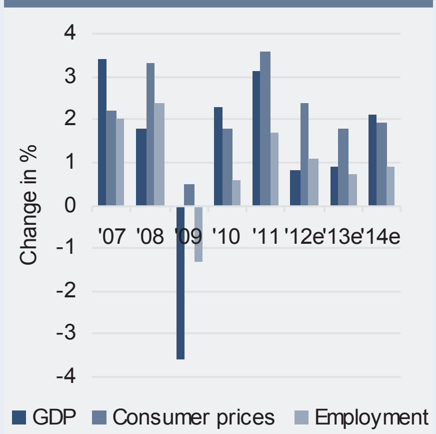
Zinshaus investments by investor type



Source: IVG Research based on Bank Austria (IRG, Immounited)

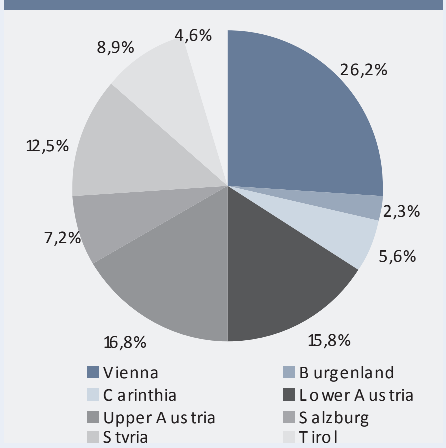
** Property brokers, developers and investors, etc.*

Economic data for Austria



Source: European Commission

GDP by region



Source: Statistik Austria

Current trends on the Austrian property market

There still remains the question of which trends characterise the property markets in the individual sectors and what opportunities this entails for institutional investors.

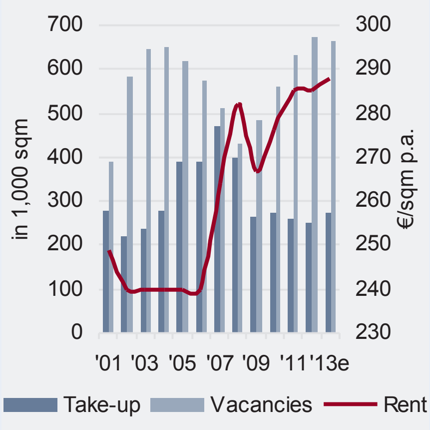
The following trends have been identified in the **office sector**:

- There is a nationwide process of consolidating space in modern, flexible, large-scale office properties in city fringe.
- Against the backdrop of cost and space efficiency, both investors and users are attaching rising importance to environmental certificates such as ÖGNI or LEED, as confirmed by a positive vote of 85% in a survey by Ernst & Young.
- The gap in rents and prices for core and non-core properties will continue to widen. Today, many properties can only be let with incentives such as rent-free periods or building subsidies, which can account for around 5% to 10% of nominal rent on five-year leases. If a property does not have a relevant environmental certificate, that means another discount on the rent.
- A lot of office users are presently postponing plans to move in light of the debt crisis in the euro area. It is therefore proving tough to let even modern, large (> 1,000 sqm) properties.
- However, the office rental market will remain largely stable in 2013 on account of the moderate completion volume. The vacancy rate will rise slightly as the consolidation of space generally means that more space will become available than is taken up in new leases. However, the vacancy rate (7%) is still low by European standards.
- Investors' fixation on core properties and their clear focus on Vienna as a location are causing a shortage of high-quality properties. The initial yields for high-quality office properties will therefore develop stably or possibly fall further.
- In the short to medium term, the break-up of several German open-ended public funds will bring a little movement to the office investment market, which is chronically short of good product.

The following trends have been observed in the **retail property market**:

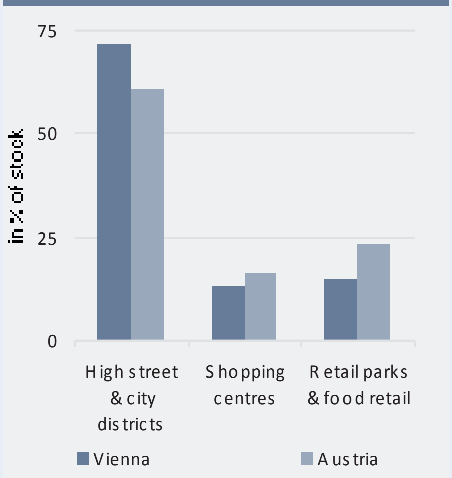
- Increasing saturation of the retail property market. As the stock of space is still growing more quickly than retail sales, the productivity of retail space will continue to decrease. With 16.2 million sqm of retail space and per capita selling space of 1.9 sqm, Austria already ranks among the countries with the highest retail stock.
- A consequence of this is that older properties without corresponding refurbishment and repositioning are dropping out of the market. This applies both to the shopping centre segment and to retail parks.
- Additional costs, especially energy costs, are rapidly gaining in significance for retail property. Retail developers are already implementing green building standards in the development of new projects, as shown by the example of the G3 Shopping Resort at Gerasdorf, which opened in the autumn of 2012.
- The actual "run" is currently happening for high street properties. With consumers returning to the notion of the city as a place to live, high street shopping is experiencing a renaissance at this time. Above all, this is leading to trends towards stable to rising rents and falling prime initial yields at prime locations throughout the country.
- In the same connection, nearly all new urban shopping centre developments will take place in inner cities or central town districts in future.
- The concentration on just a handful of operators will continue to gather pace in the segment of professionally managed retail property (shopping centres, retail parks).
- Owing to the high level of market saturation, new retail developments

Vienna office market



Source: IVG Research using data from CBRE et al., own forecast

Retail space by type of distribution



Source: WKÖ, IVG Research.

demand advanced expertise and are limited to just a few niches.
- The majority of development activities will be restricted to refurbishment and revitalisation work in the medium to long term.

The following developments can be observed on the **residential property market:**

- Austria has recorded positive population growth since the start of the new millennium. Since 2002, the number of people living in Austria – predominantly as a result of immigration from the new member states of the EU – has risen by a total of 4.7%. Vienna has even seen growth of 10%. Statistik Austria's population forecast assumes that there will be two million people living in Vienna by 2050.
- The trend towards mainly higher income groups returning to live in the city is causing a shortage of apartments and driving up rents.
- Above all, this means good prospects in commercial residential property development for Vienna's new districts, as rents here are not yet stipulated by current rent laws. The 2005 urban development plan reports a number of development areas in this context.
- Given their extremely low returns, Vienna's Zinshaus segment will probably remain a pet segment for high-equity private investors, which will be deserted by financial sector investors especially as soon as higher interest investments open up. The segment will retain its allure given its – by definition – limited supply.

4. Investment recommendations for Austria's commercial property market

IVG Research feels that the trends described above allow for various investment opportunities. In spite of low prime initial yields and a currently weak rental market, the long-term market stability opens up certain investment options for institutional investors on Vienna's **office property market**:

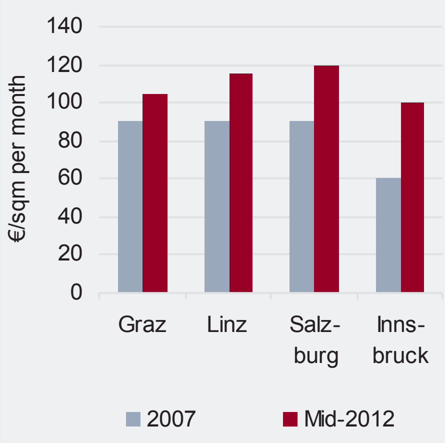
- Modern office properties in good locations (underground connections, easily reached by car) and high occupancy. Environmental certificates and flexibility of space are now prerequisites among tenants and on the market. A good infrastructure of nearby facilities means further plus factors.
- High street office and commercial buildings in Vienna's first district – ideally close to the Golden U with the option of multiple uses as a Zinshaus or hotel.
- Vacant office properties outside the city's main office locations, but in an attractive residential area or close to tourist attractions. Value added can be generated here by conversion into apartments or hotels.

Investors should steer clear of properties that do not have the right location or quality, even if the returns seem attractive. For investors who know the area, there are opportunities in very few selected areas on the city fringes of Austrian state capitals with modern office stock and good accessibility by car or public transport, as even there the public sector and big local companies have begun consolidating space. Investments in this segment require a good level of local expertise as the office markets of these locations lack transparency and are relatively illiquid.

Most investors are currently putting their hopes in the **retail property market**. Clearly preferred at present are:

- Investments in inner-city high street buildings in prime shopping locations. As there are limits to how much more space can be made

High street prime rent in capitals



Source: Cushman & Wakefield

available in prime locations, these sites guarantee a sustainable cash flow and potential for value added through rent growth.

- Big shopping centres with national catchment areas or small city district centres specially tailored to the needs and requirements of the respective location.
- Shopping centres or retail parks with development potential. As hardly any new construction projects are being approved anymore, a repositioning or refurbishment after a thorough analysis of the competitive situation at many locations can leverage value, especially as many Austrian shopping centres are overdue for redevelopment.
- Retail parks, provided that they are among the dominant centres in the competitive environment.

When acquiring **logistics property**, investors should above all focus on the logistics hub of Graz, from where goods are distributed throughout the entire country. Given the rising number of tourists, hotel investments are also an option. However, these require special expertise.

This leaves just the **commercial residential property segment**. The central, upmarket segment is interesting here as this is where the highest rents can be generated. In Vienna there are good medium-term investment opportunities in the Lasallestrasse / Dresdner Strasse development area and the central station / Erdberger Mais redevelopment. The latter will be not just Vienna's new central station, but an entire district with a new shopping centre and residential, office and commercial space for 18,000 residents and up to 60,000 employees. The location is distinguished not just by its excellent location and traffic connections to the city centre and airport, but has also established itself as a key biotechnology and media cluster within the district thanks to the university based there.

5. Excursus: The market for green buildings in Austria

The subject of sustainability has also become a significant competitive factor in the property industry. Sustainably built and economically operated buildings in particular are assumed to boast a high level of efficiency, environmental friendliness and reduced resources requirements. Furthermore, sustainable properties are guaranteed to retain their value in the long term – for investors, owners and users equally. But what are sustainable buildings? This type of property is often equated with certified buildings. But compared to the market as a whole, it is a segment that still represents a highly limited market volume. Furthermore, there are also buildings that easily meet these requirements without this having been demonstrated by a certification process. This issue is currently being discussed intensively in Austria in particular. Who pays the costs of such a certification process, and what are its short, medium and long-term economic benefits? Put more simply: why go to the effort? The situation has basically emerged that green or sustainable properties are described as buildings distinguished by efficiency of resources in the areas of energy, materials and water, thereby reducing their negative impact on the environment and health. The English phrase "green building" is now commonly used even in German.

Property certificates

Low operating costs and energy efficiency today play a highly central role for tenants especially. Certificates are becoming a crucial letting criterion more and more. A range of seals and certificates have established themselves as proof of compliance with various sustainability criteria. So far a single, internationally recognised standard has not been agreed upon, and this is not expected to happen in the near future. Thus, there is some variation between the different systems and assessment criteria; the results of assessments can therefore differ greatly. To put it in a bad way: an Austrian ÖGNI certifica-

SWOT analysis for Vienna

Strengths:

- Capital and economic centre of Austria with 1.7 million inhabitants
- "Gateway to the East": Base of operations for international organisations and national and international corporations
- Location with relatively high value stability on property market
- Low vacancy rate on Vienna office market (stock of around 10.6 million m²)
- Excellently developed high street segment, also thanks to tourism

Weaknesses:

- Only relevant investment location for international investors in Austria
- Very low prime initial yields in all market segments
- Low market transparency: definitions inconsistent, lack of data of individual transactions
- Potential for rent growth somewhat low outside high street segment
- To a degree, "Vienna clique"

Opportunities:

- Dynamic population growth: High residential space requirements mean opportunities in commercial residential construction
- Rent growth in commercial sectors thanks to positive economic performance and moderate new construction activity
- Tenants and investors increasingly focusing on sustainable properties
- Greater influence of international investors: rising market transparency and liquidity
- Renaissance of city centre shopping due to influx of higher-earning population strata

Threats:

- Relocation of corporate activities to nearby CEE countries
- Further blows to property markets in wake of euro and debt crisis
- Risks of bank exposure in CEE countries (Hungary!)
- Rise in base vacancies in office sector due to space consolidation
- Medium-term rise in yields in all market segments due to further pickup in

Source: IVG Research

te cannot be compared with a British BREEAM. Many industrialised nations today have national building certificates. However, the main internationally relevant ones are the American LEED (Leadership in Energy and Environmental Design) and British BREEAM (Building Research Establishment Environmental Assessment Method). Competition is also fierce in Austria: One of these is the Austrian Society for a Sustainable Property Industry (ÖGNI) with its associated seal of quality, another is the TQB certificate offered by the Austrian Society for Sustainable Building.

Examples for green buildings in Austria

Object	Location	Certificate	Sqm
Rivergate	Vienna	LEED, EU Green Building	40,000
Business Park TownTown	Vienna	ÖGNI bzw. DGNB	20,000
Greenworx	Vienna	LEED	19,000
Viertel Zwei	Vienna	ÖGNI bzw. DGNB	38,000

Source: IVG Research

Of the new office buildings that entered the market in Vienna in 2010 and 2011, 70% is classified as green buildings, while only 5% of buildings from before this time are certified.

Outlook

Austria – compared to Germany and Switzerland, for example – has the shortest history of certification. But it has not yet arrived at a standard of certification. Nonetheless, the history of sustainability is long and began when the MINERGIE label was created in Switzerland at the end of the 90s. Austria has been involved in the international working group "Green Building Challenge (GBC)" since 1998. Some Austrian initiatives have already attracted international attention, such as the IMMOVALUE project for the measurement of the value added of sustainability and the benchmark initiative IBI (Immobilien-Benchmarking-Institut).

Green buildings are playing an ever greater role in Austria. According to a survey of Austrian companies, they had the lowest share of certified buildings in their total portfolio at only 17%, as compared to Germany (22%) and Switzerland (33%). But according to the Austrian investors surveyed, certification is becoming ever more important in Austria: Certification is becoming the standard and is increasingly being focused on by analysts (source: Ernst & Young 2012). But from an investor's point of view, Austria needs to look away from singular certification processes for new buildings and towards its building stock as a whole. This is where the green revolution is happening – a much more significant economic and ecological lever for the market and its participants. However, the next two to three years will show which certificate takes the lead for new and existing buildings in Austria.

Overview of certified properties in Austria

ÖGNI	59
LEED	11
BREEAM	2
EU Green Building	2

Source: IVG Research

Green Buildings Costs and income

Costs:

- Higher planning and construction costs
- Costs of certification
- Poss. higher operating costs in part

Income:

- Cash flow (rent level)
- Reduction of (additional) costs
- Value / Sale price
- Risk management / risk minimisation

Source: IVG Research

Example of additional cost for green buildings

Best case:

2.20 €/sqm Greenworx
2.90 €/sqm – 3.50 €/sqm "Green"
4.50 €/sqm – 6.00 €/sqm Office towers

Source: IVG Research

Blue buildings – a new trend?

This is an **extrapolation** of the term ‚green building' Unlike green buildings, this development is moving away from pure energy efficiency and towards **holistic sustainability** over the entire lifecycle of a building. In addition to economy and ecology, **socio-cultural aspects** also play a key role. Blue buildings focus on a building's **users**.

Source: IVG Research

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